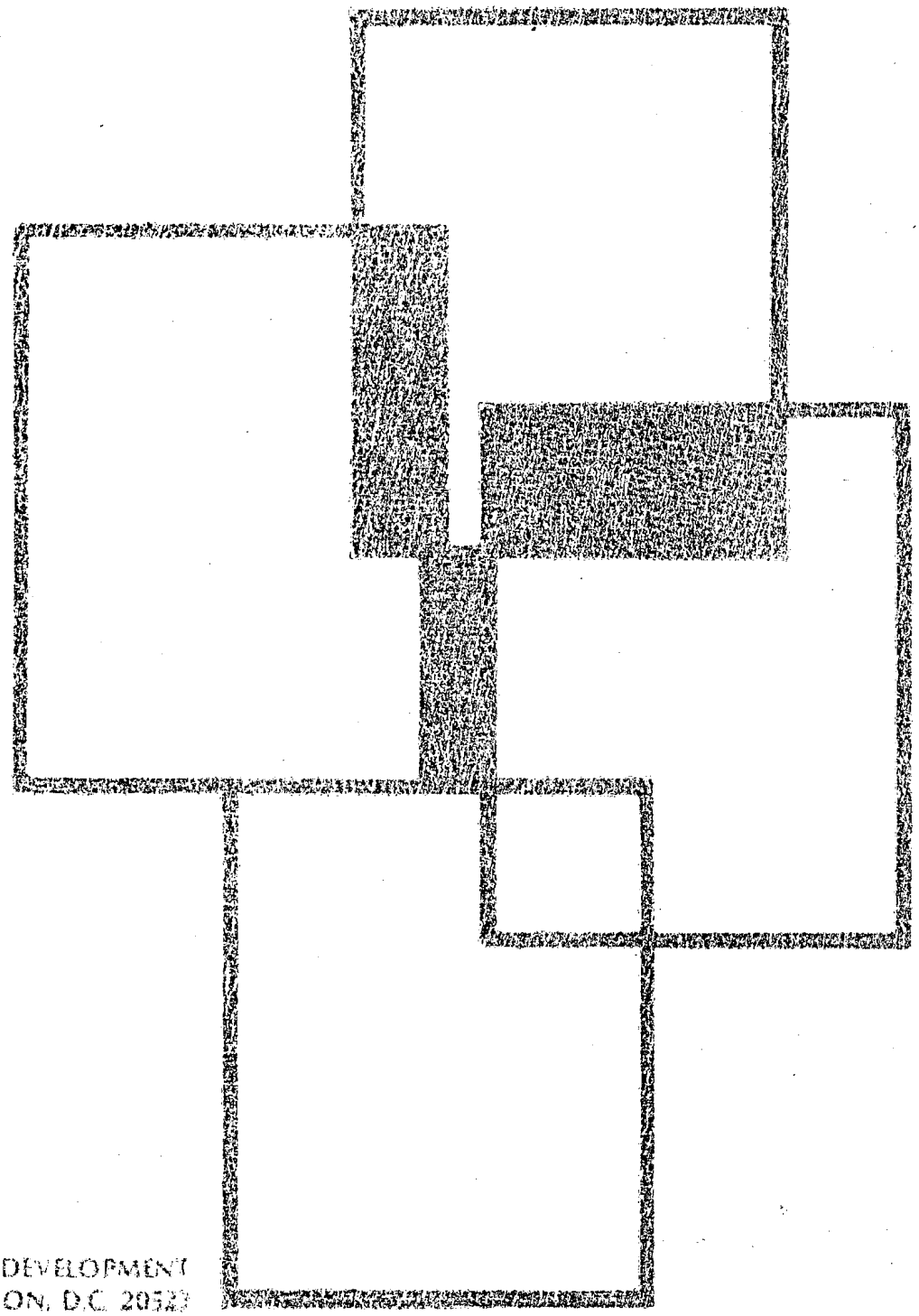
Policy



AGENCY for INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

BEST AVAILABLE COPY

I. ECONOMIC ASSISTANCE POLICY FRAMEWORK AND CORE CONCEPTS

TABLE OF CONTENTS

I. Economic Assistance Policy Framework and Core Concepts
Executive Summary (Reserved)

A. Bilateral Economic Assistance and AID's Congressional Mandate
Policy Paper (Reserved)

B. Approaches to the Policy Dialogue
Policy Paper

C. Private Enterprise Development (Revised)
Policy Paper

D. Institutional Development
Policy Paper

E. Technology Development and Transfer
Policy Paper (Reserved)

II. Sectoral Policies

A. Food and Agricultural Development
Policy Paper

1. Pricing, Subsidies and Related Policies in Food and Agriculture
Policy Paper

2. Land Tenure
Policy Determination 13

3. Agricultural Technology Development and Dissemination
Policy Determination (Reserved)

4. Assistance to Support Agricultural Export Development
Policy Determination 15

B. Food Security
Policy Paper (Reserved)

C. Nutrition
Policy Paper

D. Population Assistance
Policy Paper

E. Voluntary Sterilization
Policy Determination 3

F. Health Assistance
Policy Paper

G. Domestic Water and Sanitation
Policy Paper

H. Basic Education and Technical Training
Policy Paper

I. Development Communications
Policy Determination 10

J. Higher Education and Manpower Development
Policy Paper (Reserved)

K. Participant Training
Policy Determination 8

L. Energy
Policy Paper

M. Environment and Natural Resources
Policy Paper

N. Reserved

O. Housing
Policy Determination (Reserved)

P. Urban Development
Policy Paper

Q. Industry
Policy Paper (Reserved)

R. Transportation (including rural roads)
Policy Determination (Reserved)

S. Shelter
Policy Paper

III. Cross-Sectoral Policies

A. Economic Policies

1. Employment and Income Generation
Policy Paper (Reserved)

2. Recurrent Costs
Policy Paper

3. Financial and Market Development
Policy Paper (Reserved)

4. Tax Rates and Structures
Policy Paper (Reserved)

5. Implementing AID Privatization Objectives
Policy Determination 14

B. Socio-Economic Issues

1. Human Rights
Policy Determination 12

2. Women in Development
Policy Paper

3. Refugees
Policy Determination (Reserved)

4. Labor and Manpower
Policy Determination (Reserved)

* 5. Democracy and Governance *
Policy Paper

C. Special Cross-Sectoral Topics

1. Public Enterprise
Policy Determination (Reserved)

2. Middle-Income Countries
Policy Paper (Reserved)

3. Private and Voluntary Organizations
Policy Paper

4. Trade Development
Policy Paper

* REVISED

5. Local Government
   Policy Determination (Reserved)

6. Cooperative Development
   Policy Paper

7. Narcotics
   Policy Determination 1

8. Local Organizations in Development
   Policy Paper

9. Program Financing Arrangements with Independent Organizations
   Policy Determination 16

10. Microenterprise Development Program Guidelines
    Policy Determination 17

IV. Types of Assistance and Delivery Mechanisms

A. Project and Non-Project Assistance
   Policy Paper (Reserved)

B. PL 480 Food Aid

1. Local Currency
   Policy Determination 18

2. Using PL 480 Title II Food AID for Emergency or Refugee Relief
   Policy Determination 11

3. PL 480 Section 106/108 Local Currency Lending for Private Enterprise

a. Guidelines for Sales for Local Currencies Private Enterprise Promotion under PL 480 Title I

b. Further Guidance in the form of QS and AS

C. RESERVED

D. International Disaster Assistance
   Policy Paper

E. Mixed Credits
   Policy Determination 2

F. Co-Financing
   Policy Paper

G. Title XII
Policy Determination 4

H. Guidelines on Research
Policy Determination (Reserved)

I. ESF Cash Transfer Assistance - Amplified Policy Guidance

V. Special Topics

A. AID Loan Terms

1. Loan Terms Under PL 480 Title I

B. Evaluation
Policy Determination (Reserved)

C. Development Information
Policy Determination (Reserved)

D. Donor Coordination
Policy Determination (Reserved)

VI. Case Studies

1. Bangladesh - Family Planning Services: Social Marketing Sub-project

2. Dominican Republic - Rural Roads - Maintenance and Rehabilitation

3. Indonesia - Provincial Area Development

4. Egypt - Small Farmer Production

5. Senegal - Rural Health Services

VII. Policy Cable/Memoranda

1. Population Assistance through NGOs

2. Humid Tropical Forests: AID Policy and Program Guidance

3. Program Sector Assistance Guidance

4. The Role of Resource Transfers in U.S. Economic Assistance

5. Exchange Rate Policy Guidance

6. Policy Guidance on Criteria for Payment of Salary Supplements for Host Government Employees.

Attachment to TM 1:27

UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D C 20523

CORRECTION
1 November 1982

ASSISTANT
ADMINISTRATOR

19 OCT 1982

MEMORANDUM FOR THE WASHINGTON SENIOR STAFF AND MISSION DIRECTORS AND A.I.D. REPRESENTATIVES

SUBJECT: Revised A.I.D. Policy Handbook (Handbook 1)

The Administrator has approved the attached Outline for a Revised A.I.D. Policy Handbook (Handbook 1). PPC is undertaking this effort through the preparation of "Policy Papers" and "Policy Determinations" (P.D.s). You have already received a number of draft and final Policy Papers. These plus additional Papers and P.D.s o be written over the next year will be incorporated in the new Handbook.

Existing substantive policy documents are contained in Handbook 1 in the form of P.D.s and other statements. In addition, discrete "Policy Papers" and "Policy Background Papers" have been issued over the years but never incorporated in a Handbook. Our intension in this exercise is to bring all substantive policy together in one place: Handbook 1.

The new Policy Handbook will contain only "Policy Papers" and briefer "Policy Determinations." Certain P.D.s and statements now in Handbook 1 dealing with administrative and management matters (e.g., "Excess Property" and "Modes of Contracting") will be moved, in coordination with the Management Bureau, to other Handbooks and updated as appropriate. Other substantive items now in Handbook 1 as well as other existing "Policy Papers" and "Policy Background Papers" will either be reaffirmed, merged with or superceded by the new Policy Papers or Policy Determinations, as they are approved and issued. As the existing Policy Handbook contents are reaffirmed, superceded or moved to other Handbooks, we will issue appropriate Agency-wide notices specifying each action.

John R Bolton

John R. Bolton

Attachment: a/s

OUTLINE OF POLICY PAPERS TO BE INCLUDED IN REVISED A.I.D. POLICY HANDBOOK (Handbook 1)

(Some items to be in the form of Policy Determinations)

Headihgs and Titles (titles under-lined)

I. Economic Assistance Policy Framework and Core Concepts

Bilateral Economic Assistance Policy Framework

Approaches to Policy Dialogue

Private Enterprise Development

Institutional Development

Technology Development and Transfer

II. Sectoral Policies

A. Food and Agricultural Development

1. Pricing, Subsidies and Related Policies in Food and Agriculture

2. Land Reform

3. Food and Agriculture Systems

4. Agricultural Technology Development and Dissemination

B. Food Security

C. Nutrition

D. Population

E. Health

F. Domestic Water and Sanitation

G. Basic Education and Technical Training

II.

H. Higher Education and Manpower Development

I. Energy

J. Natural Resources and Environment

K. Forestry

L. Housing

M. Urban Development

N. Industry

O. Transportation

P. Rural Roads

III. Cross-Sectoral Policies

A. Economic Policies

1. Employment and Income Generation

2. Recurrent Costs

3. Financial and Capital Market Development

4. Tax Rates and Structures

B. Socio-Economic Issues

1. Human Rights

2. Women in Development

3. Refugees

4. Labor and Manpower

C. Special Cross-Sectoral Topics

1. Public Enterprise

2. Middle-Income Countries

3. PVO Policy

4. Trade and Development

5. Local Government

6. Cooperatives

7. Narcotics

IV. Types of Assistance

A. Project and Non-Project Assistance

B. PL 480 Food Aid

1. Integration and Use of Local Currency Proceeds

2. Food Aid and Development

C. Bureau for Private Enterprise Policy

D. Disaster Assistance

V. Mechanisms for Delivery of Assistance

A. Resource Transfers and Technology Transfers

B. Mixed Credits

C. Co-Financing

D. Title XII of the FAA

E. Guidelines on Research

VI. Special Topics

A. A.I.D. Loan Terms

B. Evaluation

C. Development Information

D. Donor Coordination

Disposition of Material in Superseded Handbook 1

Table of Contents - Old Handbook 1.	Remarks
Summary for Executives (NOTE: While the Table of Contents of the superseded Handbook contained a wide range of headings, only those which were preceded by an * actually contained a statement of policy. All the remaining headings were reserved, i.e., no written statements were issued and incorporated in the Handbook. Therefore, all headings (topics) which did not have an * as shown below have not been included in the contents of revised Handbook 1.	
PART I INTRODUCTION	
*1. General 2,3, - Topics such as AID purpose, role (incl. interagency) target groups, approach and philosophy	Topics in Part I to be included in the Economic Assistance Policy Framework Paper
PART II COUNTRY-SELECTION POLICIES AND AID TERMS	Material in Part II to be covered in the Economic Assistance Policy Framework Paper
*1. General *2. Least-Developed Countries 3. "Most Seriously Affected" Countries *4. Higher Income LDC's 5. High Income LDC's 6. Regional Recipients	These topics to be covered in the AID Loan Terms Paper and in the Middle Income Policy Paper
PART III SECTOR POLICIES	
1. General	To be covered in the Summary for Executives proposed for inclusion in the new HB 1
Priority Areas	
2. Agriculture and Rural Development (incl. food and nutrition)	Superseded by Food and Agriculture PP completed 5/82; nutrition PP, 5/82; Pricing and Subsidies PP, Land Reform PD, Food and Ag Systems PP and Ag. Tech. Development PD to be completed

*3. Population and Health	Superseded by Population PP dated 9/82; Health PP to be completed; Domestic Water & Sanitation PP dated 5/82
*4. Education and Human Resources	Superseded by Basic Ed. & Tech. Training PP & Higher Ed. & Manpower Dev. PP to be completed
Other LDC-Oriented Areas	
5. Urban Development	To be superseded by Urban Development PP
*6. Housing	To be superseded by Urban Housing PD
*7. Physical Infrastructure	Topic to be covered in following Policy Papers: Transportation, Rural Roads, Econ. Assistance Policy Framework, Energy, Resource and Technology Transfer, Private Enterprise Development, Private Enterprise Bureau
8. Small-Scale Industry	Superseded by Private Enterprise Policy Paper, PRE Bureau PP; Industry PP to be completed
U.S. Special Interest or Restricted Areas	
*9. Narcotics Control	Superseded by PD # 1 on Narcotics Control dated 8/82
*10. American Schools and Hospitals	Deleted from Handbook 1; topic covered in HB # 1-B, ch. 16A
*11. Restricted Areas (abortion, public safety, mil. items, compet. w/U.S. business, non-food surpluses, gambling facilities, weather mod. etc.	Statement to be included in proposed Executive Summary

PART IV CROSS-SECTORAL EMPHASES

1.	General	To be included in Executive Summary
	Economic-Social Concerns	
*2.	Income Distribution and Employment	Superseded by Employment and Income PP to be completed
*3.	Labor-Manpower	Superseded by Labor-Manpower PD to be completed
*4.	Popular Participation in Development	To be addressed in following: Bilateral Econ. Assistance Policy Framework PP; Institutional Development PP; Local Government PP; Cooperatives PD
*5.	Integration of Women into National Economics	Superseded by Women in Development PP dated 9/82
6.	Private Sector	Superseded by Private Enterprise Policy Papers dated 5/82
7.	LDC Export Development	To be superseded by Trade and Development PP
	Technical Concerns	
*8.	Science and Technology	Will be superseded by Tech. Dev. and Transfer PP
*9.	Research and Innovation	To be replaced by Guidelines on Research PD
10.	Development Administration	Topic to be covered in Institutional Development PP and Local Goverment PP
*11.	Environmental Impact	To be replaced by Natural Resources and Environ. PP or revised PD
12.	Special Areas, including Energy	"Special areas" to be deleted; Energy PP to be revised or PD drafted

PART V RESOURCE-USE POLICIES

	General-Purpose AID Resources	
*1.	General	To be included in Executive Summary
*2.	Reimbursable Assistance	To be deleted from HB # 1; presently covered in HB # 1-B, Procurement Policies
	Special-Purpose AID Resources	
*3.	Foreign Disaster Assistance	Will be superseded by Foreign Disaster Assistance PP
4.	Field-Discretionary Funds	Delete; no longer relevant
5.	Investment and Credit Guarantees	Topic covered in PRE Bureau PP; will be included in Housing PP and Project and Non-Project Assistance PP
	Other U.S. Government Resources	
6.	General, including PASA	Delete; not relevant
*7.	Food for Peace	To be replaced by Food Aid PP
*8.	Excess Property	Delete; presently covered in Handbook 1-B and 16
9.	Local Currencies	To be replaced by Integration and Use of Local Currency Proceeds PP
10.	Debt Rescheduling	To be covered in AID Loan Terms PD
	Private U.S. Resources	
*11.	Private Voluntary Organizations	Replaced by PVO Policy Paper, 9/82
12.	Research and Educational Institutions	Replaced by Title XII PD, 10/82 and Guidelines on Research PD to be completed
13.	Cooperatives	To be replaced by Cooperatives PD
14.	Private Enterprise (including discussion of housing and investment guarantees)	Private Enterprise Policy Papers

Non-U.S. Resources

*15. General	Material in this section to be incorporated in Donor Coordination PP
*16. Multilateral	
*17. Bilateral	
18. LDC Recipients	

PART VI PROGRAMMING AND EVALUATION POLICIES	Remarks
	Topics covered in following Handbooks:
1. Country Analysis and Strategies	HB # 2
2. Sector Analyses and Assessments	HB # 2
3. Program/Project Identification, Selection, and Design	HB # 3
4. Budgeting, Review, and Approval	HB # 2
*5. Program Evaluation	To be superseded by Evaluation PP; also covered in HB # 3

PART VII IMPLEMENTATION POLICIES	
*1. General	HB # 3
*2. Commodity Procurement	HB # 15
*3. Participant Training	HB # 10
4. Contracting	HB # 11, 1-B
5. Local Cost Financing	HB # 1-B
6. Other (to be determined)	

PART VIII MANAGEMENT AND ADMINISTRATIVE POLICIES	
(Including such topics as AID Organization, Manpower Management, Management Information System, Audit and Inspection, Public Information, and Security.)	HB # 17, HB # 18 Adm. & Personnel Handbooks

Policy Determinations

PD NO.		Remarks
37	AID's Role with Respect to Non-AID Resources in the Total Foreign Assistance Effort	Topic covered in Private Enterprise Bureau PP dated 5/82; Ec. Assistance Policy Framework PP to be completed and HB 1-B
39	Population and Family Planning	Replaced by Population PP dated 9/82

47	Guidelines on Research	PD to be updated in new Handbook
48	Employment and Income Distribution Objectives for AID Programs and Policies	To be superseded by Employment and Income Distribution PP
50	AID and the Relatively Less Developed Countries	To be rewritten or incorporated as part of the Bilateral Econonmic Assistance Policy Framework PP
51	Guidance Statement on Selected Aspects of Science & Technology	To be superseded by Technology Dev. and Transfer PP
52	Policy Determination on Labor-Manpower	PD to be updated
54	Guidance Statement on Urban Development (Policy Paper attached)	To be superseded by Urban Dev. PP
55	Shelter Program Objectives	Topic to be covered in Urban Dev. PP and Housing PD
56	AID Policies Relative to Abortion-Related Activities	Covered in Population PP and included in Executive Summary "Restrictions" Section
60	Integration of Women into National Economies	Superseded by WID PP
61	Requesting Accelerated Repayment on AID Loans	Superseded by AID Loan Terms PP/PD to be completed
63	Environmental Aspects of Development Assistance PP/PD	Will be superseded by Natural Resources and Environment PP/PD
64	Employment with International Organizations	To be incorporated in Handbook # 25, Employment and Promotion

65	Use of Collaborative Assistance Method for AID Direct Contracts	Covered in Handbook 1-B, Procurement Policies and Handbook 14, AID Procurement Regulations
66	Criteria for Determining AID Loan Terms and for Requesting Acceleration of Loan Repayments	Superseded by AID Loan Terms PP/PD
67	Urbanization and Urban Poor	To be superseded by Urban Development PP
69	Development Administration	Topic discussed in Private Enterprise Policy Papers; to be covered in Local Government and Institution Building Papers
70	AID Policy Guidelines on Voluntary Sterilization	Superseded by PD # 3 - Voluntary Sterilization; recommend inclusion in Executive Summary
71	AID Financing of Palm Oil, Citrus, and Sugar Projects & Related Products	To be covered as a design consideration /restriction in Executive Summary; also to be incorporated in Handbook # 3, Project Assistance
72	Agricultural Asset Distribution: Land Reform	Superseded by Land Reform PD to to be completed
73	AID-U.S. Cooperative Organization Relationships	Superseded by Cooperatives PP to be completed
74	AID Forestry Programs & Policies	To be superseded by Forestry PP

Policy Papers included in HB 1, Sup. A

U.S. Bilateral Economic Assistance Program Purpose and Composition:

	Remarks
Introduction U. S. Interests & Econ. Assist. History of U.S. Econ. Assist. U.S. Assist. & Internat. Resource Transfers to LDCs Implications of LDCs Diversity	These topics will be covered in the Bilateral Economic Assistance Policy Framework PP and Resource and Technology Transfer PP
Policy Papers:	**Superseded by:**
Development Assistance	Project/NonProj. Assist. PP
Security Supporting Assistance	Project/NonProj. Assist. PP
Food and Agriculture	Food & Ag Dev., 5/82
Population	Population PP, 9/82
Education & Human Resources	Education PP's
Health	Health PP Dom. Water & Sanitation PP's, 5/82
Shelter	Housing PP
Energy	Energy PP/PD
Environ. & Natural Resources	Env. & Nat. Res. PP
Urban Development	Urban Dev. PP
Women in Dev.	WID PP, 9/82
Human Rights	Human Rights PP
Labor	Labor/Manpower PD
PVO's	PVO PP, 9/82
Trade Investment & Dev.	Trade & Dev. PP
North-South Issues	Delete; no longer relevant
Narcotics	Revised PD, 8/82
Foreign Disaster Assistance	Disaster Assist. PP
Reorganization	Delete, no longer relevant

AGENCY FOR INTERNATIONAL DEVELOPMENT

HANDBOOK 1 - POLICY

(TM 1:27)
1-5-83

N O T E

Throughout this Handbook, masculine pronouns are to be interpreted as including both men and women, unless the context specifically excludes this interpretation. Future revisions will take into account the AID directive (HB 18, Part I, 2E) on the avoidance of sex-biased language.

f.B (TM 1:34)
11/9/84

A.I.D. Policy Paper

APPROACHES TO THE POLICY DIALOGUE

U.S. Agency for International Development
Washington, D.C. 20523

December 1982

I.B (TM 1:34)
11/9/84

A.I.D. Policy Paper

Approaches to the Policy Dialogue

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

December 1982

Page

I. INTRODUCTION 1
A. Purpose and Structure of the Paper 1
B. The Concept of Conditionality 2
C. Scope of the Economic Policy Dialogue 3
D. Approaches to the Use of Aid to Foster a Policy Dialogue ... 3

II. THE EFFECTIVENESS OF THE POLICY DIALOGUE THROUGH BILATERAL ECONOMIC ASSISTANCE 4
A. Assessing the Potential of Aid as a Vehicle for the Policy Dialogue 5
B. The Nature of the U.S. AID Program..... 5
1. Economic Support Fund (ESF)..... 6
2. Development Assistance (DA) 6
3. PL 480 Food Aid 7
C. Project and Program Assistance..... 7
D. The Formulation of Conditionality 8
1. Positive and negative conditions 8
2. Explicit and implicit conditions 8
E. The Implementation of Conditionality 9
1. The "quality" of conditionality 9
2. The number of conditions 9
3. The phasing of assistance 9
F. Limits to the Effectiveness of the Policy Dialogue 10

III. THE CONDUCT OF THE POLICY DIALOGUE THROUGH BILATERAL ECONOMIC ASSISTANCE 12
A. The General Tone and the "Emily Post Factor" 12
B. Major Stages of the Dialogue and Some Administrative Issues 13
C. Sensitivity, Selectivity, Stamina, Staff: Four Essential Ingredients 14
1. Selectivity 14
2. Stamina 14
3. Staff 15
D. The Host Country Participants 16

IV. BILATERAL-MULTILATERAL COOPERATION IN THE POLICY DIALOGUE..... 16
A. The Role of the IMF and the IBRD in the Policy Dialogue .. 16
B. Coordination Between the IMF and the IBRD 17
C. Coordination Between AID and Multilateral Institutions... 18
D. Coordination Between AID and Other Bilateral Donors ... 20

Annex

AID EXPERIENCE AND CURRENT MISSION VIEWS..... 22

Bibliography 25

"We should be careful to get out of an experience only the wisdom that is in it, and stop there; lest we be like the cat that sits down on a hot stove lid. She will never sit down on a hot stove lid again—and that is well; but also she will never sit down on a cold one any more."

Mark Twain, *Following the Equator.*

The U.S. interest in the soundness of the economic policy of developing countries stems largely from the concern with promoting long-term, broad-based economic growth in these countries. The policy dialogue which flows from this concern is in large measure a process of sharing information and ideas regarding economic policy actions and options which impact on the development performance and prospects of the developing country. It is important to state at the outset of this paper that donor suggestions concerning the economic policy of recipient countries must rest on familiarity with the recipient country situation, sympathy for its objectives and problems, and a valid economic development case for the policy suggestion being advanced. Only on such a basis can a policy dialogue bear fruit in terms of the recipient country's own development and the effectiveness of utilization of external economic assistance.

I. Introduction

A. Purpose and Structure of the Paper

Individual aid projects can sometimes reach their intended goals and accomplish some good even if the overall economic policy environment is less than optimal. As a general proposition, however, the United States has emphasized over the last year that even an integrated set of well planned and well executed economic assistance projects may fail to have a significant developmental impact in the absence of a favorable economic policy environment, for:

The soundness of domestic economic and social policies is in general the dominant long term influence on development . . . economic assistance in support of ill-conceived policies would be a poor investment indeed.[1]

This common sense principle bears constant repetition and frequent re-statement, for it has been periodically forgotten in the practice of aid and development. It is not the purpose of this paper to discuss the types of policies considered desirable for economic stability, growth and development. These are discussed ably and articulately elsewhere.[2] Nor can this paper articulate adequately the variety of important connections between country policies and AID's major cross-sectoral emphases on the private sector, the building of institutions and the transfer of technology. The express purpose of this paper is instead limited to outlining and discussing a comprehensive framework for systematic AID interaction with other donor institutions and with developing countries' governments, addressed to support their economic policies when they are deemed effective, and to promote their improvement when they are deemed defective. It is this *interaction* which forms the core of the "policy dialogue"

This paper is a review and synthesis of the AID experience and of the principal points of consensus and of disagreement in the important subject of how best to manage this interaction from the viewpoint of the U.S. bilateral assistance program. It is organized along the following lines. The remainder of this introductory section clarifies some important terms, sets the limits to the subsequent discussion, and outlines the general characteristics of the approach to the policy dialogue. Section II discusses the principal determinants of the effectiveness of the policy dialogue through bilateral economic assistance, and Section III pulls together the major considerations on the conduct of the dialogue in practice. Section IV deals with the issue of coordination between AID and the other major participants to the dialogue to promote sound economic policies by the developing countries — and hence the effectiveness of economic assistance to those countries. An annex discussing AID experience concludes the paper.

The current stress on the importance for long run development of the economic policy of the developing countries themselves — and thus on the need for a dialogue with aid recipients concerning the soundness of their policies — represents a significant shift in emphasis relative to U.S. aid thinking through much of the 1970s.[3] It also constitutes,

[1] *Development Issues 1982,* p. 43. (Footnote references are shown in abbreviated form in the text. Full references are given in the Bibliography.)

[2] *Development Issues 1982,* Chapter II.E.; T. Morrison and L. Arreaga-Rodas, *Economic Liberalization in Developing Countries; Some Lessons From Three Case Studies — Sri Lanka, Egypt, and Sudan,* A.I.D. Discussion Paper No. 40, October 1981.

[3] This does not imply that our assistance programs in the 1970s did not encourage or promote specific LDC policy actions and approaches. However, it is generally recognized that less explicit emphasis was given during this period to economic policy considerations than is given currently or was given during the 1960s.

however, a renewal of an interest that had been strongly felt and articulately expressed in AID for the first ten or so years of the Agency's existence.[4] The activities of the 1960s generated a substantial written record, which was useful in preparing this paper. This record, and much of the literature on efforts to foster improvements in economic policies through foreign aid, frequently suffers from a lack of clear definition of the basic terms at issue — from a kind of semantic fog so pervasive that it is essential, at the risk of being pedantic, to begin with the clearest possible definition of the principal terms. This need for clarification also derives from the negative connotations and confusion which have been associated with such terms as influence, leverage, dialogue and self-help, each of which have been used to refer to widely differing relationships and processes and sometimes have been used interchangeably. The lack of clarity, coupled with inappropriate usage of these terms, has led to unintended and undesirable interpretations of the objectives and nature of the donors' concern with the economic policies of developing countries.

A discussion of the use of aid to foster improvements in the recipient country's economic policy logically presumes some initial disagreement between donor and recipient on the direction, the scope, the degree, or the timing of policy change. *The ability to affect views and policies is best understood as a continuum,* from the logical extreme of total control over the resolution of the difference, to the opposite extreme of utter inability to affect the outcome in any way.

The process of seeking to foster improvements in host country policies within this continuum can encompass, among other things, two different concepts: leverage and dialogue. Given that the parties' viewpoints differ, *"leverage" refers to the capacity to have one viewpoint predominate over the other. "Dialogue" on the other hand is better understood as a mechanism incorporating the interchange of ideas and information whereby either viewpoint or both can change to bridge the initial difference between the two.* Through a "dialogue", then, the aid recipient comes to view the policy advice as genuinely in the interest of its own economic progress. In contrast, through the application of "leverage", the aid recipient agrees to enact a certain policy in response to positive or negative incentives by the donor, and not because it concurs with the other party's views of the policy's desirable effects. In actual practice, leverage and dialogue need not be mutually exclusive since the use of leverage does not usually entirely rule out the possibility of a dialogue — that is, of a change in either party's viewpoint, and a policy dialogue almost always entails the *possibility* that donors might alter their assistance or take other action in the future in light of the policies and actions taken by the recipient.

However, focusing attention on the *availability* of potential leverage as a means of fostering improved economic policies can be badly misleading. *Potential leverage is at best only a possible facilitator of the policy dialogue, and is neither a sufficient nor a necessary condition for the success of a policy dialogue.* On the contrary, if exercised clumsily, it may in the longer term be counterproductive.

Indeed, experience has shown that constructive results are more likely to occur where the recipient countries are aware of the existing potential of such action but the potential is not actually used. Reflecting this fact, this paper and AID policy focus on the establishment of an ongoing *policy dialogue* with the host country.

Another term often used without clear definition is *"self-help"*. Self-help can be defined, as in the AID program lending practice of the 1960s, to encompass a recipient government's policies to affect positively those development variables over which it has some control. Since self-help effort is difficult to prove or disprove, much less to measure, the "effort" dimension of self-help should where possible be complemented with some assessment of its "results". At least, self-help must mean that the recipient country's policies have not allowed, as a result of aid, a reduction in the amount of financial resources mobilized domestically for development purposes. (The question of what constitutes development expenditures is itself a fit subject for the policy dialogue.) At best, self-help entails recipient country policies that yield — as a result of, or at least concomitant to, the provision of aid — greater mobilization of domestic resources for development and/or improvements in the efficiency of their allocation and utilization. In current parlance, aid then acts as a "catalyst".

B. The Concept of Conditionality

The discussion throughout this paper is grounded on two basic principles, to which

[4] Edward Mason, a principal academic advisor to AID in the 1960s, had occasion to state, in an internal memorandum of April 8, 1968, that "Current AID doctrine holds that the inducement effect of aid on development can be more important than the effect of resource transfers."

reference shall be made again and again. The first principle, discussed above, is that the donors' ability to affect host country policy is a continuum. The second, discussed here, is what we may call the *principle of appropriate conditionality*, i.e., that the formulation and implementation of any conditions to be attached to aid, in any form, depends on the objectives of the aid.

Clearly, there can be no "conditionality" that does not *imply* the provision of incentives — whether of the positive or the negative kind. It is not sensible to ask "whether" economic assistance does or should carry conditions. The sensible questions are instead "which" conditions, "how and by whom defined", and — the most important question of all — "why".

The term "conditionality" refers to policies which a lender/donor expects or requests the recipient to follow (or to avoid), in order to use the former's resources. The use of such resources, in turn, must be in furtherance of, or at least in keeping with, the lender/donor objective(s) in providing the resources.[5] Thus, *conditionality is a device to promote use of the resources in conformity with the purpose of providing them.* The concept of conditionality of assistance is utterly meaningless if divorced from the objectives the assistance is meant to achieve. If follows that a change in the goals of assistance will normally require a change in conditions as well. Further, to the extent that one of the several objectives of a bilateral assistance program may be inconsistent with another, this will necessarily be reflected in a conflict between specific conditions.

Whether in the specific case conditionality is in keeping with the objectives of the assistance is partly a matter of interpretation. Just as commercial bank and business borrower may be in perfect agreement on the objective — safe and profitable use of the loan — but differ in their assessment of such safety and profitability, so aid donor and recipient may hold identical views on the economic objectives to be pursued but disagree sharply on whether a particular condition is in keeping with those objectives. The likelihood of such a disagreement, other things being equal, increases with:

— the ambiguity of the objective;
— the time span over which the objective is to be achieved;
— the number of different objectives.

C. Scope of the Economic Policy Dialogue

Of the myriad possible conditions on the provision of economic assistance, the discussion of the policy dialogue entails an examination only of those related to the twin objectives of fostering the economic stability and improving the prospects for sustained long-term economic development of the recipient country (primarily the latter). The remainder of this paper shall not, therefore, concern itself with the conditionality needed to prevent fraud, theft, abuse of misuse of aid funds[6], nor with the use of aid for short-term foreign policy objectives, for purely commercial goals (such as the tying of aid to purchases from the U.S.), or for long-term political development (except insofar as economic development may itself be conducive to political liberalization and institutional growth).

Finally, the notion of the policy dialogue is centered on the sphere of *discretionary* conditionality, and not on statutory prescriptions or prohibitions. Every donor's assistance program is subject to a set of statutory conditions.[7] These are usually taken as a given in the policy dialogue, but it should be noted that in the long run statutory conditionality is *not* a given, and all prescriptions are variable, including charter provisions.

D. Approaches to the Use of Aid to Foster a Policy Dialogue

The use of aid to foster improved economic policies may be approached in two general ways: in an "ex post" approach, good economic performance by the aid recipient justifies financial support; in an "ex ante" approach, the provision of aid is linked to a future policy change. These approaches are not mutually exclusive, and may even be complementary in certain circumstances.

The principal advantages of the *ex post approach* are alleged to be that it does not generate accusations of interventionism — and that it does not run the risk of causing damage to the aid recipient if the policy advice happens to be wrong.[8] These advantages are illusory, however. For, offsetting the absence of the "interventionism" charge,

[5] See Joseph Gold's *Conditionality*.

[6] Chapters 2 and 3 of AID's Handbook 3 contain a detailed listing and discussion — running to well over 100 pages — of the criteria and procedures to optimize the administration of aid funds in practice.

[7] The State Department's Legal Adviser lists about 120 specific prohibitions concerning the use of U.S. economic assistance, mainly on grounds of security, and other foreign policy considerations — such as human rights, combating terrorism and nuclear proliferation, and other non-economic grounds.

[8] For an elaboration, see the AID Discussion Papers by C. Gulick and J. Nelson, and by J. Nelson and G. Ranis. See also Nelson's *Aid, Influence and Foreign Policy*. (The Bibliography contains the full references.)

there is the inevitable charge of "paternalism" in the judging of economic performance; and, the damage caused a country by wrong policy advice may be no greater than the consequences to that country of an incorrect donor assessment of past events. The advantages of the *ex ante approach* include the possibility of having some beneficial effect through specific microeconomic policy decisions (while the ex post approach is in practice more applicable to macroeconomic performance). Equally important is the capacity to support desirable policy changes as they are occurring; many such changes do need external support in order to become feasible. (The classic example is the need for assisting with the financing of a surge in imports caused by a liberalization of import restrictions urged by the donor as a desirable policy measure.)

The policy dialogue usually involves an element of negotiation. Generally, the outcome of a negotiating process may involve: (i) a loss to both parties; (ii) a zero-sum game whereby one party's loss corresponds to the other party's gain; and (iii) a gain to both parties. An example of the first negotiating situation would be demands by labor which lead to bankrupting the company and thus also to eliminating the union members' jobs. An example of the second situation might be negotiations on royalties to be paid to the owner of mineral deposits. An example of the third situation — where both sides can gain — is the dialogue between aid donor and recipient concerning the latter's economic policies. An adversarial approach is characteristic of the first two types of negotiating situations; this approach rests on a narrow linear perspective, by which it becomes a truism that, the closer the outcome is to the position of one party, the farther away it must be from the position of the other party.

The alternative is a *cooperative approach to negotiations,* which rests on a more realistic view of the complexity of the parties' different sets of objectives, leading each party to define its subjective gains in a significantly different way from the other. The cooperative approach has the potential of yielding a perceived gain to both parties. It is especially well suited to a negotiating situation in which the fundamental objective is shared by both sides — as in the case of the policy dialogue between aid donor and recipient to improve the prospects for the economic development of the latter.[9]

The key to a successful policy dialogue is mutual respect and familiarity with (and sympathy for) the other party's objectives, possibilities, and constraints. In particular, unless the donor understands the country situation well enough to identify the important policy measures at issue, it is impossible to provide valuable and relevant advice. And if the donor does not have such advice to offer, the recipient obviously will have no interest in listening to the donor's viewpoint.

II. The Effectiveness of the Policy Dialogue Through Bilateral Economic Assistance

In macroeconomic policy issues, the lead in engaging developing countries in a dialogue is usually taken by the International Monetary Fund (IMF) or the World Bank (IBRD). These issues are also discussed in the context of IBRD-led consultative groups and in the Board meetings of the Multilateral Development Banks (MDBs) and the IMF. U.S. views are articulated both through its Executive Directors to the MDBs and the IMF, and in the context of its own bilateral programs. These policy issues, however, also affect every part of the U.S. bilateral economic assistance program.[10]

As noted earlier, little attention was paid during much of the 1970s to the overall economic policy context in developing countries, and the explicit stress of the 1960s on using economic assistance as a vehicle for the long-term improvement of the overall macroeconomic policy landscape has only recently reappeared. This should not be interpreted to mean that no interaction on policy issues was taking place in the 1970s between AID officials and the host governments. On the contrary, many specific AID programs have continued to have a significant policy dialogue component, and notable successes have been achieved in a number of instances. While the policy issues that are addressed in project preparation are rarely macroeconomic in scope, they often do go beyond the narrow scope of the project, and have country-wide implications.

Experienced aid practitioners agree that the "receptivity" of the host country government is an essential ingredient of the success of the

[9] As only one illustration among many, the A.I.D. Policy Paper on Recurrent Costs (May 1982) concluded that inefficient or shortsighted macroeconomic policies by the aid recipient or the donor can given rise to a recurrent-cost problem. When this is inadvertent, an ongoing dialogue on a cooperative basis can do much to improve the situation in a manner conducive to the achievement of *both* parties' objectives.

[10] The AID experience of the 1960s is discussed in the Annex.

use of aid to foster improvements in economic policies. But what does such receptivity depend on? For starters, there naturally needs to be valuable economic advice for the host government to be receptive to; in the absence of a constructive contribution by the donor the dialogue cannot have substance. Beyond that, the effectiveness of the dialogue depends to a large extent on the practical conduct of it and on the tone and history of U.S.-recipient country relations. The conduct of the dialogue, the administrative implications and the personal elements are discussed in section III. This section examines the more concrete determinants of the dialogue's effectiveness.

A. Assessing the Potential of Aid as a Vehicle for the Policy Dialogue

The potential of aid as a vehicle for the policy dialogue depends on several interrelated elements — many of them factual, including:

— the size of the U.S. aid program *relative* to the magnitude of the recipient country's financial needs, to the inflows of assistance on comparable terms from other sources, and to the country's access to private lenders;
— the specific country circumstances, e.g., the urgency of its needs for additional external financial resources;
— the existence and importance of U.S. foreign policy goals other than the recipient country's own economic stability and development, e.g., strategic, human rights, etc.

With reference to the first point, there is no doubt that the quantitative weight of U.S. bilateral economic assistance has declined in relative terms from the peaks of the late 1960s.[11] It is thus probable that, in the aggregate, the potential of U.S. aid to promote sound LDC economic policies is not as high today as it was in the 1960s. However, the actual effectiveness of U.S. aid in this direction can be preserved, or even increased, with respect to the specific (fewer) countries to which it applies, by greater selectivity in the issues to be discussed and greater persuasiveness of the case being advanced.

[11] In FY 81, U.S. bilateral economic assistance to countries with a 1981 per capita income lower than $2,000 amounted to about $4.5 billion, of which about $1.7 billion was for Development Assistance; in CY 1981, by comparison, the combined current account deficit of these countries was 22 times as large, $99 billion. For a specific illustration, the large U.S. economic assistance program in Pakistan will over the next few years account probably for less than 5% of that country's import bill, compared to an FY 1962-68 average of over 11% from U.S. program lending *alone*.

What if it is concluded that U.S. aid has very low scarcity value to the specific recipient country? Recalling the earlier definition of a "dialogue" as leading to an acceptance of the policy advice on being in the recipient's own economic development interest, the vast potential of a genuine policy dialogue is not necessarily compromised by the lower relative volume of aid.

In the final analysis, economic policy improvements will be implemented on a lasting basis (however they may have been initially induced) only by successfully demonstrating to the host government the validity of the economic development case for policy reform. Hence, a relatively small size of the U.S. assistance program in a particular country does not by itself rule out all possibilities of a constructive impact on the country's policies. The very presence of a resident AID staff is evidence of U.S. interest in the country's economic progress. The aid program, even if fairly small, is a useful entree, a sort of calling card, a "proper introduction" without which discussion would be difficult to initiate and maintain. Beyond this, as noted, the success or failure of the dialogue rests on the persuasiveness (and, ultimately, the real economic validity) of the arguments. But, as argued earlier, this is true even if the aid program is very large.

B. The Nature of the U.S. Aid Program

U.S. bilateral economic assistance is composed mainly of three distinct though interrelated programs, each with its own characteristics and a different mix of objectives: Economic Support Fund (ESF), Development Assistance (DA), and P.L. 480 food aid. (Other small programs include the Housing Guarantee Program and the Trade and Development Program.) While the constituency, characteristics, motives, and mix of objectives differ in the three major components of the U.S. economic assistance program, the *uses* of the assistance are in all cases expected to be consistent with long-term economic development goals. These goals may occasionally be overriden by other considerations, but should never be disregarded. Consequently, *there is almost always a point in discussing possibilities for a constructive dialogue on the recipient country's economic policy, regardless of the specific aid program in question.* Naturally, the limits and shape of the policy dialogue do, among other things, depend on the specifics of the aid program.

In a sense, the aggregate AID program in a particular country can be used as the vehicle

to discuss policy issues. However, the difference in emphasis and scope among ESF, DA, and PL 480 means that each offers different opportunities and constraints in serving as a vehicle for the policy dialogue and is worth discussing separately.

1. **Economic Support Fund (ESF)**

While foreign policy motivations are clearly dominant in the provision of ESF, the functions of the assistance may include short-term stabilization as well as longer-term developmental results. The kinds of activities financed through ESF also vary, from those with a heavy project orientation (e.g., Jordan and Pakistan) to straight balance of payments support (e.g., Israel). The strength of ESF as a vehicle for a dialogue on a wide range of macroeconomic policies thus depends on the specific program under consideration. Generally, though, ESF is provided in more quick-disbursing and flexible form.

Since ESF assistance is usually provided for the economic stability and development of the economy as a whole, its effectiveness naturally depends mainly on the soundness of the country's overall macroeconomic policies, i.e., those concerning aggregate production, employment, taxation and public spending, interest rates, foreign trade, and exchange rate policies. This, too, is likely to be viewed as a reasonable connection by the recipient government, which is therefore much more likely to be receptive to such a dialogue. This does not rule out, of course, the possibility of using an ESF program to affect positively some economic policy affecting a specific major sector, especially where the ESF program is heavily project- or sector-oriented.

The main constraint on use of ESF for the policy dialogue is the U.S. basic political commitment of support to the country, of which the host government is obviously very much aware. This was thought by many to virtually rule out an effective impact on the recipient's economic policies.[12] The U.S. economic assistance experience of the 1950s and 1960s shows that the emphasis on economic self-help has tended to increase whenever the program motivation shifted from security or short-term political objectives to longer-term development goals. This tendency may not be irresistible, however. Some current programs show promise — notwithstanding the security and foreign policy importance of the assistance — to continue to develop a substantial and useful interaction with the government concerning economic policy in several major sectors and in certain macroeconomic areas as well.

2. **Development Assistance (DA)**

In DA, the sectoral emphases of AID on agriculture and human resource development carry an inevitable policy component. DA is mainly project-oriented, but with somewhat more flexibility than in the recent past, and with a new accent on improved economic analysis in support of programs and policies. One limit to the policy dialogue through development assistance can be that in some countries the amount of aid is very small. However, as argued earlier, a constructive dialogue can still take place based on the entree provided by even a small (but not insignificant) aid program. Also, as the following table shows, the number of countries where U.S. bilateral economic assistance is significant is rather large. In FY 1981, 32 developing countries received over $20 million each in total U.S. bilateral economic assistance. Of these, U.S. assistance accounted for over 5 percent of imports in 10 cases.

In DA, the formulation of a specific aid-assisted project is incomplete if it does not include explicit consideration of the economic policy environment within which it is expected to function, and which has an inevitably large effect — positive or negative — on the developmental impact of the assistance. It follows that negotiations with the host government concerning the project can and should serve as an opening for at least an exchange of views on how the economic policy environment directly affects the efficiency of the project, and consequently the effectiveness of U.S. assistance in helping with the country's economic development. Project assistance can be a good vehicle for the dialogue on the country's microeconomic policies — i.e., those affecting the demand, availabilities, and prices of the products in the specific sector under consideration, and of the resources needed to produce them, as well as policies affecting the competitiveness of the product and resource markets in question.

The dialogue through project assistance need not be limited to a discussion of the policies that directly influence the efficiency of the particular project. It occasionally may even serve as an entree for the discussion of broader policy issues. Such discussion will be

[12] Indeed, the argument is often heard that the magnitude and strength of commitment of U.S. support may enable a recipient to avoid the need for painful needed policy adjustment, which would otherwise be insisted upon by the international financial institutions.

facilitated to the extent that the project assistance is substantial, and/or that the U.S. aid program in the aggregate is large. Equally, if not more important, the connection between the efficiency of the project itself and the macroeconomic policy being discussed cannot be too indirect — if the host government is to be at all receptive to a discussion of the policy. In any event, discussions with the host government concerning the overall U.S. bilateral assistance program also provide the opportunity to address important macro as well as micro policy issues, even if the various components of the assistance program are in the form of project assistance.

3. P.L. 480 Food Aid

Since 1967, P.L. 480 food aid has been explicitly linked to developmental objectives, and greater emphasis has been placed recently on the use of P.L. 480 assistance to promote more effective agricultural and rural development policies in the recipient countries. P.L. 480 assistance can potentially serve as a vehicle for a discussion of either or both macroeconomic policies and specific rural development policies (including therein measures in the areas of nutrition, population planning and education, in addition to policies affecting pricing, production and marketing of agricultural products). This is, of course, because P.L. 480 carries general balance-of-payments implications at the same time as it affects food availabilities and rural development in the recipient country.

The U.S. emphasis on the developmental impact of food aid is evident in the relevant legislation. Titles I and III of P.L. 480 are obviously much more suitable vehicles for the policy dialogue than is Title II, although a policy dialogue on the effectiveness of non-emergency Title II programs (e.g., maternal-child health, food-for-work, and school feeding) deserves more emphasis than it is usually given. Title I loans are made on condition that the recipient countries undertake self-help measures to improve the efficiency of agricultural production and marketing. And Title III, too, provides for multi-year food aid commitments and forgiveness of dollar repayment obligations, as incentives to low-income developing countries to mobilize resources for development and to undertake development-oriented economic policy reforms.[13] The main constraint on the use of food aid as a vehicle for promoting sound recipient country policies appears to be assurance of sufficient availability of commodities to permit program continuity.

[13]On this and related points see the AID Policy Paper on Food and Agricultural Development, May 1982.

C. Project and Program Assistance[14]

Few topics raise the temperature of a discussion on economic assistance as quickly as the project/program controversy does. It may be useful to begin, therefore, with a reminder that this section does not touch on any aspect of the relative effectiveness of project or program aid other than their potential as a vehicle for the improvement of economic policies in the recipient country. Secondly, it is well to underline that project and program assistance are not mutually exclusive. On the contrary, they are complementary tools, in the context of the policy dialogue as much as in the broader context of the contribution of economic assistance to international development and other U.S. foreign policy goals. Thirdly, it is always salutary to keep in mind the familiar distinction between the *ostensible* linking of aid to specific projects and *effective* project-tying.[15] Nevertheless, there are three major categories of advantages of program aid.

— Program aid has a *higher scarcity value,* both because the amounts provided are typically larger and because few donors are willing to provide it.
— Program aid is a *flexible* instrument. It is quick disbursing, it can be increased or decreased at the margin or delayed in timing, and can be released in tranches. One can therefore support economic policy changes as they occur, as well as monitor their implementation. Project assistance, by contrast, cannot be turned on and off easily, and its potential leverage on economic policies is correspondingly weaker.

[14]This section draws heavily from Schiavo-Campo and Singer's *Perspectives of Economic Development.*

[15]If the recipient country's own resources are not entirely absorbed by the aid-financed project "A", *and* project "A" is of sufficiently high priority for the recipient country to be otherwise undertaken with the country's own resources, then clearly the aid enables the release of the country's resources to finance some other project "X". In such a case, notwithstanding the various possible good reasons for still going ahead with the nominal linking of aid to project "A", the fungibility of financial assistance means that in reality the donor has given program aid, whether it is realized or not. However, despite fungibility, the donor probably has more of an impact on the sector it is actually assisting. Also, as noted earlier, the policy dialogue presumes some disagreement between donor and recipient on desirable economic policies — and hence probably also on the composition of the development budget. It then becomes quite possible that project "A" will be carried out only because aid is available for it specifically, and the linking of assistance to project is effective.

— Program aid is *more directly relevant* to a discussion of macroeconomic policies; to link program aid to broad policy changes is more likely to appear reasonable to the host government, and thus increases its receptivity to the dialogue.

A review both of the AID experience of the 1960s (see the Annex), and of the World Bank's influence on LDC policies in its three decades of project-oriented assistance might lead to the conclusion that program assistance is the most effective form of aid for influencing macroeconomic policies. Two important qualifiers, however, take some of the wind out of this conclusion:

— To identify a form of aid as the most effective for a particular purpose is not equivalent to ruling out the usefulness of other forms of aid for that purpose, nor to assuming that the most effective form will actually be available under the specific circumstances.

— The first two of the three categories of advantages of program aid (higher scarcity value, and flexibility) belong more in the realm of strict conditionality than of dialogue. Thus, if a decision is made in the particular case to formulate and implement precise performance criteria, then program aid is unquestionably the superior instrument.[16] If the dialogue aspect is instead stressed, the choice is far more equivocal.

D. The Formulation of Conditionality

Conditionality is the most controversial aspect of the effort to promote improved economic policies through a bilateral assistance program, perhaps because it is in this area that the need for painful policy choices or a disagreement between the parties usually comes to the surface. It helps to frame the following discussion if we refer back to the principle of appropriate conditionality, i.e., that conditionality is meaningless without consideration of the objectives of the assistance and of the country situation. The first proposition is thus that *the formulation of conditions must always be consistent with the purposes of the assistance*. A second general proposition is the obvious one that it is important to *acquire familiarity with the recipient country's political, economic, social, and ideological landscape* prior to deciding whether to set conditions concerning economic policy, and if so, which specific conditions to ask for.

[16]Thus, the World Bank's introduction in 1980 of Structural Adjustment Lending (SAL) added a significant new policy and conditionality dimension to the Bank's assistance.

1. Positive and Negative Conditions

In purely economic terms, the distinction between positive and negative conditions is hollow. In principle, there is no difference between causing a loss and causing the cessation of a gain.[17] It is a matter of esthetics, not of economics. Causing a country to become less rich is the same as causing it to become more poor; the only relevant question concerns the quantitative impact of the intervention. However, the major political and diplomatic dimension of the policy dialogue calls for a very delicate handling of the positive versus negative formulation of conditions.

2. Explicit and Implicit Conditions

There appears to be a consensus and a wealth of precedent within AID that explicit and formal understandings openly incorporated into aid agreements are preferable to informal agreements, unless there are very good reasons for not insisting on doing so in an individual case.[18] The same is true of the choice between *specific or general* conditions, with specific and measurable conditions generally preferred to vague and generic criteria, both from the U.S. viewpoint and in order to provide a clear benchmark to the recipient country. It should be noted, however, that specific and precise conditions can be either *quantitative or qualitative*. This is important to stress, for — when shifting to new and different objectives of assistance that are less capable of quantification — there is often the temptation to accept vagueness or even to forego the elaboration of performance criteria concerning the new objectives. Again, it is perfectly possible to spell out precisely certain conditions even though they may be expressed qualitatively rather than quantitatively. Qualitative conditioning may include dated commitments to undertake actions defined in generic terms, or undated commitments to undertake specific actions. In more recent practice, U.S. bilateral aid has included precise but qualitative conditions (such as "strong and concrete measures to curtail the tendency to capital flight" by a specified date) but has generally tended to rely on the IMF for a specification of quantitative conditions.

[17]This principle has been recognized for centuries. For example, the medieval escape clauses to the prohibition of usury rested on either *lucrum cessans* (cessation of a gain), or *damnum emergens* (emergence of a loss).

[18]In countries where a charge of external interference is considered a total disaster for a politician, oral agreements may be far more easily reached than formal written ones. Depending on the judgment concerning the seriousness of the government's efforts at policy reform, the quiet, informal approach may not necessarily imply a weaker policy dialogue.

E. The Implementation of Conditionality

Implementation can be exercised through performance reviews, loan negotiations, and tranche releases. The twin objectives should be to: (i) establish credible consequences flowing from nonperformance, and (ii) decide on the type of implementation best suited to the specific country situation. Credibility can be established through a combination of tact with firmness, along with refraining from threats or promises unless it is certain that, if needed, they can be made good. A decision on the type of implementation naturally depends on the particular circumstances. The effectiveness of implementation is a function of three important elements:

— the quality of conditions,
— the number of conditions, and
— the phasing of the assistance.

1. The "quality" of conditionality

Performance criteria should, ideally, be both necessary and sufficient for the achievement of the policy and economic objectives of the assistance. As a rule, this is extremely difficult to achieve, frequently owing to unforeseen external economic changes. The international financial landscape is littered with the remains of bilateral and multilateral loan agreements that were formally abided to without any amelioration of the economic problems their conditionality was meant to address. It is, of course, important to be confident at the negotiation stage that conditions will prove to be at least necessary, if not sufficient. The establishment of conditions which turn out to be basically irrelevant to the purposes of the assistance and to economic policy improvements only discredits the policy dialogue. It is also important, as discussed later, to build in a mechanism for frequent review of conditions and of country performance.

2. The number of conditions

Common sense as well as the practice of multilateral and bilateral institutions indicate clearly that more conditions do not necessarily mean greater impact on policy improvement. On the contrary, there is — beyond a certain small number — an inverse relationship between the number of conditions and the effectiveness of their implementation. The consensus is that it is far better to insist on a few key points, and make sure that it is known to all concerned that the U.S. will follow through. Often, the most practical course may be to explicitly state *one* major criterion (as, for example, food price changes in a specified degree and on a clear timetable) and incorporate a *discussion* of other self-help conditions related to the major criterion.

3. The phasing of the assistance

Whenever applicable and practically feasible, the assistance should be disbursed in installments — "tranches" — taking care that sufficient time elapses between tranche disbursements to allow for at least minimal assessment of country performance. "Backloading" (later installments larger than earlier ones) increases the credibility of conditionality, though obviously it also delays the economic impact of the assistance. This, and the various other practical aspects of the phasing of assistance, can be determined only in light of the circumstances of the specific case. Generally, however, tranching has a number of advantages. It allows a flexible adaptation of the agreement to possible major changes in economic circumstances — tightening, slackening, or changing performance criteria in pursuit of effective implementation of the purposes of the initial conditionality. Also, it builds in a mechanism for periodic review of country policies, that is, *for the policy dialogue itself*. This is such an important feature that it may be by itself suffice to justify the tranching of assistance.

It is recognized that regular tranching may not be feasible in some instances, especially for some kinds of project assistance, such as establishing an agricultural research system or other forms of institutional development. Even in these cases, however, a tranche might be linked to the beginning of a new phase of a project or to an in-depth mid-term evaluation. Where a pre-determined tranche is not feasible, the mid-term evaluation or some other natural phase in project life should be a time for review of performance, including relevant country policies, with a mutual understanding that depending on the outcome of the review, the project might be modified and scaled upward or downward.

The nature and number of conditions, the tranching, the formulation of performance criteria — all facets of the conditionality addressed at promoting sound LDC economic policies — are a *means* to stimulate the host government in that direction and to arrive at the best informed possible assessment of its efforts and successes. In the final analysis, however, an inherently qualitative *judgment* by the donor is inevitably called for — a judgment of the seriousness, good faith, and competence of the host government in pursuit of the agreed economic goals identified through the policy dialogue.

F. Limits to the Effectiveness of the Policy Dialogue

Several important limitations are implicit in the previous remarks. Indeed, virtually any statement of "desirable" features of the policy dialogue contains within it a corresponding expression of a limit to its effectiveness. It may be useful, however, to recapitulate here the principal limits, keeping in mind that they do not necessarily rule out the possibility of a useful policy dialogue — but only imply the need for realistic expectations and for carrying out the dialogue in specially careful ways.

The presence of *overriding U.S. foreign policy objectives* other than the economic stability and development of the recipient country has already been noted as a constraint on the economic policy dialogue. Even then, a constructive exchange with the recipient country can take place regarding the maximum developmental impact of the resources provided — and hence regarding the overall policy context. The same is true of the possible limit posed by project-orientation of the assistance.

The existence of *large programs of other bilateral donors and of multilateral institutions*, as well as the activities of the IMF and the potential availability of funds from private international lenders — naturally also affect the capacity of the U.S. bilateral economic assistance program to promote improvements in a recipient country's economic policies. The important coordination issues involved are examined in the next section.

A third limit is set by *internal political and social conditions in the recipient country*. Insecurity, instability, administrative incapacity — all serve to lessen the chance of successfully inducing policy improvements. Paradoxically, external efforts to encourage improved policy may be least effective just when the need for improved economic policies and administration is most urgent. A variation on this theme is the possible extreme sensitivity of a recipient country to the slightest suspicion of interference with its sovereignty — sensitivity which is sometimes alleged to rule out a policy dialogue. But, that a host government may be particularly sensitive implies that the dialogue on its economic policies should be conducted in a particularly careful fashion — not that it should not be attempted in the first place.

One approach would be to ask as a condition of assistance that the recipient government formulate and present its own specific program of measures to deal with current economic problems. While much more palatable to the host government than U.S. insistence on certain policies, this approach still has the merit of leading the host government to recognize economic realities, and in all probability leading it to identify a set of measures similar to those which the U.S. would have specified in the first place. Even if this does not happen, discussion of the recipient government's own program would constitute a useful entry for a dialogue on concrete policy measures.

Finally, one often hears that the fundamental limit on the ability of donors to foster improved LDC economic policies is the incompleteness of our *understanding of the economic development process*. The incompleteness is real, but the limit is imaginary. It is, of course, salutary to keep in mind that the market for truth is a competitive one — where no monopoly survives for long — and that arrogance should be avoided.[19] The benefits expected from proposed major policy reforms should be substantial enough to allow for the inevitable large margin of error.[20] But to stretch this point too far leads to paralysis. It leads to the unscientific dead end of not ever counselling anybody about anything, for fear of not being entirely correct.

The fact is that if a donor government possesses a great deal of accumulated experience in economic development problems, information and insights about a particular developing country's economic difficulties and possibilities, and is in sympathy with the country's aspirations and long-term goals — it has a *responsibility* to its own people and to the recipient country to offer the best policy advice it can formulate, to urge effective economic policies, and to use its bilateral assistance program as a vehicle for promoting them. In addition, it is frequently a case of supporting LDC governments in doing what they recognize is needed and often want to do, and not at all a case of forcing them along a policy path which they do not find desirable for their country's economic development. Similarly, participation by donors in policy dialogue adds weight to economic development considerations in the recipient country policy formulation process, a process which — as in most countries — involves various and sometimes conflicting objectives.

[19] As the summary record of the *20th High-level Meeting* of the DAC notes, there was widespread agreement at that meeting that "past failure on the part of donors as well as recipients, should be sufficient to call for a certain humility with respect to the offering of policy advice" (DAC/M(81)11(Prov.), of 3 December 1981, p. 15).

[20] Nelson, *Aid, Influence, and Foreign Policy*, p. 83.

That said, there appears to be no disagreement among aid practitioners, development scholars, and policymakers, of the importance of a careful handling of the policy dialogue process:

External donors . . . assume a heavy burden of responsibility when they intervene vigorously and on a continuing basis in a developing country's policy formulation. This is not to argue against such intervention . . . external influence may be extremely useful as a counterweight to internal resistance to needed change, as a supplement to analytic capacity in countries lacking their own trained analysts, and as a stimulant to fresh perspectives in more sophisticated countries. But effective use of influence also demands recognition of the limits of our understanding of development problems, the patience to work toward a consensus on goals and means, and the willingness to stand by the implicit obligations of the game.[21]

[21]Nelson, *Aid, Influence and Foreign Policy*, pp. 89-90.

COUNTRIES WITH A 1981 CAPITA INCOME LOWER THAN $2,000 RECEIVING MORE THAN $20 MILLION IN TOTAL U.S. BILATERAL ECONOMIC ASSISTANCE[a]

	Country	(1) FY 81 Actual Programs (million of dollars)	(2) FY 81 Imports (millions of dollars)	(3) 1 ÷ 2 (percent)
AFRICA:	Ghana	12.2[b]	1,010.1	1.20
	Kenya	49.9	1,990.8	2.50
	Lesotho	10.4[b]	224.1	4.26
	Liberia	57.8	471.8	12.25
	Senegal	35.6[b]	754.8	.13
	Somalia	57.0	177.9	32.04
	Sudan	109.4	1,640.9	6.66
	Tanzania	36.3	1,199.7	3.02
	Upper Volta	30.7	329.9	9.30
	Zaire	29.6	676.4	4.37
	Zambia	38.5[b]	727.2	5.29
	Zimbabwe	22.9[c]	1,198.0	1.91
ASIA:	Bangladesh	151.6	2,475.2	6.12
	India	275.1	13,675.6	2.01
	Indonesia	135.0	14,747.0[c]	.91[c]
	Korea	29.0	25,300.0	.11
	Pakistan	79.3	5,407.3	1.46
	Philippines	97.5	8,464.4	1.15
	Sri Lanka	71.7	1,921.7	3.73
	Thailand	30.8	9,950.1	.31
LAC:	Dominican Republic	38.6	1,627.1	2.37
	El Salvador	104.0	931.9	11.16
	Haiti	27.5[b]	218.6	12.60
	Honduras	38.5	965.6	4.00
	Jamaica	70.8	1,334.1	5.30
	Nicaragua	18.5	1,008.1[c]	1.84[c]
	Peru	81.0	3,283.4	2.46
NEAR EAST:	Egypt	1,133.0	7,748.2	14.62
	Morocco	55.7	4,336.3	1.28
	Tunisia	40.6	3,752.0	1.08
	Turkey	201.0	8,859.4	2.26
	Yemen Arab Republic	7.7[b]	1,283.8	.60

Sources: *A.I.D. Congressional Presentation, FY 83* Main Volume
International Financial Statistics, IMF, Various Issues
U.S. Overseas Loans and Grants, July 1, 1945 - September 30, 1982

[a]In addition to these, Israel received $764 million in FY 81, and Poland $47.6 million.
[b]FY 78 data. For Ghana, Lesotho and Yemen, the FY 1981 actuals were higher than $20 million.
[c]Estimate.

III. The Conduct of the Policy Dialogue Through Bilateral Economic Assistance

As mentioned at the beginning of the previous section, the conduct of the dialogue cannot be divorced from its effectiveness, of which it is a major determinant. It is discussed separately here because it is much more eclectic than the other determinants of the dialogue's effectiveness — as it includes practical (though important) considerations as well as systemic and organizational issues.

A. The General Tone and the "Emily Post Factor"

The introductory section outlined a "cooperative approach" as an alternative to the adversarial, confrontational, approach to negotiations, and concluded it to be particularly appropriate to negotiations where — at least in principle — donor and recipient share the common objective of the economic stability and progress of the latter.[22]

A correct *tone* of the dialogue with the host government officials is uniformly agreed to be essential to the chances of its success. Among other things, the tone of the approach ought to be generally consistent with the prior realistic assessment of the potential for U.S. influence in the concrete situation and avoid conveying an adversarial and confrontational flavor — for, once again, there need be no conflict of goals between donor and recipient in a genuine dialogue on the latter's economic policies.

A number of common sense maxims emerge from an examination of the practice of the policy dialogue. The following may be listed:

— as already mentioned, the obvious precondition to the dialogue is that the donor must *understand the country situation* well enough to identify the key policy measures at issue. This is much easier said than done. An essential prerequisite is an overall economic analysis of the country's major development problems and prospects. (Such analysis need not necessarily be carried out by the donor agency from scratch or independently of the analyses by other institutions. The *assessment*, as opposed to the research, must be independent, however.) This assessment needs to be based, moreover, on a thorough, balanced and sensitive understanding not only of the economic situation, but also of the political and cultural setting, including the historical evolution. This argues for country expertise by donors; ideally, in-country resident expertise.

— The donor and its representatives must pay attention not only to the *clarity of the policy message* as it is "broadcasted", but also to the clarity of it as it is "received", keeping in mind that governments do not discuss issues; people discuss issues. Needless disputes may result from a simple misunderstanding of each other's actual position. It is, for example, perfectly clear to say "private sector promotion". Nevertheless, if there is any chance that this might be misunderstood by the interlocutor to be limited to "private *foreign* sector promotion", it is far better to spell out "local and foreign private sector promotion", however repetitious it might become. This point leads, among other things, to the desirability of asking the host country representatives to articulate *their* understanding of the policy "message" being delivered.

— The dialogue must be conducted on a basis of *mutual respect*. For example, any chance of a successful dialogue on economic policies is — in most countries — badly compromised if the host government gets the impression that its sovereignty is considered to be "for sale". On the other hand, naturally, a recipient country must accept the donor's right to advance and promote its own position on the country's economic policies.

— *Open mindedness* is quite important too. It makes for better listening. Better listening makes for better quality advice, and advice which is more legitimate — hence more acceptable — from the recipient's viewpoint. It consequently allows the possibility of a stronger and more robust insistence on following the policy course and performance according to the agreement. That is, open mindedness in the formulation of policy advice leads to more forceful implementation of the outcome of the policy dialogue. And, since the parties' open mindedness is likely to improve the quality of the initial advice in the first place, the result is better policy, more forcefully implemented.

— A variant of the above maxim is that it is important that the *recipient government reach its own conclusions*, and not feel that it is being manipulated.

— *Policy concerns should be introduced early* in the aid negotiating process. Sometimes the policy concerns are not broached with the recipient government until the process is well underway. Occasionally, these concerns are allowed to remain dormant until just before

[22] A similar point was emphasized from the very beginning of A.I.D., with the 1961 Report of the President's Task Force on Foreign Assistance counselling reliance on "persuasion" as the primary means of influencing recipient countries' economic policies.

the agreement is to be concluded. Clearly, this results either in not having them taken seriously or in generating justifiable resentment by the host government. In addition, it is probable that the very design of the project is improved by early consideration of the policy issues relevant to the purposes of the assistance.

— The dialogue must be mindful of the "*Emily Post Factor*", that is — as mundane as it sounds — the need for behaving in manners that do not clash with common politeness or with the host country's social conventions.

B. **Major Stages of the Dialogue and Some Administrative Issues**

A fundamental administrative problem is the assignment of appropriate weights to the necessarily partial views of the different components of an institution in such a way as to lead to an outcome which conforms to the objectives of the institution. *The dialogue with a recipient country cannot be productive unless the prior dialogue within the U.S. Government successfully takes place.*

The economic policy dialogue must be consistent, of course, with U.S. foreign policy overall and with respect to specific countries. Thus, the interaction between AID, State, Treasury, USDA, USTR and other U.S. agencies is a very important component of the eventual effectiveness of the policy dialogue with the recipient country, both in Washington and in the field. In Washington, a formal interagency coordination mechanism is provided by the Development Coordination Committee (DCC), which is chaired by the AID administrator, and its subcommittees on multilateral assistance, food aid, and so on. This formal mechanism needs to be supplemented by informal contacts between appropriate AID staff and that of other agencies. Such informal contacts, which already do take place frequently and constructively, should be extended to the area of the policy dialogue, its effectiveness and conduct. Coordination in Washington, whether formal or informal, is of course incomplete without parallel efforts in the field, to assure that all components of the U.S. presence in a country — including the Embassy, the USIA mission, and others — are at least aware and at best strongly supportive of the objectives of the economic policy dialogue being conducted by AID.

In the specific AID context, one must first of all acknowledge that Mission perspectives differ — and properly so — from the AID/W perspective, and hence assign a significant weight to both sets of views, *in order that the policies decided by AID/W be vigorously implemented.* Many of the principles outlined for a successful policy dialogue with recipient countries apply also to the successful exercise of AID/W influence and guidance for USAID mission activities and the vigor with which they are carried out. While the "leverage" possessed by AID/W vis-a-vis USAID Missions is clear to all participants, it is nevertheless true that *willing* cooperation by the Missions is indispensable for the achievement of a successful policy dialogue.

A meaningful and lasting response by Missions requires, among other things, clear and manageable instructions. So far, the Missions' response to AID/W emphasis on the policy dialogue have been supportive. The requirements for a further strengthening of Missions' interest and capability to engage in a robust policy dialogue with their counterparts in the recipient country are discussed in the next section. Here it is sufficient to note that one of the findings of a review of the AID experience of the 1960s in this area is "a strong tendency to 'package' existing activities in a particular field . . . in order to comply with Washington's directive . . . superficial packaging adds nothing to their effectiveness."[23] Thus, *asking for policy changes should never be allowed to become just another item on a statutory checklist.* To do so would tend to create the tendency to repackage exactly the same activities with a new cover fulfilling the formal conditions, but with no effective change.

The nature of the interaction with the recipient government will depend among other things on the country's level of development, its analytical capabilities, and its relationship with the United States. Except for the very few instances where strict and formal conditionality of assistance is a realistic option, such interaction may encompass one or another of the following approaches, or a suitable combination of all three. A *low-profile informal* approach entails discussions over an extended period of time, with an array of host government representatives, academics, etc. in whatever fora and occasions may be suited for raising policy issue. A *long-term planning relationship* entails the provision of a contract team to work for an extended period with the host country Ministry of Finance, Planning Office, etc., with the delicate dual responsibility of helping to implement host country policies at the same time as it attempts to promote their improvement.

[23]Nelson, *Aid, Influence and Foreign Policy*, p. 63.

Finally, we may *concentrate aid resources* in those countries (or sectors) where the probability of successful policy improvement is greatest. All of these approaches lead to the same set of practical implications, discussed below.

C. Sensitivity, Selectivity, Stamina, Staff: Four Essential Ingredients

There is an unbroken consensus of experienced opinion that sensitivity, selectivity, stamina, and staff are essential to a successful policy dialogue in the circumstances of the 1980s. "Sensitivity" has already been discussed earlier under the heading of the tone of the dialogue. As for the latter three elements, while many aid practitioners and policy-makers might differ on other aspects of the strategy of the policy dialogue, or on the desirable policies themselves, there is no disagreement that the dialogue must:

—build on the Agency's strengths and concentrate on a few key policy changes;
—be conceived and carried out on a sustained, long term basis;
—be implemented by a knowledgeable and competent staff, on both sides.

1. Selectivity

The policy dialogue needs to be concentrated in areas where it can make a difference, rather than scattered across the entire economic policy landscape. The important question is the identification of the specific policy areas selected as fit subjects for the dialogue. Officials in the recipient countries inevitably help define the policy issues that are discussed. But it is also necessary that AID choose to discuss those key issues and policies about which we are best informed and which we feel are most important. These would normally lie in the areas of special AID expertise and/or interest, such as agricultural policy, parastatal enterprises, health and population, taxation and government expenditures, and trade and tariff policy.

The enormous economic, social, and political diversity among developing countries points to the need for defining those key issues and policies on a country-specific basis — albeit, of course, from among a "basket" of policy areas on which constructive discussions might be possible. Agency precedent as well as common sense thus combine to suggest that there is no substitute for allowing — indeed, requiring — the USAID/Missions to determine their own key area priorities for policy intervention or dialogue, on the basis of their familiarity with the country situation and with the strengths of the AID program in that country. (This is in fact the approach that has been followed so far.)

There is, of course, a need for "stimulation" by AID/W and for follow-up of Mission responses. The key policy areas to be identified ought to meet the following three criteria:

— They must be areas of importance to the economic development of the country. If they are unimportant, efforts at a policy dialogue are not a cost-effective use of mission staff. For example, the economic efficiency costs of subsidizing consumers by means of controls on agricultural producers' prices are a topic of great general importance. It would be, however, wasteful for a Mission to discuss this point in a country where such intervention on prices is minimal and thus not an important issue.
— They must evidence a significant and identifiable difference between the U.S. views of desirable economic policy and the host country practice. If there isn't a significant difference, the dialogue is moot.
— They must belong in the host government's discretionary sphere. If the economic policy measure is dictated by an overriding national imperative — domestic or external — the host government cannot be at all receptive to the dialogue. Thus, it would not be reasonable to harp on the economic inefficiency of a certain regional allocation of public spending when the expenditure "quotas" — as in several African countries — are dictated by the need for preserving minimal national cohesion in a multi-ethnic plural society.

2. Stamina

Any attempt at promoting policy changes must recognize the axiom that any economic policy measure, no matter how desirable or sensible, by itself always harms somebody somewhere.[24] Under special country circumstances, a sudden and large policy reform might be the only way to overcome successfully the predictable opposition by the vested interests of prospective losers. When a government, however, does not possess the requisite strength and authority for such a quick, broad stroke, its implementation of economic reforms requires gradual overcoming, pacifying, or compensating the groups that stand to lose from the reform — and this is delicate and time-consuming political

[24] A recent analysis concluded that the extent of liberalization in various policy areas has depended largely on the interaction between the government and those groups that stood to lose from the liberalization. Morrison and Arreaga, *Economic Liberalization in Developing Countries*, p. 6.

business. Correspondingly lengthy and gradual is an aid donor's build up of its capability to demonstrate to the recipient government how the latter can lessen, escape, or weather the political opposition to economic policy changes.

A policy dialogue will need to be considered as a long term investment of talent and resources. When progress is achieved, it will most likely occur in small increments and when we are most successful, it will be from gradual progress over an extended period. We should not delude ourselves that we will be able to catalyze large or dramatic changes in the macroeconomic policy arena for a small investment of time and resources.

If the policy dialogue is properly viewed as continuing involvement on a long-term basis, one may add to the *direct* policy dialogue (such as may be exercised during program loan negotiations, for example) all the various *indirect* ways through which the U.S. viewpoint on desirable economic development policies is advanced — including help to build up the host government's policy analysis capacity, support for applied research in certain policy areas, professional exchanges among government agencies, seminars and conferences, and the provision of short-term technical assistance for the analysis of the political and economic implications of certain policy measures. Indeed, it can be argued that the bulk of the policy dialogue in many countries is and has been effected through these techniques rather than through U.S. officials' conversations with host government officials. However, it was not possible in this paper to do justice to the elusive topic of the possible long-term policy impact of these indirect measures.

The long-term nature of the policy dialogue leads to one final point. Experience suggests that one should "never give up on countries": today's basket case may be tomorrow's growth model. A case in point is Korea, which in the late 1950s was considered to have extremely poor economic prospects.

3. Staff

The AID staffing implications of three other ingredients of a successful policy dialogue — sensitivity, selectivity, and stamina — are predictable, yet valid. It is unrealistic, and ultimately counterproductive, to try and carry out a dialogue on economic policies of great import to the recipient country without knowledgeable, competent, and sympathetic people to conduct it. This is not the place for a discussion of numbers and credentials of AID staff that may be required.[25] One may, however, note that much can be accomplished by optimal use of a relatively small number of high-quality staff.

There are a number of ways in which the staffing requirements of the emphasis on the policy dialogue can be kept down to manageable proportions. First, adhering strictly to the criterion of selectivity of intervention entails a significant potential for targeting efforts on a few key policy areas even with a relatively small staff. Second, as noted earlier, independent AID assessment of the host country's economic policy context does not necessarily require original research. A lot can be done by intelligent critical scrutiny and synthesis of other institutions' analyses — notably those by the World Bank and by the IMF, along with relevant documents by regional MDBs and other sources — and by frequent exchanges of views with staff of these institutions and of other U.S. agencies. Superimposing the U.S. priorities and perspective onto another institution's work will normally result in certain significant differences in conclusions, or at least changes in emphasis, from the original assessment. An independent economic policy assessment need not, therefore, require a great deal of in-house analytical capacity. (Whether the conclusions of such an assessment should be pressed independently of other donor institutions is a separate major issue, taken up in the next section.)[26]

Even after all possibilities for limiting new staff are utilized, there remains the hard core reality that a constructive policy dialogue, however selective, *mandates* a minimum in-house analytical capability — consisting of a sufficient number of U.S. direct-hire economists on the staff of USAID Missions along with supporting local staff and analytical backup in the form of TDY

[25] A detailed plan concerning the use of economists in AID and requirements for new positions has been prepared by the Chief Economist, partly on the basis of the staffing implications of the economic policy dialogue.

[26] U.S. Embassy personnel often possess the needed economic skills and relevant experience, and judicious coordination with them at the country level can do much to limit direct AID staffing requirements. Much of the same point can be made with regard to coordinating with State and/or Treasury on the economic policies to be urged on the MDBs, or on the IMF. Certainly, better coordination and a greater AID role in the formulation of instructions to the U.S. Executive Directors of the MDBs and of the IMF, would do much to lessen the need for conducting the policy dialogue on a bilateral basis, and would consequently serve to keep down the number of AID staff required.

assistance from AID/W or on contract. At present, in a large number of Missions such analytical capability is notable for its absence.[27]

These considerations do not mean that the policy dialogue can be carried out by staff. Subject to the authority of the Ambassador, the AID Mission Director has the major role (though not an exclusive one) to play in the interaction with host government officials of the requisite level. However, it should be clear to both sides that there are limits on a Mission Director's autonomy. It is good for the effectiveness of negotiations to be able to disclaim authority and to have to refer major issues to AID/W. (The "policy staff" should, of course, enjoy easy access to the Mission Director — or, at AID/W, to policymakers in the regional bureaus.) A management/organizational corollary is that Mission Directors ought to be chosen partly on the basis of their ability to engage in substantive economic policy discussions, and of their understanding of the importance of sound domestic policies in the economic development process. Also, it is necessary that the policymakers in the regional bureaus at AID/W appreciate the importance of the policy dialogue, and evaluate Mission Directors in part on the basis of their performance on this score.

D. The Host Country Participants

The quality and attitude of the host country interlocutors is also very important. All too frequently outside experts quickly interpret non-optimal economic policies undertaken by LDCs as indication of ignorance rather than political constraints or contradictory objectives. Few mistakes can be more damaging to the chance of a constructive dialogue than to underestimate the technical competence and savvy of the host country counterparts. The story is told of the aid organization representative who gave a paternal lecture to a host government economic official concerning a particular conclusion of economic development research — only to find out after the interview that the official had co-authored the original research. Especially in countries with a large economic assistance program, AID will often be negotiating with the host country's most competent professionals, and must be represented by individuals capable of commanding respect and thus attention from their counterparts.

[27]It should also be kept in mind, as the experience of the 1960s shows, that the size and "deployment" of the policy dialogue staff depend on the nature and intensity of the dialogue, with more staff required by a formal conditioning approach than by an informal dialogue.

By contrast, in countries with a limited economic and administrative capability, the dialogue may be constrained by inability of the host country interlocutor to understand what the issue is about and why a certain policy course may be desirable. When this is the case, AID assistance to build up the host country capacity for policy analysis would be in line both with the requirements for a successful policy dialogue and with the institutional strengthening which is of general importance for the development.

IV. Bilateral-Multilateral Cooperation in the Policy Dialogue

The etymology of "dialogue" does not reflect the complexity of the problem of assuring the developmental effectiveness of external assistance. More than "two voices" are involved and "the" policy dialogue in practice comprises a number of formal or informal exchanges, whether joint or several. The contact between a U.S. AID Mission Director and the host country counterpart is only the intersect of two complex decision-making planes. In turn, the U.S. economic assistance program is, in most countries, only one among a constellation of sources of external finance, including the MDBs, the IMF, other bilateral donors, and private international lenders. The need for coordination among these is an age-old issue, with the objective to assure — at best — maximum stimulation of economic policy improvements, and — at least — that one program or one donor not undercut valuable efforts through another program or by another donor.

A. The Role of the IMF and of the IBRD in the Policy Dialogue

The IMF and the World Bank are always potential actors in the dialogue, and very often play the leading role - in large measure owing to their substantial resources. The interaction between AID and these multilateral institutions thus ranks as the first item in any discussion of coordination by AID in the area of the policy dialogue. The burgeoning literature on IMF conditionality and on the World Bank's approach to influencing economic policy in developing countries is too vast to be examined here in detail.[28]

[28]On IMF conditionality, the most useful references are: Joseph Gold's *Conditionality*; Manuel Guitian's three articles in *Finance and Development* of 1980-81; IMF documents EBS/81/152 of July 14, 1981, and EBS/81/152 Supplement 1 of September 1, 1981. A number of papers were also presented at a conference on IMF conditionality, organized by the Institute for International Economics in Washington on March 24 - 26, 1982, and some of these are useful analyses. Another recent treat-

Even though the IMF practices have to an extent changed in response to international economic developments in the 1970s, and notwithstanding the views of some that IMF conditionality has "slipped", it remains true today that the IMF policy conditionality is still by far the strongest and clearest of any international institution, albeit, of course, limited to measures consistent with the Fund's purpose of helping the member country achieve a sustainable balance of payments position in a reasonable period of time. Three interrelated factors are probably responsible for this. *First*, the theory underlying international financial adjustment is reasonably complete, and better established than the theory of economic development, so that IMF conditions can be formulated with more assurance and thus implemented more vigorously. *Second*, the IMF can marshal significant amounts of quick-disbursing financial resources to back its economic policy advice. *Third*, member countries in balance of payments trouble usually yield to the natural temptation to postpone the recourse to unpleasant adjustment measures as long as possible — with the result that when they do go to the IMF for financial assistance their needs are acute, and lend a certain special weight to IMF adjustment policy conditions. It should be stressed that the Fund has often urged member countries to *anticipate* a need for drawing from the Fund, and not wait until their financial problems become severe. The "lender of last resort" terminology is not the Fund's own.

The World Bank's influence on macroeconomic policies of developing countries has generally been more diffuse. Historically, the Bank has been primarily a project lender, and within that vehicle there has always been a concern with the economic policy environment. The recent introduction of program lending with an explicit policy dialogue component (Structural Adjustment Lending — SAL), may, however, have given added robustness to the Bank's economic policy dialogue with recipient countries and increased their success in fostering improvements in host country policy.

B. Coordination Between the IMF and the IBRD

The introduction of SAL has been a major factor in the establishment of closer Bank/Fund links than had been the case previously — although the Bank and the Fund have cooperated with each other throughout their history.

The division of labor — and therefore the nature of cooperation — between the IMF and the IBRD is not as easily defined as it was in earlier days, when the distinction between "stabilization" and "development" was clearer — largely because the duration of "temporary" balance-of-payments disturbances was shorter. It was more acceptable then to think of the Fund as dealing with "short term" difficulties, and of the Bank's function as applicable to the "long run". The onset of oil crises, and the progressively longer duration of temporary balance of payments problems has changed all that. To neglect external financial problems can be fatal to long term development and, conversely, the lack of needed structural changes is eventually paid for in the form of financial crises.

The Fund has correspondingly lengthened the time horizon of some of its activity (with the introduction of the Extended Fund Facility — EFF), and broadened its institutional concern to include production issues; and the Bank has foreshortened its own time perspective to a degree and — within that — begun paying serious attention to requiring certain policy adjustments. Neither Fund nor Bank representatives find it fully acceptable any longer to define their boundary as short-term versus long-term, or stabilization versus development, or macroeconomic versus microeconomic — although it remains beyond argument that the Fund is in all three cases closer to the former of these two terms of comparison, and the Bank to the latter.

What is left as a fairly clearcut dividing line (in addition to the very different "personality" of the two institutions) is the respective institutional policy competence and experience. The Fund possesses primary competence/responsibility in the analysis of balance of payments adjustment problems and has therefore a comparative advantage in the dialogue on exchange rate, monetary, and incomes policies. The Bank possesses primary competence/responsibility concerning development programs and priorities and project evaluation, and has thus a comparative ad-

ment is R.S. Eckaus' important conceptual piece "The Conditionality of International Financial Institutions and U.S. Policy", presented in draft form to the M.I.T. conference on U.S. International Financial Policy on February 25, 1982. On the World Bank, Edward Mason and Robert Asher discuss the earlier Bank experiences with the use of leverage in their 1973 study *The World Bank Since Bretton Woods*. For a description of the policy dialogue through structural adjustment lending programs, see Pierre Landell-Mills' "Structural Adjustment Lending: Early Experience", *Finance and Development*, December 1981. See also the Treasury Department's *U.S. Participation in the MDBs in the 1980s*. (Full references are shown in the Bibliography.)

vantage in the dialogue on the size and composition of the investment program, on the efficiency of the use of resources, and on individual pricing policies.

Coordination and cooperation between the Bank and Fund has naturally been easier in regard to the areas of clearcut primary responsibility of one or the other institution, than in the remaining policy areas "in between" (especially fiscal matters and external debt problems). Still, with some limitations and difficulties arising partly from the different pace of activity in the two institutions and their different operational time horizon, cooperation has evolved in keeping with the substantive changes made by both Fund and Bank in response to the changed international economic environment. Outside observers are understandably skeptical that Bank-Fund cooperation has been characterized by as much unbroken smoothness and amity as the representatives of both institutions are typically careful to project. However, it is very probably true that, at least, coordination has not proven to pose any constraint to the operations and overall effectiveness of either the Bank or the Fund.

C. Coordination Between AID and Multilateral Institutions

The dialogue on macroeconomic policies to a large extent does need to be carried out by multilateral institutions, not only for the standard reasons of their greater volume of assistance and their non-political nature, but also because — to be plain — 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. But U.S. bilateral economic assistance programs must themselves have the capability to serve as an independent vehicle for the dialogue on LDC economic policies. This capability is useful to support and reinforce the dialogue when it is led by the IMF or the Bank; and it is an indispensible check on the policy advice rendered through those sources. Lacking such capability, U.S. support for the policy dialogue conducted by the multilateral institutions would suffer form a knee-jerk automaticity which would be very hard to justify — from the U.S. standpoint, from that of the recipient country, or from that of the multilateral institutions themselves.

An opposing argument is often heard, however, to the effect that the dialogue on macroeconomic policy should be left to the multilateral financial institutions, or — which amounts to almost the same thing — that the U.S. effort to foster improved economic policy should "piggyback" entirely onto the IMF or IBRD conditionality. Supposedly, policy changes urged by multilateral institutions are more acceptable to the recipient countries because they are advanced on "technical" and not on "political" grounds.

As Edward Mason put it fourteen years ago:

> [The stigma of aid] becomes less embarrassing and loses much of its sting, we are told, if aid comes from a multilateral agency in which a recipient country and countries in a similar position of dependence have a voice.[29]

It is not sensible, however, to regard economic policy issues as merely "technical"; indeed, it is not good economics to do so. The historical pattern of reaction to the IMF's own conditionality makes this quite clear. Related to the "technical" character of multilateral policy advice is the alleged greater capability of multilateral institutions to undertake a more vigorous policy dialogue. The record of the IMF is invariably cited in this regard, and the argument indeed carries weight in this specific case.

A second argument put forward to support a policy of "100% piggybacking" by the U.S. on the conditionality of the Fund or the Bank is the greater analytical capability underpinning these institutions' assessments and policy dialogue. This is a valid, but not determining, argument. There are still three specific reasons why 100% piggybacking would be an undesirable policy. First, as competent and thorough as the staffs of the IMF and the IBRD are, there is always the possibility that their analysis may be faulty in some respect in any particular case. Second, while the analysis may be on mark, they may have a different perspective on the kinds of ecoomic policies that would lead to broad-based economic development. Third, and most important, the principle of appropriate conditionality should be recalled once again: it is to be expected that the policy dialogue will be carried out by different institutions in pursuit of the achievement of their own statutory objectives and functions. Since these are significantly different, the shape and direction of the policy dialogue carried out through one institution cannot be identical to that which another institution should in principle adopt, and the *possibility* of an independent stance must not automatically be ruled out.

This problem is especially relevant to the next

[29] "Notes on Bilateral and Multilateral Aid", p. 13.

section's discussion of the difficulties of coordinating the policy dialogue through U.S. bilateral economic assistance with other bilateral donors — whose objectives, and the time phasing of those objectives, have the greatest overall divergence from one another. This problem is, instead, least troublesome as regards coordination with the MDBs, with which the U.S. economic assistance program shares the major objective of promotion of long-term economic development.

Interaction with the IMF is somewhere in between, and requires separate consideration. There has been generally strong Agency support for IMF programs from the early days of AID and even before. The U.S. has occasionally conducted parallel (and sometimes even joint) negotiations with those of the Fund and of the Bank with recipient countries. Recently, the connection between U.S. assistance and the IMF imprimatur on recipient country policies has been underlined — consistently so at the level of public support, and often including clear linkages to the probability and amount of bilateral economic assistance.

To a large extent, such strengthening of support for IMF conditionality is grounded on the recognition that the danger to long-term development posed by short-term financial crises is greater than ever. However, lest this posture become purely automatic and hence, by definition, no longer defensible from the viewpoing of the U.S. interests and those of the international economy, it is well to be reminded of the difference between the objective of financial and economic stabilization and the objective of long-term broad-based economic growth. This difference, although blurred by recent events, is still very much an economic reality. While, in most cases, well conceived adjustment programs and sound long-term development plans are mutually reinforcing, the possibility that stagnation and stability might occasionally go hand-in-hand obviously exists.

Bilateral economic assistance, naturally, cannot afford to disregard considerations of economic stability in developing countries — both because stability is linked to longer term development and because it is an important component of U.S. foreign policy objectives in its own right. But neither should one forget that the *weight* assigned to various economic objectives will in most cases be quite different for U.S. bilateral economic assistance than it is for the IMF. Although the strong presumption should continue that the policies counselled by the IMF (or the Bank) are conducive to economic stability and to broad-based development, in light of these institutions' substantial analytical capacity and integrity of purpose — such presumption must not be absolute, and needs to allow the possibility of proving otherwise in any given specific case. Furthermore, the need for consistency of the bilateral economic policy dialogue with overall foreign policy goals also requires leaving open the possibility of an independent U.S. stance — in general, or with reference to specific countries.

This principle has an important implication for internal policymaking processes within the U.S. If indeed the policy dialogue to be carried out through U.S. bilateral economic assistance is to reflect largely (though never unquestioningly) the conditionality of IMF programs, it is plain that AID, which has a major role in formulating policy in regard to bilateral economic assistance:

— should participate in the making of U.S. policies vis-a-vis the IMF to a much greater extent than is currently the case; and
— should interact with the IMF in such a way as to allow for the possibility of changes in views or modification of policy prescriptions by *either* side. At a minimum, any unquestioning presumption that IMF prescriptions are invariably correct or complete should be avoided by the U.S. participants to that aspect of the dialogue.

This is not intended to suggest a need for significant variance from the present practice of Treasury-led coordination of the U.S. dialogue with the IMF. Nor should the arguments of this paper be read as counselling that AID should "duplicate" the multilateral policy dialogue, but, more modestly, that it is important that the bilateral economic assistance program in a specific developing country support and reinforce the multilateral policy dialogue, *in an informed and knowledgeable fashion and in keeping with the U.S. own foreign policy objectives* — including the sustained economic development of the country in question. Informed and knowledgeable support by AID naturally must be grounded on a capability for independent assessment, which can be accomplished by optimal use of a relatively small number of high-quality staff. At the same time, country-specific U.S. support for the IMF or MDB-led multilateral dialogue could be much stronger if the bases of such dialogue incorporated more fully the AID perspective on the importance of development considerations and sound macroeconomic policies to begin with.

D. Coordination Between AID and Other Bilateral Donors

The need for policy reform is not limited to countries receiving aid. It extends to the aid practices of the different bilateral donors. There are severe limits, however, to the feasible extent of bilateral donors' coordination for the purpose of fostering sound macroeconomic policies in the recipient countries. As often noted earlier, the greater the difference in objectives, experience and outlook, the more difficult is the task of coordination; that bilateral donors differ greatly from each other in both general aims and economic perspective is a point that requires no elaboration. It is clear that, *at this time*, some other donors do not attach as much importance to LDC economic policies as the U.S. does; even when they do, some appear generally wary of bilateral involvement in sensitive macroeconomic policy issues. Greater bilateral coordination for a more effective policy dialogue should, of course, be attempted and is achievable. The reasons behind the initial reluctance of some other donors do, however, need to be considered in any concrete effort at achieving greater coordination.

The great diversity among bilateral aid programs is well known. There is no clear donor consensus on providing a major portion of bilateral aid for specific purposes or objectives (with the possible exception of aid for stimulating food production). There appears to be only partial donor agreement on aid priorities and development strategies in particular LDCs. In several development areas, e.g., basic human needs, physical infrastructure, industrialization, etc., donor involvement also varies a great deal. In actual historical practice, therefore, major donors have not sought actively or consistently to coordinate their positions on economic policy questions. Some donors have traditionally strongly disapproved of any attempt to link bilateral aid to policy changes, and prefer looking to the multilateral institutions to raise LDC policy issues. However, it would appear, based on U.S. experience in the OECD's Development Assistance Committee (DAC), that over the last year the interest of other bilateral donors in policy dialogue has increased.

For the most part inadvertently, donors at times work at cross purposes. One example of this is the uncoordinated provision of assistance from several sources for overambitious development efforts, beyond the means of the host country and with a plethora of recurrent cost problems. Another example is one donor's provision of general unconditional aid support which as a by-product relieves the incentive of the host government to take needed policy measures urged by another donor.

One difficulty with formal inter-donor coordinating mechanisms is that most policy questions are politically and economically sensitive, and thus not a good subject for productive and frank discussions in open settings. Confidential, one-to-one relationships in all probability must complement — and preferably precede — whatever formal coordinating mechanisms exist. The pre-requisite for a better coordinated approach, naturally, is a greater degree of agreement by other bilateral donors concerning (a) the importance of LDC policies, and (b) the desirable policy direction toward which a recipient country ought to be urged. Once again, one is confronted with the necessity of a *prior* dialogue — this time, between donors — if the dialogue with the recipient country is to be successful. The U.S. must, therefore, persist in its efforts to present others with an ever more persuasive case in support of its development perspective. This is much more important than elaborating additional mechanisms of coordination — which may or may not be necessary or even desirable, in view of the probability of suspicion by aid recipients.

This policy dialogue among donors can be pursued in a number of already-existing ways including discussions:

— among donor representatives in the field,
— between senior aid officials in donor capitals,
— in MDBs and international organizations,
— in regional donor/LDC groups, e.g. Club du Sahel, the CBI.

Two fora in particular should be mentioned: the Development Assistance Committee (DAC) and the Consultative Groups (CGs).

DAC: As a central coordinating forum, DAC is most suited for broad scale discussions of the need for appropriate LDC policies, the relationship between aid and LDC policies, and the desirability for coherent collective donor positions. Individual LDC situations are not considered in DAC. It would be useful to aim for discussion in DAC on how development critically depends on appropriate LDC policies; on the desirability to provide aid in support of such policies; on the definition of policy areas within which some agreement is possible; on the desirability of coordinated donor positions on policies in respective LDCs; and on the ways and means for reaching agreed donor positions.

Consultative Groups: While there are limits to the utility of CGs for pursuing the policy dialogue, certainly this is a useful mechanism for reinforcing donor views on the importance of policies. As most CGs are managed by the IBRD it is necessary that bilateral donors and the Bank work closely together to ensure that the issues selected are appropriately highlighted, discussed in country economic reports, and prominently considered in CG meetings. Donors, individually and collectively, should be urged to be less hesitant to raise country-specific policy questions in the CGs. However, the positions of major donors must be similar or at least compatible.

When consortia or consultative groups do not exist for a particular developing country, it is in the interest of a constructive discussion of economic policies of developing countries for the U.S. to support formation of a consultative group — if circumstances permit. In addition, the possibility of country-specific mechanisms along the lines of the Club du Sahel may be worth exploring: a systematic mechanism of consultation, convened at intervals, and led on a rotating basis by that bilateral or multilateral donor institution that has special experience and/or interest in the particular issue to be discussed. It would be desirable, also, to examine the possibility of arrangements through which host government officials could participate in such consultations as well. Possible fora for such joint discussions include the UNDP in certain countries and the Development Center of the OECD.[30] The UNDP through its round tables represents another mechanism for coordination and dialogue which has been useful, particularly in the case of very small developing countries, where consultative groups do not currently exist and may not be practical.[31]

[30] LDC officials have in fact participated in their personal capacities in meetings at the Development Center and in informal workshops held under DAC auspices. The subjects of these meetings, such as rural development, have often dealt with recipient country as well as donor policy issues.

[31] As a follow-up to the UN Conference for the Least Developed Countries (LDCs) in September 1981, the UNDP has organized a series of roundtables at the request of individual LDCs.

Annex
AID EXPERIENCE AND CURRENT MISSION VIEWS

Several of the principal conclusions from and examples of the AID experience with the use of program lending to influence LDC economic policies have already been noted in the body of this paper. In most cases, contemporary comments and opinions echo those conclusions, although without the "can do" tone and the presumption of omnipotence of public policy pervading some of the 1960s attempts at shaping the course of economic change in the developing world. The main results of a comprehensive survey of AID experience with program lending in the 1960s are summarized here.

An important generalization emerges from this material, as well as from comments by individuals. By and large, the greater the distance from the recipient country, the less appears to be the concern with special local sensitivity — since the knowledge of those sensitivities is less keen and the perceived cost of adversely affecting them are much smaller. Thus, at Mission level, concern with host government sensitivity is greater and — other things being equal — willingness to urge policy changes is generally less. At central AID levels, the recognition of the delicate nature of the dialogue and of its practical limits may be less clear, but the perspective on the policy problem is also keener. The crucial administrative question is to assure that the decision-making process embodies that particular pair of weights assigned to Mission versus AID/W views on the policy dialogue that will lead to a realistic but not paralyzing strategy on the dialogue.

AID Experience with Program Lending in the 1960s

Some of the earlier experiences with the use of aid to promote sound economic policies were not good, and well publicized blow-ups occurred. These were partly caused by style differences but partly also by substance. Less known are the quietly successful efforts to encourage improvements in economic policies the U.S. aid program undertook in other countries during that period. Nevertheless, one important lesson of those earlier experiences is that a bilateral aid program — however large — cannot be effective as the sole vehicle for a macroeconomic policy dialogue, nor even perhaps perform the leading role in this respect.

A comprehensive review of program lending in the 1960s found that program lending did indeed affect the economic policies pursued by recipient countries, more so than project loans, which were narrower in their scope and exerted only occasional and localized policy influence, or sector loans, which were relatively new during the 1960s and offered no substantiated results. (The conclusions concerning individual country cases were, however, sometimes rosier than the evidence available at the time — let alone the aftermath — indicates.)

Through observation and documentation of program loans as a means of promoting economic policy improvements, two characteristic methods were found to be typically used in their implementation. The first was the "Latin American Strategy", characterized by "tough" and "formal" conditioning and performance evaluation. The second was the "Near East-South Asia Strategy", which exemplified "informal" conditioning, with an emphasis on a continuing dialogue. Although no conscious effort was made to formulate two such divergent methods of promoting economic policy improvements, the AID experience generally proved that the approaches taken in countries in each of the respective regions tended to pattern themselves along the lines of their regional approach. The following table provides a visual summary of the pattern and modality of the AID approach to promoting improved economic policy.

The Brazilian country experience provides a good example of the Latin American or formal conditioning system. Brazilian economic performance was judged on the basis of its fulfillment of both quantitative and qualitative performance targets which were previously agreed to in formalized, written agreements. In turn, tranche releases of program loan funds were contingent on a judgment of whether these specific and explicit loan conditions were met. The Agency concluded that this approach did encourage host governments to pursue policies which would not have otherwise been followed in the areas of monetary and fiscal stability.

India is illustrative of the Near East-South Asia or informal approach to the dialogue. In this case, more emphasis was placed on maintaining a continuing dialogue through gradual persuasion in verbal program loan agreements. Often, agreement on a loan was finalized after the prescribed policies had already been adopted, such as India's devaluation of the rupee.

More generally, the AID experience during

the 1960s leads to several useful recommendations and conclusions, many of which (but not all) are still applicable to the policy dialogue today. Regardless of which type of approach is used, a recipient country needs to understand that its cooperation and performance in self-help efforts are critical to its economic development. Therefore, the host government needs to cooperate with the AID Mission, by providing the Mission with an influential contact point in its government and encouraging relations with the Mission Director and his staff in order to establish a firm foundation for the dialogue.

AID should also concern itself with the human element in promoting development and foster diplomatic relations between the Mission Director, his staff and other local counterparts. The AID Mission should be cognizant of potential political, military and commercial considerations which could possibly reinforce or undermine the success of policy discussions.

Certain conclusions pertaining to the use of the program loan itself as a means of promoting policy improvements, and to the time factor, merit additional attention. Although a dialogue can take place in almost any policy area, with the exception of an area of ideological importance to a country, a time allowance should be made for the adjustment needed to accompany and accommodate changes in fiscal and monetary policies. Another important point is that a host government's receptivity to policy suggestions does not usually remain constant over time. The characteristics of the policy dialogue need therefore to be periodically reviewed.

Multilateralism, whether in conjunction with the IMF or the IBRD, including consortia and consultative groups, is useful in promoting improvements in economic policy. The Chilean country experience during the 1960s is indicative of how IMF fiscal and monetary stabilization policies were incorporated into AID program loan conditions. The 1970 PPC study also concluded that donor consortia can be useful in promoting sound economic policies consistent with the views of the United States, yet at a lesser political and diplomatic cost.

Country	Nature of Conditions	Implementation of Conditions X = Strict[a]	Areas in Which Conditions Were Specified	Environmental Factors: Diplomatic Relations	Domestic Politics	Unforeseen Economic Developments	Multilateral Presence: Consortium	IBRD	IMF	Mission-Host Relations
Brazil	Specific	X	Stabilization Policy Federal Budget Coffee & Wage Policy Fiscal and Monetary Policy Inflation	Good	Unstable	Inflation		X	X	Good
Chile	Specific But Implicit	X	Stabilization Policy Balance of Payments Inflation	Good	Obstacle to Aid Relations military press. pol. system	Favorable Copper Prices		X	X	Conducive to Diplomatic Relations
Colombia	Specific and Explicit	X	Stabilization Policy Exchange Devaluation Coffee Policy Agriculture, Education Export Promotion	Fair	Political System Provided a more Secure Yet Less Powerful Government	Exchange Rate Crises		X	X	Strained Staff Capabilities Excessive Staff Demands
India	General and Implicit		Development Policy Agriculture Family Planning Import Liberalization Export Promotion Exchange Rate Devaluation Increased Foreign Private Investment.	Indian Neutrality Emphasized	Political System Sensitive to Outside Influence	Indo-Pakistani War 1965	X	X	X	Continuing Dialogue Emphasized
Pakistan	General But Explicit		Import Liberalization Population, Agriculture Fiscal Policy	Good	Good Stable	Indo-Pakistani War 1965	X	X		Continuing Dialogue Emphasized Persuasion
Turkey	Implicit		Balance of Payments Stabilization Policy Foreign Exchange Import Liberalization	Politico-Military Relations Interfered	Sensitive to Outside Influence	Perennial Balance of Payments Difficulties	X	X	X	Continuing Dialogue Emphasized
Tunisia	Explicit	X	Stabilization Policy Credit, Public Expenditure, Tax, and Private Investment Policies Agriculture Fiscal Policy Current Account Viability	Good	Good		X	X	X	U.S. Attempt to Find Another Principal Donor
Korea	Specific		Stabilization Policy Credit, Fiscal, and Foreign Exchange Policies	Good	Good		X	X	X	Good Working Relations

[a]Strict program loan condition implementation may be characterized as having more than 15 loan conditions in a given year accompanied by 2 or more tranche releases and/or penalties in the form of delays and deobligations of loan funds.

SOURCE: *The Use of Program Loans to Influence Policy*, AID Evaluation paper, March 1970.

Bibliography

Agency for International Development Documents

These are especially relevant to the Policy Dialogue through bilateral assistance. AID and State Department cables are not included.

"Comparative Studies of Resource Allocation Development Policy," Harvard University Contract Report, January 1973.

Ingle, Marcus D., *Implementing Development Programs: A State of the Art Review*, Washington, D.C.: AID, January 1979.

Mason, Edward, "Notes on Bilateral and Multilateral Aid," Internal AID Memorandum, 8 April 1968.

Office of Program Coordination, "Development Policies and Assistance Requirements," AID Staff Paper, December 1964.

_____, "Policy Guidance for Foreign Assistance," AID Staff Paper, 14 May 1963.

Program and Policy Coordination Evaluation Staff, "The Use of Program Loans to Influence Policy," AID Staff Paper, March 1970.

Strout, Alan M., "Factors Affecting the Allocation of Foreign Economic Aid," AID Staff Paper, July 1969.

International Monetary Fund Documents

These are especially relevant to conditionality in IMF programs.

Ankara, Fulya, *Aid and Donor-Recipient Relationship*, International Monetary Fund, 1975.

Gold, Joseph, *Conditionality*, IMF Pamphlet Series No. 31, Washington, D.C.

Guitian, Manuel, "Fund Conditionality and the International Adjustment Process: the Early Period, 1950-1970," *Finance and Development*, March 1981.

_____, "Fund Conditionality and the International Adjustment Process: A Look into the 1980s," *Finance and Development*, June 1981.

International Monetary Fund, "Review of Upper Credit Tranche Stand-by Arrangements Approved in 1978-79 and Some Issues Related to Conditionality," 14 July 1981, EBS/81/152.

_____, "Review of Upper Credit Tranche Stand-by Arrangements Approved in 1978-79 and Some Issues Related to Conditionality - Supplementary Observations," September 1981, EBS/81/152.

_____, "The Size of the Fund in the 1980s," 2 December 1981. EB/CQuota/81/3.

Johnson, Omotunde and Joanne Salop. "Stabilization Programs and Income Distribution," *Finance and Development*, December 1980.

World Bank Documents

These are especially relevant to the discussion of the policy dialogue through World Bank lending.

Ezckiel, Nission, et al, "Indonesia: Development Prospects and Policy Options," World Bank, 1981.

Stern, Ernest, "Structural Adjustment Lending," World Bank, 9 May 1980, R80-122.

Stewart, Frances, "International Technology Transfer: Issues and Policy Options," World Bank Staff Working Paper No. 344, 1979.

World Bank, *Accelerated Development in Sub-Saharan Africa: An Agenda For Action*, Washington, D.C.: IBRD, 1981.

_____, "Arab Republic of Egypt: Domestic Resource Mobilization and Growth Prospects for the 1980s," World Bank, December 1980.

_____, "Lending for Structural Adjustment," 5 February 1980, IDA/R80-22.

_____, "Lending for Structural Adjustment," World Bank, 31 March 1980.

_____, Mission to Korea - Policy Issues for Long-term Development, Washington, D.C.: Johns Hopkins University Press.

Other Sources and References

Balassa, Bela A., *The Policy Experience of 12 Less Developed Countries, 1973-1978*, the World Bank.

_____, *Policy Reform in Developing Countries*, New York: Pergamon Press, 1977.

Cline, William R. and Sidney Weintraub, eds., *Economic Stabilization in Developing Countries*, Washington, D.C.: Brookings, 1981.

Cohen, Benjamin J., "Balancing the System in the 1980s: Private Banks and the IMF," Paper prepared for the International Law Institute Conference on "The International Framework for Money and Banking in the 1980s," Fletcher School of Law and Diplomacy: Tufts University, May 1981.

Connors, Thomas A., "Evaluation of Changes in IMF Conditional Lending Criteria," Federal Reserve Board, 27 March 1981.

Cox, Robert W., *The Anatomy of Influence: Decision-Making in International Organizations*, New Haven: Yale University Press, 1973.

Dasgupta, Ajit Kumar, *The Objectives of Macroeconomic Policy*, London: Macmillan Press, 1971.

de Vries, Egbert, *Administration of Development Programs and Projects: Some Major Issues*, New York: United Nations, 1971.

Eckaus, R.S., "The Conditionality of International Financial Institutions and U.S. Policy," M.I.T. Conference on U.S. International Financial Policy, 24 February 1982.

Faaland, Just, *Aid and Influence: The Case of Bangladesh*, New York: St. Martin's Press, 1980.

Gulick, Clarence S. and Joan M. Nelson, *Promoting Effective Development Policies: A.I.D. Experience in Developing Countries*, September 1965.

Jacoby, Neil H., *U.S. Aid to Taiwan: A Study of Foreign Aid, Self-Help and Development*, New York: Frederick A. Praeger, Publishers, 1966.

Johr, Walter Adolf and H.W. Singer, *The Role of the Economist as Official Advisor*, London: George Allen & Unwin Ltd, 1955.

Krassowski, Andrzei, *The Aid Relationship*, London: Overseas Development Institute, 1968.

Landell-Mills, Pierre M., "Structural Adjustment Lending: Early Experience," *Finance and Development*, December 1981.

Nelson, Joan M., *Aid, Influence and Foreign Policy*, Harvard University: Center for International Affairs, 1968.

O'Kelly, Elizabeth, *Aid and Self-Help*, London: C. Knight, 1973.

Schiavo-Campo, Salvatore, *International Economics*, Cambridge, Mass.: Winthrop, 1978.

_____, and Hans W. Singer, *Perspectives of Economic Development*, Boston: Houghton-Mifflin, 1970.

Selwyn, Percy, ed., *Development Policy in Small Countries*, London: Croom Helm in Association with the Institute of Development Studies, 1975.

Streeten, Paul Patrick, *Aid to Africa: A Policy Outline for the 1970s*, New York: Praeger Publishers, 1972.

Treasury Department, *U.S. Participation in the Multilateral Development Banks in the 1980s*, Washington, D.C.: February 1982.

I.D (TM 1:34)
11/9/84

A.I.D. Policy Paper

INSTITUTIONAL DEVELOPMENT

U.S. Agency for International Development
Washington, D.C. 20523

March 1983

I.D (TM 1:34)
11/9/84

A.I.D. Policy Paper

Institutional Development

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

March 1983

TABLE OF CONTENTS

Page

EXECUTIVE SUMMARY 1

I. Introduction: The Concept of Institutional Development 1

II. Institutional Development Priorities for the 1980s 2

A. Analysis and Reform of the Policy Environment . 2

B. Consideration and Introduction of Organizational Alternatives 3

C. Development of Institutional Learning Capacity . 4

D. Transfer of Knowledge and Technology 4

E. Analyses and Improvement of Institutional Linkages/Coordination 5

F. Improvement of Management Systems 5

G. Provision of Skills and Training 5

H. Capitalizing upon Local Capacities and Participation 6

I. The Role of Institutions in the Development of Supporting Infrastructure 6

III. Conclusions 6

A. Institutional Analysis 6

B. Time Horizons and Financing 7

C. Private and Non-Governmental Institutions 7

Executive Summary

It is A.I.D. policy to help countries establish and strengthen public and private institutions in support of mutually agreed, priority development objectives. This is because effective institutions:

- enhance a country's ability to marshall its own human and financial resources for development;
- expand people's opportunities to undertake successful development by providing increased incentives for investment;
- provide individuals with opportunities to acquire the skills, resources, and services needed to increase their productivity, income, and well-being; and
- increase the likelihood that A.I.D. and host country resources will foster development that can be sustained after external assistance is withdrawn. That is, A.I.D.'s investment should stimulate a process of investment and re-investment by beneficiaries themselves that continues after the termination of donor involvement.

In undertaking institutional development efforts, A.I.D. will adhere to the following principles:

1. Institutional development should be addressed as an issue in all projects, and should not be seen as a special activity of its own. This does not preclude support to particular institutions (e.g., regional management training entities) where the prime focus is in fact institutional development. Although analysis of institutional issues is required in all projects, no special institutional development effort is required where concerned institutions are demonstrably strong.

2. Institutional development must address weaknesses in complementary institutions, since institutional deficiencies elsewhere in a sector (e.g., extension) may well inhibit the effectiveness of particular institutional interventions (e.g., in research).

3. Institutional development must encourage institutions that are flexible and which can adapt to changing local and national needs. This entails building effective information-handling systems, strong analytic capacities and close linkages to client or user groups. Well-functioning markets will support this goal as well.

4. Institutional development must provide for the active participation of clientele in the assessment of their needs, and in the design, implementation, and evaluation of field programs. This helps to ensure that AID-supported institutions will meet their own implementation goals, be relevant to local needs, and become self-sustaining. Where possible, these methods and objectives should be realized through development of private sector institutions.

5. Institutional development must be aimed at providing people increased ability to acquire essential resources, and greater opportunity to apply these resources in rewarding ways. This can often be achieved by reducing the role of government and expanding the role of the private sector in development.

6. We conclude that private sector options for institutional development must be considered carefully. Experience has indicated that with the exception of such areas as basic public administration, major transportation infrastructure, and certain aspects of agricultural research, public preventive health measures, and basic schooling, private sector options are both less costly and more responsive to clientele, and at the same time more innovative, dynamic, and efficient, than public enterprise. **Thus, where there is a choice, A.I.D. should encourage and support institutional development options in the private sector and should avoid activities that explicitly or implicitly preempt private sector options.**

I. Introduction: The Concept of Institutional Development

This paper outlines A.I.D. policy on institutional development. It begins with a short discussion of the concept of institutional development, and proceeds to a review of institutional development priorities in the 1980s. Here a number of important policy goals are set forth, and suggestions are made regarding various interventions likely to achieve these goals. The paper closes with recommendations for how the Agency can prepare itself to deal with institutional development needs in the coming years.

Effective public and private institutions are essential for providing a country the self-sustaining capacity to solve critical development problems. Furthermore, they:

- enhance a country's ability to marshall its own human and financial resources for development;
- expand people's opportunities to undertake successful development by providing increased incentives for investment;
- provide individuals with increased oppor-

tunities to acquire the skills, resources and services needed to increase their productivity, income, and well-being; and

- increase the likelihood that A.I.D. and host country resources will foster development that can be sustained after external assistance is withdrawn, through a process of indigenous investment and reinvestment.

It is therefore A.I.D. policy to help recipient countries establish and strengthen public and private institutions in support of mutually agreed, priority development objectives, by drawing upon support from Title XII universities, the US cooperative movement, US and LDC institutes of management, PVOs, and other organizations with appropriate capacities.

By "institutions" we mean specific organizations (a commercial bank, a ministry of health), but we also mean institutions in the broader and more fundamental sense, such as financial and commodity markets, systems of land tenure, and legal institutions.[1] A nation's economic, political, legal, and social institutions determine the basic framework of incentives and opportunities within which development efforts take place. Even the best of organizations can accomplish little when this broader institutional framework is antithetical to development goals. However, because institutions become tangible only through the policies and actions of particular organizations, much of A.I.D.'s institutional development effort will be focused on improving the policies and procedures of key organizations.

A.I.D. has viewed institutional development as an important element of its development assistance program for many years, but, although the experience has been long, few universally valid approaches seem to have emerged. Rather, the clearest lesson is that nearly any type of initiative will be well suited to some situations and will fail in others; similarly, nearly all projects with significant institutional development components experience substantial implementation difficulties.[2] A.I.D.'s experience in this regard is mirrored by that of the World Bank; a staff paper on the topic has concluded that "the lack of clearly superior approaches in this field calls for considerable experimentation," while a Bank audit review of recent projects and their institution building components shows that most methods (e.g., training, expatriate consultants, forming a new agency or unit, etc.) achieve only partial success under most circumstances.[3] This suggests that we have much to learn about how donors can assist in building effective LDC institutions. Thus, this paper makes few prescriptive statements about the relative utility of various institutional development models, of short or long term technical assistance, the role of various types of training, and so forth. At the same time, it is possible to point to some of the issues and lessons which seem consistently to emerge in discussions of institutional development, and to highlight the implications for mission programming and development strategies. This is done in Section II below.

II. Institutional Development Priorities in the 1980s.

The most critical areas of concern in institutional development today relate to:

— the host country policy environment;

— the potential of various alternative forms of organization;

— the importance of institutional learning capacity;

— the problem of transferring knowledge and technology;

— improvement of coordination and linkages among institutions;

— improvement of management systems;

— provision of training;

— the role of local initiative and participation; and

— the role of institutions in undertaking the development of physical infrastructure.

Each of these areas of concern is discussed in detail below.

A. Analysis and Reform of the Policy Environment. There is a strong interaction between a country's policies and the effectiveness of its institutions. Unfavorable policies can seriously inhibit institutional

[1] See Ken McDermott, "Institutions in Agriculture and Rural Development," TPCA Occasional Paper No. 2, 15 January 1981.

[2] "Effective Institution Building," A.I.D. Program Evaluation Discussion Paper No. 11, March 1982.

[3] "The World Bank and Institutional Development: Experience and Directions for Future Work", report prepared by Projects Advisory Staff, 12 May 1980, and "Eighth Annual Review of Project Performance Audit Results," Operations Evaluation Department, September 9, 1982.

development. For example, many donor-supported community development efforts in the 1950s failed because they ignored the need for complementary policies to encourage investment in the agricultural sector. Domestic private enterprise can be impeded or supported by the nature of enabling legislation, regulatory codes, and licensing procedures, as well as economic policies.

On the other hand, successful institutional development can also mitigate the impact of unfavorable policies. In India, for instance, cotton marketing associations permitted farmers to capture some of the value added from processing cotton even though prices for cotton were maintained at low levels. Because policies are always imperfect, full of conflicts, biased against some, and characterized by lags, organizations will frequently seek to compensate for policy deficiencies. Often, however, organizational solutions to policy problems will simply shift the cost of poor policy to some other group in society. A.I.D. may support organizational solutions of this sort on a short-term basis, when the clear intent is to gain leverage for policy dialogue, but A.I.D.'s long-term emphasis must remain on reform of poor policy.

Finally, effective organizations may serve to bring steady influence to bear on governments for needed policy changes. Popular organizations, national business associations, and planning units within ministries have proven effective in encouraging policy change. Thus, missions should undertake an ongoing assessment of host country policies, legislation, and regulatory procedures which facilitate or impede private and public institutional growth and effectiveness, and should develop within their overall programs a dialogue with host country governments and assistance activities aimed at improving the content of host country policies.

B. Consideration and Introduction of Organizational Alternatives. Very often A.I.D.'s approach to development issues is to focus on increasing resources or opportunities to acquire resources, typically by introducing or strengthening an implementing organization. Thus, for instance, lack of credit is often identified as a problem in the agricultural sector, and the response is to build credit-dispensing institutions. But the reasons why resources are lacking often have nothing to do with the capacities of particular organizations; rather, the problems may stem from poor policies (in the case of credit, artificially depressed interest rates) or weak national level institutions (e.g., poorly-articulated financial markets). Hence missions that are considering organization-type interventions to increase the availability of development resources should direct close attention to the broader institutional and policy environment, and the associated framework of incentives and opportunities. If these are fundamentally flawed, it is unlikely that an organizational intervention will be more than minimally effective.

If an organizational intervention is justified, then a number of other considerations come into play. For organizations to be effective, both their structure and their procedures must be suited to their socioeconomic environment, the nation's administrative and political traditions, and the technology around which they are organized.

Organizational theory has long recognized that the nature of an organization's environment profoundly affects its structure. An agriculture department designed for a small homogeneous group of farmers with the security afforded by a well-established irrigation system, for example, would be quite different from one serving large numbers of small farmers, diverse in their conditions, and subject to the vagaries of natural rainfall. In the development of human resources, the organization required for training in technical skills related to employment is quite different from that required to manage a uniform system of primary schools. Similarly, although administrative traditions in much of the Third World are characterized by highly centralized, control-oriented management systems, environmental diversity and the technology of production militate in favor of decentralized, flexible structures. Hence, missions should explicitly consider the implications that an institution's proposed function may have for the form it should take; and missions should ensure that the institutional structure is appropriate to the function. A.I.D. should therefore see the task of institutional development not simply as institutional transfer, but rather as institutional invention and/or adaptation. Because of the uncertainty involved, it may sometimes be appropriate to encourage institutional diversity and perhaps even organizational competition, although un-

productive organizational conflict must be minimized.[4]

In examining organizational alternatives particular attention should be given to the complementary roles of the public and private sectors. Where high returns redound to the economy but not to the individual investor, public sector institutions are likely to be required. This situation tends to prevail where fixed costs are extremely high but returns are very risky or low in the short-run, or because it is not feasible to charge a price to each consumer that will cover total costs (e.g., in the case of transportation infrastructure and some types of agricultural research). Nevertheless, investments in national public institutions must be balanced both by the establishment of decentralized institutions at regional and local levels, and by encouragement to the private sector. Balanced assistance of this sort is essential if excessive centralized control is not to inhibit individual and local initiative. Private institutional development can be promoted by assisting local business organizations (firms or associations) in management, technology assessment, accounting systems, and so forth; by providing funding for financial intermediaries; or by undertaking other activities as discussed in A.I.D.'s Policy Paper on Private Enterprise Development.

C. Development of Institutional Learning Capacity. Institutions must have the ability to learn from and adapt to the environment in which they work. Such learning capacity enables organizations to adjust development programs to their environment. For example, technology developed by agricultural researchers must be reconciled with the local knowledge, capacities, and goals of the farmers for whom such technology is intended, if the technology is to be generally useful and widely adopted.

This concept has gained currency in the management field, where learning and adaptability are now defined as requirements of successful organizations. This requirement is particularly critical for development institutions, because many urban-based managers and professionals are unfamiliar with the diversity of conditions found in rural areas, and with the speed and extent of the changes taking place.

Private sector institutions depend directly on market forces and thus generally face strong incentives for learning from their environment and for adapting to changes in the needs of their clientele. In the public sector, however, the incentive structure tends to be weaker, and so special efforts to create such incentives must be made, for instance by instituting performance- or impact-based employee reward structures, or by providing formal links between institutions and user or clientele groups. This may also help to ensure that public institutions phase down or alter their program content when the need they were originally formulated to address has been met.

D. Transfer of Knowledge and Technology. Key institutions in the development process are those that generate, adapt, and disseminate knowledge and technology at international, national, and local levels. Technology transfer is accomplished most effectively by those countries which have a scientific establishment capable of evaluating and adapting knowledge and technologies to local conditions. The establishment of local institutions that have the capacity to tap and contribute to the world knowledge supply must therefore be a high A.I.D. priority.

A.I.D.'s considerable experience in building such key institutions in the past, however, indicates that it is not possible simply to "transfer" institutional models to developing countries. They must be adapted to their environment. Of course, they must have qualified staff and adequate facilities to produce quality products; the best management systems and most responsive institutional structures fail when they have nothing to deliver to their clientele. But we have also learned that national knowledge and technology producing organizations must be linked institutionally to the people who are expected to apply the knowledge and technology. Without such institutionalized interaction with user groups, the national institutions will remain isolated and ineffective. Where this requirement has been ignored, it has been common to hear that LDC researchers are more responsive to the research agendas of the developed world and the disciplinary interests of international associations than to the problems of their own farmers. We must learn from the successes of

[4] Institutional diversity can be either helpful or wasteful, depending on the context. Offering farmers the opportunity to sell their grain to institutions other than a monopsonistic national marketing board is likely to be beneficial both to farmers and to the economy as a whole, but encouraging a nation to support a number of different agricultural research institutions may hinder scientific advance and the utilization of findings.

the past to structure institutions and incentives so as to combine technical excellence with accountability to the user. One way this may be done is to forge ties between new or developing organizations and established organizations with demonstrated records of success in the relevant field.

E. Analyses and Improvement of Institutional Linkages/Coordination. Many developmental efforts involve more than one organization in the planning and implementation process, and so an oft-encountered problem concerns the development of mechanisms which link these organizations into a unified, effective whole. Donor agencies and host country governments have experimented with a wide array of organizational structures and processes in seeking to achieve more coordinated development efforts. Improvements in information systems which permit and encourage feedback are a first step. In addition, basic changes in budgetary and planning procedures are required to achieve horizontal links among development departments or ministries, and to place expenditure authority in the hands of those directly responsible for implementation, rather than retaining these powers in central offices.

Integrated rural development projects provide an example of the linkage problem. Donor funded projects within defined geographical areas may be well integrated so that activities take place in a systematic and mutually supportive manner. However, these projects are often developed in isolation from normal organizations and administrative procedures, an isolation which is usually reinforced by direct donor involvement in project management. Typically, therefore, the model proves to be non-replicable, and has no enduring impact. Hence, A.I.D. should rely less on special project units of this type and strive instead to improve coordination among existing organizations.

Institutional coordination in the private sector can be improved by such measures as expanding and improving transportation and communications infrastructure, by fostering the development of local and national business associations, and by improving the efficiency of formal and informal financial and commodity markets, especially in rural areas where access to markets may be particularly limited, or where markets may be fragmented.

F. Improvement of Management Systems. To assure organizational effectiveness, key organizational systems, (e.g., decision-making and resource allocation, information processing, budgeting, personnel, and logistics) must be strong. These basic components of organizational action allow policies and programs to be translated into concrete accomplishments. But an institutional development perspective must also focus on the informal aspects of organizations, i.e., how employee behavior is influenced by the structuring of authority, incentives, and information within organizations. Ultimately, it is these patterns of employee behavior, which are molded by the internal organizational environment, which determine whether an organization will be responsive to the external environment. A variety of techniques to create such systems are available and have been demonstrated to be effective in LDC settings. Thus, management improvement activities should include not only traditional emphases on financial management, training, and planning, but a new emphasis on assessing and restructuring patterns of behavior within institutions so that overall effectiveness can be improved.

G. Provision of Skills and Training. Successful institutional development depends upon persons trained in appropriate technical and managerial skills. In both skill areas a broad range of people need to be considered for training, e.g., private artisans and business people as well as government technicians, paraprofessionals as well as professionals, and local level administrators as well as central ministry personnel. To carry out this training a range of possible mechanisms is available, including traditional long-term degree programs, short-term seminars, action training workshops, non-formal education, and individual consultation/instruction. A general presumption exists in favor of in-country training. Various considerations, including the topical specialization required, costs and budget, and the best setting for training, will influence the decision on venue: on-site, elsewhere in-country, in another LDC, or in the U.S. Training programs intended to benefit private sector employees, managers, or entrepreneurs should involve private sector representatives in design, implementation, and financing to the greatest possible extent. However necessary these training programs may be, we should not lose sight of the fact that the need for project-related skill training is directly related to inadequacies within existing education and training systems. It is the

latter which must ultimately be made adequate and self-sustaining, or else there will be a perpetual need for project-related training.

H. Capitalizing upon Local Capacities and Participation. The first step in a broadly based development strategy which fully mobilizes available human resources is to assure that people have the opportunity to acquire resources (e.g., land, water, technology, and knowledge), as well as the incentives and opportunities to utilize the resources productively. Where political, economic, social, or geographical factors deny individuals a secure opportunity to obtain essential resources, or where there are strong disincentives for individual initiative and investment, the removal of these constraints must have priority in A.I.D.'s country strategies.

The development experience of the past two decades also indicates clearly that the impact and sustainability of public sector investments can be significantly improved if local citizens assume a role in needs assessment, project design, and implementation. Local participation (in both urban and rural areas) is essential in adapting development priorities, designs, and implementation strategies to particular contexts, and in communicating to planners local needs, constraints, and priorities. Participation of this sort ensures that public policies and programs are consonant with and supportive of existing private patterns of production and investment. For example, farmers or farmer organizations can provide agricultural planners valuable information about local production patterns, market conditions, and investment constraints, without which such planning tends to become irrelevant.

Local involvement in the development process also enables communities to provide a range of private resources (labor, materials, money, leadership) that can facilitate and guide both government financed and private sector projects. Equally important, community-level involvement may contribute to the management and maintenance of new programs, which can help defray recurrent costs. Finally, beneficiaries themselves must invest their own time and resources in development efforts to begin the process of indigenous investment and re-investment which marks the beginning of a successful development initiative and makes possible the termination of donor support. Operational guidance on encouraging popular participation is contained in Handbook Three as an appendix to Chapter Two on PID preparation.

I. The Role of Institutions in the Development of Supporting Infrastructure. Many organizations require physical infrastructure in the form of buildings and equipment. A.I.D. will consider provision of capital assistance to meet these needs where resource availabilities permit, and where such assistance is integrated with sound planning to strengthen the organizational, managerial, and technical aspects of institutional capacity. Conversely, it is often essential to *add* an institutional and human resource development component to projects (roads, water supply) which have in the past been approached strictly in terms of physical infrastructure needs.

These areas of emphasis are for the most part complementary, and should all be addressed in a comprehensive program of institutional development. However, depending upon program size, the current activities of A.I.D. and other donors, the political environment, and absorptive capacity, mission institutional development efforts may address a strategic subset of the areas outlined above. At one extreme, A.I.D.'s institutional development program may be limited to portions of a specific project or projects; at the other extreme, it may be a separate project to improve performance across several sectors—e.g., by analyzing and improving interest rate policy, or by increasing the effectiveness of local and national revenue generation efforts.

III. Conclusions

Implementing this policy implies some changes in the way A.I.D. has approached institutional development in the past. These implications are summarized below.

A. Institutional Analysis.

Implicit in this paper is the assumption that missions will incorporate into their country development strategies, sector assessments, and project analyses a more complete analysis of host country institutional performance. Clearly, most missions will have, at least initially, neither the data nor the technical skills required. Over time, A.I.D. should increase its in-house capacity to address development issues that are institutional in nature, and should simultaneously build LDC capacity to do so. This should take the form of supporting or creating national or regional private sector centers of business management and/or public administration, because it is only

through the sustained involvement of such local institutions that long-lasting and self-supporting institutional development can be expected to occur.

B. Time Horizons and Financing.

Institutional development takes time—time to build capacity, time to develop effective working relationships with local populations, time to adapt *a priori* models of institutional development to on-the-ground circumstances. Thus, A.I.D. must be in a position to make longer term commitments to institutions (both public and private), and must be prepared to support a wide range of institutional development requirements. There are two implications: First, projects clearly dependent upon sustained institutional development will normally be designed and approved for a period of five to ten years, including provision for timely evaluation and redesign. Some projects may require two or more phases, lasting, in total, more than ten years. Second, A.I.D. will approve recurrent cost and capital cost funding, but only when the national policy and manpower frameworks ensure effective utilization and when the government is doing as much as possible to mobilize domestic resources. Further details are presented in A.I.D.'s Policy Paper on Recurrent Costs.

Long term commitments and comprehensive recurrent and capital cost support are among the most powerful tools available to missions to accomplish needed policy and institutional changes. At the same time, financing too large a share of an institution's growth can lead to dependency and a diminution of indigenous capacity. Thus missions should link such support to a definite schedule according to which local resources will be increasingly used to meet the needs of the institutions concerned, particularly with regard to recurrent expenditure.

C. Private and Non-Governmental Institutions.

Public sector resources for development, in terms of money, manpower, and capacity for innovative and efficient action, are usually meager in comparison to the private sector. Hence, A.I.D. should devote greater attention to the identification of alternative private and non-governmental organizations to perform important development functions, and should explore how our development assistance can support these institutions. One approach is to ensure that A.I.D. support to the public sector is (a) aimed at developing public services to private entities, such as technical institutes, credit facilities, trade and marketing associations, and vocational education programs; and (b) meant to improve the effectiveness of market institutions, for instance through increasing the opportunity to acquire technical information and to enter markets, through encouragement of private entrepreneurship, and through improved management in private sector enterprises. Another valuable approach is to support private organizations that can strengthen the capacity of government institutions to plan and implement programs. Private and voluntary organizations, Title XII universities, the US cooperative movement, and other organizations can be helpful in this regard.

II. SECTORAL POLICIES

II.A (TM 1:34)
11/9/84

A.I.D. Policy Paper

FOOD AND AGRICULTURAL DEVELOPMENT

U.S. Agency for International Development
Washington, D.C. 20523

May 1982

II.A (TM 1:34)
11/9/84

A.I.D. Policy Paper

Food and Agricultural Development

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

May 1982

TABLE OF CONTENTS

Page

Preface ii

Quotation from President Reagan's Remarks before the Philadelphia World Affairs Council, October 15, 1981

Background 1

I. Objectives 1

II. Elements of Policy 2

A. Improved Country Policies 3

B. Development of Human Resources and Institutional Capacity 4

C. Expanding the Role of Developing Country and U.S. Private Sectors 6

D. Providing Food Aid and Food Security 7

III. Programming Implications 8

PREFACE

At the request of the Administrator an inter-bureau Task Force, including IDCA and BIFAD representation, was established to review A.I.D. policy on food and agricultural development assistance, and to make recommendations based on experience in developing countries and A.I.D.

This statement constitutes the report of the Task Force. It sets forth the overall objectives and policy elements of A.I.D. food and agricultural assistance funded from Development Assistance, Economic Support Fund and PL 480 budgets. It provides the basis for development of an A.I.D. Strategy Paper on Food and Agricultural Development that will delineate a strategy for linking the resources A.I.D. can draw upon for accomplishing its policy objectives.

This statement will also form the basis for discussions with other USG agencies, leading to the formulation of a U.S. Policy Statement on Food and Agricultural Development Assistance that will include policy implications for U.S. participation in multilateral organizations that provide food and agricultural assistance.

This statement supplements the A.I.D. **Agricultural Development Policy Paper** of June 1978 by providing a focus on major elements of A.I.D. policy.

The fulfillment of this policy requires long-term commitment from the United States and other donor nations and from developing countries, as well as from the private and public sector institutions involved. With mutual commitment to the policy, significant accomplishments can be expected over the next twenty years. Hunger and suffering will not be eliminated, but a significant number of additional countries will have become self-reliant in food and able to assure food security for their populations.

"Increasing food production in developing countries is critically important—for some, literally a matter of life and death. It is also an indispensable basis for overall development. The United States has always made food and agriculture an important emphasis of its economic assistance programs. We have provided massive amounts of food to fight starvation, but we have also undertaken successful agricultural research, welcomed thousands of foreign students for instruction and training at our finest institutes, and helped make discoveries of the high-yielding varities of the Green Revolution available throughout the world."

Ronald Reagan, PRESIDENT

Remarks to the World Affairs Council of Philadelphia,
October 15, 1981

Background

Food production and consumption prospects are seriously deteriorating in a number of low-income, food-deficit countries. The basic causes of continuing hunger and malnutrition in these countries are inadequate food availability and inability of the malnourished to purchase or otherwise acquire and consume the food they need.[1] While this chronic deficiency receives less attention than outright starvation, it has a far wider impact on human lives and productivity.

Real progress has been made toward food and agricultural self-reliance in a number of Asian and Latin American countries, but many other countries remain beset with serious and precarious problems. Millions in Asia, Latin America and the Near East are still impoverished and malnourished. A deepening food crisis with chronic famine conditions in some areas is developing in sub-Saharan Africa, where per capita food and agricultural production continue to decline in a majority of countries.

Future prospects are influenced by two major factors: population growth and income growth. About 90 percent of the almost two billion increase in world population projected for the year 2000 will occur in developing countries, many of which are unable to assure adequate food supplies even for their current populations. Continuing per capita income growth in the middle-income and advanced developing countries is expected to generate substantial increases in the demand for basic grains for direct human consumption and for livestock production. Unless the production of major staples and/or other agricultural commodities in developing countries improves significantly more than it did during the 1960–75 period, and unless the effective demand of low-income families is increased through broad-based growth, a deterioration in per capita food availability and consumption, especially in low-income countries, may occur.

This is a grim picture, but it is by no means hopeless. The experience of the last 30 years shows that carefully planned and administered economic assistance, when combined with the fundamental efforts that a government and its people must themselves undertake, can establish a dynamic, self-sustaining food and agricultural system. U.S. assistance in the form of scientific and management expertise, and food and financial aid, has made critical contributions to the creation of such systems in South Korea, Brazil and Taiwan and to emerging self-reliance in countries such as India, Thailand and the Philippines.[2]

Experience over the last three decades also shows that dynamic agricultural growth is in most countries a necessary though not sufficient condition for broadly-based overall economic growth that permits the conquest of hunger, malnutrition and sustained improvement in per capita living standards. Broadly-based and shared economic growth, along with the effective provision of voluntary family planning services, will also bring about a reduction in rapid population growth. The United States should continue sustained support of efforts by the entire donor and international community to help developing countries achieve these goals.

The President of the United States has recently highlighted the importance of developing country food and agricultural problems and the role the U.S. is prepared to play in helping countries resolve these problems.[3]

I. Objectives

The overall objective of United States bilateral economic assistance is to stimulate in developing countries broadly-based, self-sustaining economic growth that promotes international peace and stability and that assists people to conquer poverty, hunger, illness and ignorance (see Sections 101 and 531 of the Foreign Assistance Act).

The objectives of U.S. **food and agricultural assistance** are to enable countries to become self-reliant in food, assure food security to their populations and contribute to broadly-based economic growth.

These broad objectives entail two major sub-objectives, namely:

1. **Increased food availability**, through:

- increased agricultural production, with an emphasis on increasing and sustaining the

[1] Inadequate nutrient absorption linked to disease and poor sanitation is a significant auxiliary cause, especially among infants and children.

[2] Self-reliance in food is defined as the ability of a country to assure continuing food security to its population from a combination of domestic production and importation of food at commercial terms paid from foreign exchange earnings. Short-run food security implies the ability to maintain normal consumption levels in the face of an emergency food shortage. Long-run food security is defined as the ability of a country to assure a nutritionally adequate food supply to its population on a continuing basis. Several of the countries mentioned above have clearly not yet achieved long-run food security in terms of nutritional adequacy. See p. 7 for further discussion.

[3] Of particular relevance are the "Remarks of the President to the World Affairs Council of Philadelphia" October 15, 1981, and the President's Statement of October 24, 1981, at Andrews Air Force Base on his return from the "North-South" Summit Conference at Cancun, Mexico.

productivity, incomes and market participation of small farmers, with special attention to food production;

- greater economic efficiency in the marketing and distribution of agricultural and food production, exports and imports; and

2. **Improved food consumption in rural and urban areas**, through:

- expanded productive employment and incomes of men and women who at present lack the purchasing power to obtain adequate food;
- increased awareness and incorporation of sound nutritional principles in the design and implementation of production, marketing, health and education policies and programs, including improved access to, and utilization of, food for those at nutritional risk;
- effective direct distribution of food from domestic or external sources to those facing severe malnutrition and temporary food shortages (i.e., a short-run lack of food security).

A.I.D. will seek to concentrate assistance for food and agricultural development in countries that share these objectives and are committed to an appropriate policy framework as elaborated in the following section on "Elements of Policy."

In supporting the objective of food self-reliance, A.I.D. does not rigidly subscribe to the goal of food self-sufficiency. A.I.D. supports a balanced approach involving economically viable expansion of agricultural production, including production for export and importation of food and agricultural products where comparative advantage exists.[4] As in the case of domestic food production, the employment, consumption and nutritional implications of export expansion will also be considered.

II. Elements of Policy

A.I.D. will emphasize four major, inter-related elements to accomplish food and agricultural development objectives:

- **improve country policies** to remove constraints to food and agricultural production, marketing and consumption;
- **develop human resources and institutional capabilities**, especially to generate, adapt and apply improved science and technology for food and agricultural development, and **conduct research on developing country food and agriculture problems;**
- **expand the role of developing country private sectors** in agricultural and rural development, and the **complementary role of the U.S. private sector in assisting this expansion**; and
- **employ all available assistance instruments in an integrated manner**, including provision of **PL 480 food aid in a way that contributes to the other three strategy elements** as well as meeting food security and nutritional needs.

Each of these elements is intended to increase the **effectiveness** of U.S. economic assistance resources. While the mix of these elements will vary according to the differing needs and problems among countries, the achievement of lasting food security requires greater attention to each of them in most developing countries.

The United States has strong technical competence in identifying and solving problems in food and agriculture. Maximum utilization will be made of this competence. A.I.D., other elements of the U.S. Government, such as USDA, cooperating universities and private sector organizations are prepared to make a **long-term commitment** to help those countries prepared likewise to make the requisite policy and resource commitments.

A main thrust of the policy is on the development of a **domestic human and institutional capacity** that permits a country to develop and apply food and agricultural science and technology. This recognizes the location-specific requirements for the effective application of improved agricultural technology. However, the policy also requires a more vigorous effort by A.I.D. to support the identification, transfer and adaptation of **existing appropriate technologies**, as well as the **carrying out of food and agricultural research** and application of improved technologies through U.S., international, regional and national institutions. These recommendations recognize that the continuing advance of agricultural technology, while not sufficient in itself, is an essential prerequisite to sustained improvement in food and agricultural performance. The policy also envisions strengthening institutional capability in other critical areas such as the management of irrigation and credit systems.

In pursuing this policy, A.I.D. will encourage countries to promote **participation** in food and agricultural development by the large majority of rural producers and workers, **men and women**, through:

- broadened access to production incentives and resources, including land and water, as well as opportunity to take advantage of education and training and other productive services;

[4] In determining a balanced approach between production for domestic consumption and export, a country will weigh the risks inherent in increased dependence on world agricultural markets. These risks can be reduced somewhat by diversified production for export.

- increased productivity, employment and incomes; and
- expanded involvement in making policy and program decisions, including those affecting the development and operation of institutions that affect their productivity and well-being.

The policy also includes an emphasis on effectively increasing the productivity, incomes and market participation of **small producers.** These producers comprise the great majority of rural economic units in most countries and are thus important for both increased food production and consumption.[5] Evidence indicates they tend to employ land and purchased inputs in an economically efficient manner relative to large farmers. Furthermore, the demand for goods and services by the bulk of small farmers and their families who participate in market sales and purchases may constitute an important stimulus to off-farm rural enterprise and the generation of employment opportunities for landless laborers and for families engaged primarily in subsistence agriculture.[6] Improvement of the employment opportunities of the landless and near-landless is a crucial requirement for improved food consumption in many countries.

A. Improved Country Policies

The success or failure of the development process in a country depends heavily on its policy framework and the determination of the country itself. External assistance, while helpful and particularly critical in low-income countries, is in no case sufficient to achieve national food and agricultural development objectives. **Sound country policies are fundamental to agricultural growth and to the effectiveness of external economic assistance.** An appropriate policy framework is one that:

1. relies largely on free markets, the provision of adequate production incentives and the provision of equitable access to resources so that the broad majority of farmers, rural private sector entrepreneurs and workers—both men and women—have productive opportunities for employment, saving and investment; and
2. gives sufficient priority to complementary public sector investments in rural infrastructure and institutions that interact effectively with rural populations and complement and encourage rather than compete with healthy private sector growth.

Incentives are affected by direct attempts by government to influence the prices of food or agricultural products and inputs, but in many countries macro-economic policies affecting exchange rates, interest and wage rates and tariffs and taxes have an even more powerful impact on incentives to produce, employ, consume, save and invest. Furthermore, a wide range of government-promulgated regulations and privileges affect equitable access to such resources and services as land, water, credit, extension and marketing facilities. **That is, distorted policies have hampered agricultural growth and have hurt the poor by excluding them from access to productive resources and employment.**

Essential public sector investments are generally those that yield substantial returns to the economy but are of such a nature that the private sector is not prepared to undertake them, especially in low-income countries (reasons include high cost, uncertain or low returns in the short run, and/or difficulty for an individual investor to capture the returns). These investments usually include such major physical infrastructure as road networks and gravity irrigation systems as well as institutions for agricultural research, training and extension and for basic education and health services and control of epidemic diseases. However, in some aspects of research and extension, health services or training, for example, there may be more scope for private sector involvement than is often acknowledged.

- As part of its development assistance programming, A.I.D. will critically examine country policies affecting food and agricultural development and will seek to concentrate assistance in those countries where an appropriate policy framework already exists or where there is commitment to improvement.
- A.I.D. will analyze the constraints to improved policies in countries where it provides

[5] The definition of a "small producer" will vary from country to country and region to region within countries. Influencing factors include sectoral (agriculture or industry), sub-sectoral or commodity mix, soil quality in the case of agriculture, etc.

[6] Of particular interest to A.I.D. are those small producers whose **marketable surplus** can be increased. It is recommended that a paper be prepared to analyze the extent to which increased production by commercial and/or semi-commercial farmers in developing countries will also meet employment and food consumption objectives through increased employment on such farms and indirectly through stimulus to off-farm rural enterprise. Although available evidence confirms the relatively high economic efficiency of small farmers, the question is complex. An analytical paper might explore further this question as well. In his Philadelphia World Affairs Council remarks, op. cit., President Reagan indicated that the focus of American food and agricultural development assistance will be on "raising the productivity of the small farmer, building the capacity to pursue agricultural research and stimulating productive enterprises that generate employment and purchasing power."

assistance and will engage in dialogue with countries on changes in policies intended to improve incentives and opportunities.

- Technical assistance and training to improve a country's **policy analysis and planning capacity** will also be provided.

As part of its concern for improving the quantity and quality of food consumption, A.I.D. will continue its efforts on how to integrate effectively the implications of **nutritional** problems and practices into the design, implementation and evaluation of projects and programs. This concern includes but goes far beyond specialized efforts to correct specific nutritional deficiencies (e.g., Vitamin A, iodine, iron). A concern for nutritional implications will be included in dialogue on agricultural policies and in the design of assistance for planning and policy analysis; agricultural research and extension; education and training; marketing and processing; and food aid and food security. It will also be included in the formulation of assistance for health services, potable water and sanitation.

The incorporation of nutritional considerations raises complex, multi-sectoral issues that will be addressed further in an A.I.D. Nutrition Policy Paper in preparation.

B. Development of Human Resources and Institutional Capacity

A major priority of A.I.D. policy is to assist countries to develop and/or strengthen private and public **institutions** dealing with the host of technical, administrative, economic and social problems constraining increased and more efficient food and agricultural production, marketing and consumption.

Effective institutions provide a country the self-sustaining capacity to solve critical development problems. Furthermore, they:

- enhance a country's ability to marshall its own human and financial resources for food and agricultural development;
- enable individuals to obtain access to the skills, resources and services needed to increase their productivity, incomes and well-being; and
- increase the absorptive capacity and effectiveness of external assistance, thereby fostering development that continues beyond the period during which assistance is provided.

The creation and strengthening of institutional capacity, including development of the human resources needed for effective institutions, often requires a **long-term commitment and effort**—e.g., ten years or more—from A.I.D., the host country, other donors and cooperating organizations (Universities, PVO's, etc.).

Missions must provide a sufficiently long-term assessment of how A.I.D. and other resources will be utilized to improve institutional capacities crucial to food and agricultural development in the host country.

Effective public and/or private institutions are required in most phases of food and agricultural development, including planning and policy analysis; construction, maintenance and operation of rural infrastructure (e.g., irrigation systems and rural roads); delivery of inputs, credit and other services; storage, marketing and processing of farm products; and other areas such as local government and taxation, and resource conservation and management.

Particularly vital to the establishment of self-reliant, sustainable food and agricultural systems are national institutions that give a country the capacity (1) to generate and apply a continuing stream of innovations designed to increase agricultural productivity and incomes; and (2) to evaluate and adapt technologies transferred from developed countries and international institutions. Advances in food and agricultural science and technology have not only increased productivity but have also facilitated the substitution of less expensive and more abundant resources for more expensive and increasingly scarce resources.

While the economic returns to agricultural research have been extremely high, it does take time to develop and test new technologies and to strengthen the national and local institutions required to adapt and apply technologies to location-specific conditions. The need to develop new technologies and strengthen institutions is especially critical for the large areas of the developing world that will continue to be dependent upon rain-fed agriculture.

In view of these considerations, A.I.D. will continue to provide direct support for food and agricultural research, training and technical assistance by U.S.and regional institutions, and by the system of international agricultural research centers. Collaborative projects with these institutions will be coordinated closely with efforts to improve national systems; networks for sharing knowledge among these institutions will be strengthened.

There are important interrelationships between country policies and institutional development. Institutions develop, implement and monitor policies that profoundly affect food and agricultural development. At the same time, the process of institutional development and of science and technology transfer, generation and application should be guided by a sound economic policy environment which reflects

market forces. If this does not happen, improved agricultural technology may not be adopted by farmers, or if adopted, it may be inappropriate to the broader economic environment. For example, in some countries distorted economic policies have made capital artifically cheap and labor artificially expensive, resulting in the introduction of excessively capital-intensive technology. By the same token, production incentives alone are not usually sufficient to yield **sustained** advances in agricultural production. A continuous stream of productivity increasing, cost-reducing farm technology is also required.

- A.I.D. will therefore give special emphasis, with a sufficiently **long-term commitment**, to helping countries develop the institutional capacity for food and agricultural planning and policy analysis; basic and adaptive research, education and training; and disseminating improved technology and related information in a cost-effective manner.
- Social scientists (e.g., economists, anthropologists, development planners and policy analysts) and physical and biological scientists and technicians from developing countries and the United States will work together to conduct applied research and to develop individual and institutional capabilities intended to increase the productivities and incomes of the broad majority of rural producers.
- U.S. universities will marshall their best talent to play a major role in implementing A.I.D. assistance for food and agricultural institutional development. Other U.S. government agencies, particularly USDA, agribusiness enterprises, cooperatives and private voluntary organizations will also play significant roles.
- Aspects of agricultural research to be considered will include: innovative research to increase the genetic capabilities of plants and animals that are used as food; research on existing and more profitable farming and marketing systems, including their social, employment, energy, ecological and nutritional implications (including multiple cropping and water management); field-testing involving farmers; research and control of debilitating human and animal diseases that constrain agricultural productivity; and regular feedback to researchers of farmer experience with improved technologies.

A.I.D. will also encourage:

- an expanded role where appropriate for **private enterprise** in the provision of agricultural research and the dissemination of improved technology as well as in the processing, preservation and marketing of agricultural commodities (see following section);
- research and other institutions that expand access by low-income, **small producers** to improved technology, productive resources and services;[7] and
- voluntary institutions that mobilize local efforts for agricultural and social development.

Local institutions, including farmer organizations and land tenure arrangements, can also be critical in assuring that the majority of farmers benefit from improved technology and infrastructure. Clarity of ownership and title is critical to stimulating increased capital investment (and therefore production) at the level of the individual farmer.

Consequently, A.I.D. will give favorable consideration to requests for assistance in the form of feasible projects and programs that:

- establish wider access to agricultural assets, including land, and in providing more secure tenure arrangements; and
- strengthen local participatory organizations of agricultural producers that help assure access by farmers to resources and services and, through farmer involvement, improve the efficiency of such activities as irrigation utilization and maintenance.

Adequate **human resources development is essential if food and agricultural institutions are to be effective.** This means adequate training for professional and technical staff and for farmers.

A.I.D. will support:

- in-country training of scientists, technicians, managers, extension agents, and also farmers and skilled workers in food and nutrition, and agricultural and rural development, with expansion as necessary, of in-country training facilities;
- external training, in the United States or third countries.

Important in these regards, is the **special role of and concern for women**, including their role as agricultural producers, workers, and family food providers. Greater efforts are therefore required to expand opportunities for women to serve as administrators, scientists, technicians, extension workers and other food and agricultural professionals. A.I.D. will provide support to promote the enhancement of the role of women through:

- research and analysis;
- planning and policy dialogue;

[7] Section 103A of the Foreign Assistance Act requires that agricultural research carried out under the Act take account of the special needs of small farmers in setting research priorities, as well as support research on the various factors affecting small farmers, and emphasize field-testing and research dissemination.

- design and implementation of institutional and human resource development and other programs; and
- A.I.D. staff recruitment, training and placement.

C. **Expanding the Role of Developing Country and U.S. Private Sectors**

Private sector business enterprises, including farmers and manufacturing, trade and service firms, account for the bulk of food and agriculture-related economic activity in many developing countries. Non-profit private and voluntary organizations (PVO's) also make significant contributions to food and agricultural development in many countries, as do universities (some developing country universities are entirely private; i.e., non-government, and others are perceived as private or quasi-government, due to their largely autonomous nature, even where mandated and funded by government).

Given an appropriate policy environment and the complementary support of public sector institutions and physical infrastructure, the private sector can constitute a **dynamic, efficient and innovative mainspring for food and agricultural development.** Furthermore, most private sector rural enterprise in developing countries tends to be relatively small-scale and labor-intensive. It thus also has the potential for generating substantial employment and purchasing power.

Realization of the full potential of the private sector to contribute to food and agricultural development requires attention to:

- government policies and regulations that encourage rather than discourage the private sector;
- programs to overcome deficiencies in management and technical skills; and
- private sector access to market and technical information, credit, infrastructure, services and materials.

In some countries long-established public enterprises or para-statal organizations dominate agricultural marketing, processing, storage and/or distribution activities. These operations are often highly inefficient and tend to discourage food and agricultural production. Avenues for improvement include: (1) policy and management reforms that give public enterprises a greater **market orientation** and put them on a commercial basis; (2) encouraging greater competition from private enterprises in the same spheres; and/or (3) turning public enterprise management and/or assets over to the private sector.[8]

A.I.D. will:

- identify private and public sector institutions, such as banks, technical institutes, and trade and marketing associations, through which technical and financial assistance can be effectively provided to private enterprise;
- engage in dialogue with governments on changes in policies and other regulations to encourage and strengthen private sector development, including small and medium-scale enterprise; and
- where appropriate, help countries improve the efficiency of public and para-statal enterprise engaged in food and agricultural-related activities. This is a complex issue that will be addressed further in a separate paper.

A.I.D. also encourages utilization of the invaluable skills and resources of the American private sector—of agribusiness enterprises, other firms and consultants, universities, cooperatives and other farmer organizations, and private and voluntary organizations—to stimulate broadly-based food and agricultural development.[9]

- A major effort will be made to involve U.S. business firms in **strengthening developing country private enterprise.**
- A.I.D. will develop mechanisms and processes to facilitate the involvement of the U.S. private business community in food and agricultural development, including technical assistance and training as well as direct and joint investment.

Private and voluntary organizations (PVOs) have a number of potential strengths for assisting food and agricultural development. PVOs can be effective in developing local institutions that organize local energies to provide both development and social services and productive inputs. Compared with the public sector, they often provide flexible, low-cost approaches that take local attitudes and conditions into account. Through their U.S. networks, they have the further advantage of mobilizing private

[8] Such enterprises were often initiated for arguably laudible motives, such as reducing sharp, seasonal fluctuations in farm prices. Performance of public enterprises in accomplishing such objectives has been spotty, however, and the cost has been high. Private sector alternatives, including increased on-farm storage capacity, need more attention.

[9] U.S. universities will be used principally in support of A.I.D. policy to develop and strengthen institutions and train people serving agricultural and rural development as set forth in section B above. Such universities may also be utilized to support and strengthen the role of the private sector, including such activities as training, technical assistance, and joint efforts with PVO's and other public or private institutions.

American resources and commitment for development.

- A.I.D. will encourage and seek to strengthen PVOs that are commited to sustained food and agricultural development consistent with A.I.D. policy, and that have indicated through performance or potential the ability to provide effective developmental assistance.

D. **Providing Food Aid and Food Security.**

Food security considerations have played an increasingly important role in international discussions of food and hunger. The concept of international food security implies assurance world-wide of regular and adequate basic food supplies.

In emergencies or dire food shortages, national food security requires adequate capacity to channel available food supplies to population groups experiencing severe food shortages so as to maintain normal consumption levels. In the longer term, the achievement of national food security requires a country to be self-reliant in food and agriculture, to be capable of assuring its population a continuing, nutritionally adequate food supply through increased domestic production, more efficient distribution, expanded purchasing power and international trade, and a healthier and better informed population.

While external assistance can help accomplish these objectives, the responsibility for food security, especially in the longer term, is fundamentally that of each country. In the short term, international food assistance—led by the United States as the world's largest food aid donor—plays a vital role in assuring food security.

The United States has **agreed to back up its pledge of food aid under the International Food Aid Convention with a national grain reserve**—4 million tons of U.S. Government-owned, privately-held wheat, of which 300,000 tons may be used for disaster relief in any one year **regardless of U.S. domestic supply conditions.**[10]

PL 480 food aid can be a valuable development resource for augmenting local production, enhancing short- and long-term food security and reducing malnutrition, providing it is made available under conditions that support rather than discourage domestic food and agricultural production. PL 480 food commodities can enhance food security through augmenting domestic food sales and distribution programs and may also be used to help build national food reserves. Local currency generated from these food sales provides financial resources to assist with development of food and agricultural institutions and infrastructure.

- A.I.D. seeks to improve the impact of both PL 480 commodities and local currency proceeds on food and agricultural development, including increasing their integration with other U.S. bilateral financial and technical assistance at both the policy and project levels. PL 480 resources should support A.I.D.'s strategic emphases to improve country policies, develop human and institutional capacity and enhance the role of the private sector in food and agricultural development.
- The negotiation of PL 480 agreements is an opportunity for discussion of these issues with country governments and for including broader policy issues such as agricultural pricing and overall policy toward the private sector. Policy dialogue on PL 480 must reach agreement on supplying and/or conditioning food aid in a way that avoids disincentives to increased food and agricultural production through food subsidies or lowered government priority to domestic production. A.I.D. will pursue such policy **dialogue in the context of total U.S. assistance to the country.**

PL 480 Title II programs not only directly alleviate hunger and malnutrition but also have the potential to support human resource development and self-help efforts that increase the employment and employability of the lowest income groups. A.I.D. will continue to give greater emphasis in the use of PL 480 Title II resources to programs that have been shown to have greater nutritional impact, such as maternal-child health combined with nutrition education programs, rather than school-feeding programs, and encourage PVOs to design and implement Title II programs so that governments and local communities eventually assume responsibility for them and/or replace them with programs that increase production and incomes.

[10] Under the U.S. Wheat Reserve Act of 1981. The 300,000 tons are to be used through PL 480 Title II after existing Title II resources have been committed or exhausted. In addition, access by foreign buyers to U.S. grain reserves held for commercial purposes also helps to assure food security. A related question is the extent to which it is feasible and desirable for a developing country to hold food reserves as opposed to financial reserves to meet short-term food security problems. This is a complex question that depends upon a range of factors, including the size of the country, its location relative to international sources of supply, the nature of its comparative advantage for domestic food production and production for export, the effectiveness of its import and export infrastructure, its access to the recently-established IMF Food Financing Facility and other factors. It is recommended that guidelines be prepared on this question, including on the appropriate role for A.I.D. assistance.

III. Programming Implications

United States assistance strategy at the country level requires multi-disciplinary analysis of the policy, socio-economic, institutional and private sector settings for food and agricultural development as well as a long-term commitment of the United States and host countries. These will vary according to the differing needs and problems of countries. The precise content of assistance will thus depend on the conclusions of this analysis. The modes of assistance will be a combination of technical, capital, commodity and food aid assistance.

Although the context of A.I.D.'s assistance may vary from country-to-country for the reasons indicated above, the need to utilize limited budget and staff resources as effectively as possible implies a **focused country assistance strategy**, concentrating on a limited number of core sectors and sub-sectors. Missions should think in terms of long-term efforts in a few priority areas that involve joint and collaborative efforts with host country public and/or private institutions at every stage: identification and design, implementation, monitoring and evaluation. This approach should also permit some freeing-up of USAID staff for the important but relatively neglected implementation stage. It should be recognized that long-term commitment does imply that a certain portion of A.I.D.'s portfolio will be "mortgaged" for periods of a decade or so. But this is "mortgaging" consciously undertaken because of its positive developmental impact.

Technical assistance in the form of training opportunities and technical advisors will comprise a major mode of A.I.D. support for food and agricultural development.

The main U.S. sources of technical expertise are A.I.D. staff, American universities, private sector firms and organizations (agribusiness, consultants and other firms, cooperatives, farmer and private voluntary organizations), the Department of Agriculture and other U.S. Government agencies. A.I.D. will also draw upon technical assistance from other developing countries as well as on the food and agriculture development experience of the U.N. Food and Agriculture Organization (FAO), World Food Council (WFC), International Fund for Agricultural Development (IFAD), World Food Program (WFP) and other donor agencies.

In the utilization of these technical assistance resources A.I.D. will:

- encourage and strengthen the capacities of the various sources of U.S. and developing country technical assistance to, in turn, strengthen the counterpart capacities of host countries to address and solve their own food and agricultural development problems;
- give greater emphasis and importance to the Agency's science and technology capabilities, including creation of a strong professional staff; and
- enhance the role of American university expertise, as provided for by Title XII of the Foreign Assistance Act, in the implementation of A.I.D. food and agricultural development policy.

A.I.D. will also provide, **under appropriate conditions**, capital assistance, food aid, agricultural or other enterprise credit and/or commodity assistance. Such assistance can be especially critical to the development efforts of low-income countries. Capital assistance in particular is often closely linked to policy and/or institutional improvement in a project—e.g., capital assistance to construct or rehabilitate physical structures of an irrigation system linked to technical assistance for improved water management. Similar linkages should improve the effectiveness and lasting impact of all forms of assistance—e.g., elimination of subsidies or converting to private sector distribution as part of fertilizer assistance; interest rate reform as part of assistance for agricultural credit. Therefore, A.I.D. will provide capital, food, credit or commodity assistance only when:

- a need for such assistance exists and other sources of financing have first been explored, including co-financing arrangements between A.I.D., other donors and/or private sources; and
- such assistance is linked to proposed changes or effective performance in the areas of institutional development, technology transfer or development, and/or economic policy. Country performance will be closely monitored and evaluated to determine whether such assistance should be continued.

For low-income countries with severe local resource constraints, A.I.D. will consider financing a **share of recurrent costs** of food and agricultural research, education, extension or related institutions during the project development phase (up to ten years under current A.I.D. procedures), providing that the policy and institutional frameworks assure effective utilization and the country is making maximum and/or increasing domestic resource mobilization efforts.

II.A1 (TM 1:34)
11/9/84

A.I.D. Policy Paper

PRICING, SUBSIDIES, AND RELATED POLICIES IN FOOD AND AGRICULTURE

U.S. Agency for International Development
Washington, D.C. 20523

November 1982

II.A1 (TM 1:34)
11/9/84

A.I.D. Policy Paper

Pricing, Subsidies, and Related Policies in Food and Agriculture

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

November 1982

Table of Contents

Executive Summary i

I. Introduction 1

A. Purposes and Scope 1
B. The Subject 1

II. Economy-Wide Considerations 3

III. Pricing and Subsidy Policies in Three Sub-Sectors 3

A. Food 3

1. The Objectives of Food Pricing and Distribution Policies 3
2. Targeting Net Benefits from Consumer Food Subsidies 4
3. Price Control on Consumption 4
4. Producer Price Policies 5

B. Agricultural Inputs 7

1. Income Compensation 7
2. Popularizing New Inputs 8
   a. Pricing Inputs within Agricultural Projects 8
   b. Economy-Wide Price Control 9
3. Excess Demand and Allocation Problems 9

C. Finance 10

1. The Role of Financial Services 10
2. Financial Policy 10

IV. Implementation 12

References 13

Executive Summary

A. Scope.

This paper describes and analyzes the consequences of certain policies regarding pricing and distribution in markets directly connected with food and agriculture: markets for agricultural inputs, agricultural credit, and food itself. These policies involve interventions found both in LDCs and in developed economies, such as price control, subsidization, public-sector production and distribution, and rationing. These interventions have tended to result in substantial reductions in efficiency and productivity, with little or no benefit to the disadvantaged groups they are often supposed to help. In many cases, the benefits of these policies do not redound to low-income groups, but go to relatively well-off groups instead.

Consistent with U.S. foreign policy, A.I.D. will, through the process of policy dialogue with host-country governments, and through its programs of technical, financial, and commodity assistance, encourage countries to modify such policies so as to minimize governmental intervention in price-formation and distribution systems (except for certain limited circumstances identified in the paper).

The paper recognizes that the achievement of an efficient allocation of resources and of the overall goal of sustained, broadly-based economic growth also often requires complementary reforms, such as the promotion of competition in the private sector, and complementary public investment in basic physical infrastructure, development of human resources, and research, which encourage and facilitate growth in the private sector. Policy dialogue and assistance programs can also help achieve these complementary objectives.

The paper also recognizes that the political environment will often constrain the *degree* of policy change possible over the short term, and that interim steps toward longer-term goals for policy reform may be the best feasible course. A.I.D. should, however, persist in seeking policy changes favoring competitive and free markets.

A.I.D. will provide technical assistance and training to strengthen the capacity of host-country governments and A.I.D. Missions to analyze the effects of existing and alternative policies regarding pricing and distribution related to food and agriculture.

B. Food

Food subsidies do not reduce the cost of food, but merely shift this cost's financial burden through the fiscal system back onto the public (or onto donors, thus depriving the public of the benefits of alternative uses of aid). Therefore, the *net* benefits received by consumers from broad food subsidies are smaller and distributed differently than are the gross benefits of price reductions. Meeting special nutritional needs through such broad programs is costly and inefficient.

Therefore, it is the objective of A.I.D. policy to support food distribution programs that:

- are targeted to particular groups with special and substantial unmet nutritional needs,
- do not rely on suppression of producers' prices,
- do not regulate food prices or the bulk of the private food market, but instead use market mechanisms so far as possible, and
- procure supplies at minimum economic cost.

The secular level and the stability of farmgate prices of foodstuffs are adversely affected by general economic policies in many LDCs and by natural causes, such as seasonal crop cycles and climatic fluctuations. Efficient price-formation by a competitive private-sector trading system can, however, mitigate these adverse effects. Therefore, A.I.D. is prepared to assist the creation and development of such systems, where appropriate, through assistance to governmental provision of infrastructure and technical assistance in the area of marketing.

A government may nonetheless decide to accumulate a certain amount of food to guard against the coincidence of a poor harvest and a scarcity of foreign supplies (commercial and concessional). The often high costs of storing and managing such reserves must be weighed carefully against alternative approaches to enhancing short-term food security, such as accumulating foreign exchange reserves or participating in the IMF's cereal import facility.

C. Agricultural Inputs

Governments sometimes attempt to control (or to "subsidize") the prices of agricultural inputs to compensate the farm sector for its losses under food-price regulations. However, the farm sector's compensation is generally not complete, and benefits received are concentrated on better-off farmers who buy more controlled inputs. Furthermore, the input supply system must also be subsidized to compensate for reduced input prices. The supply system's dependence on fiscal subsidies (and thus frequently on foreign aid) can reduce its effectiveness and thus hamper agricultural productivity.

Therefore, it is A.I.D. policy to encourage the freeing of output prices where they are controlled, thereby eliminating the need to compensate farmers, rather than to compound the inefficiency of the intervention in output markets by adding other interventions in input markets.

Temporary subsidization of the experimental use of inputs may be justified within projects that introduce new techniques to farmers. However, prices should not be set below the farmers'

(limited) willingness to pay for new inputs and should be increased to market levels by the end of the project. If it appears likely that a project's input subsidy will lead to lasting economy-wide price control on inputs, then another method of inducing farmers to participate in the project (*e.g.*, insurance) should be considered.

D. Finance

The primary purpose of a country's financial institutions should be to mobilize and to allocate private indigenous financial resources. Interest-rate controls prevent financial institutions from doing this efficiently. Savers respond to higher real interest rates by increasing deposits in financial institutions. Further, farmers are willing to pay interest rates charged in unregulated markets when profitable investments are available and credit and repayment are scheduled conveniently. However, controls that artificially hold interest rates down discourage saving and lead to credit rationing which often excludes small borrowers that some programs were intended to help. Furthermore, regulated rates are sometimes below the rate of inflation. Negative real interest rates contribute to the decapitalization of financial institutions.

Therefore, interest rates should be set according to the market demand for funds, so that as much resources will be mobilized as the economy's borrowers are willing to pay for. One condition for support from A.I.D. to or through financial institutions is that interest rates be set according to these principles or that substantial measures be taken to reduce interest-rate controls where they have adverse affects on mobilization and allocation of funds. A.I.D. is prepared to assist the development of innovative institutional approaches to meeting the credit needs of small farmers and other small enterprises in ways that do not distort the price of credit.

I. Introduction

A. Purposes and Scope

The purposes of this policy paper are to state on a general level some propositions about the consequences of certain economic policies affecting food and agriculture in less developed countries (LDCs), and to establish, subject to the Ambassadors' authority, certain goals for A.I.D. Missions to pursue in the process of policy dialogue with host governments. Through policy dialogue as well as technical, financial, and commodity assistance, A.I.D. will encourage host-country governments to modify policies that impede economic efficiency and sustained, broadly-based economic growth. In cases where it is judged that success in achieving a project's purposes would require a policy environment that does not exist and cannot be created, however, A.I.D. will not provide (or will withdraw) support.

As is true of efforts to lift technical and resource constraints on economic development, the effort to lift constraints posed by counterproductive economic policies cannot be expected to produce major results overnight. There are real and substantial reasons for the resistance to policy reform: the potential for political opposition from major groups that benefit (or perceive a benefit) from existing policies, for example. Overcoming such obstacles is the object of the day-to-day exercise of ingenuity in politics and in the design of policy dialogue and of foreign assistance. For the implementation of policy dialogue and reform to be successful, it must identify constructive interim solutions to policy problems and recognize the relatively long time-frame of the process of improving upon each interim solution in pursuit of desirable goals. It is hoped that this policy paper will assist efforts at policy reform by more clearly stating certain reforms' underlying rationale and by increasing the emphasis on their practical importance.[1] These efforts must take place within the framework of the overall dialogue between the U.S. Government and A.I.D.'s host governments, and therefore must be consistent with overall U.S. foreign policy and with U.S. policy toward the host countries.

The scope of this paper is narrowly limited to certain governmental pricing and subsidization policies in food and agriculture. Some closely related subjects are therefore not treated fully in this particular paper. For example, this paper does not comprehensively review the problems of private markets in LDCs, nor does it attempt to give complete guidance on promotion of more competitive market structures, on promotion of private-sector involvement, or on the role of parastatals and other public-sector agencies. There are many improvements in such areas that would complement the reforms discussed in the present paper. Such policies and programs, including public investment in agricultural research and physical infrastructure, have been found to be essential to the promotion of growth of the private sector, as well as to achieving broadly-based growth overall. Some of these other topics are discussed in A.I.D.'s Policy Papers on Food and Agricultural Development and Private Enterprise Development, or will be discussed in the forthcoming policy paper on Public Enterprise.

Furthermore, the present paper does not analyze the *ideal* governmental role in the area of pricing and subsidization. Rather, the paper's subject is the set of pressing problems caused by some *existing* governmental policies. Therefore, the reforms discussed in this paper are not proposed as a complete policy framework for governments in LDCs or for donors. These reforms are steps that may be complementary with other desirable initiatives, and that may indeed be the prerequisites of these other initiatives in some cases.

B. The Subject

Although there is a wide range of productive governmental interventions in the development process that may affect and improve markets, the particular area of price formation is one in which many interventions have proved to be counterproductive. Subsidies and related price and distribution controls[2] adopted by many LDC governments, in such areas as food marketing and distribution, marketing of agricultural inputs, and agricultural credit, have tended to result in substantial reductions in efficiency and productivity, with little or no benefit to the disadvantaged groups they are often supposed to help. In many cases, the benefits of these policies do not redound to low-income groups, but go to relatively well-off groups instead. The gross benefits of these policies tend to be offset by the costs of taxation and other fiscal measures used to pay for any subsidies that may be involved. As a result, *net* benefits are much smaller and may be distributed quite differently than gross benefits. Government-fixed prices frequently discourage production of valuable outputs and promote instead activities that have excessively high true costs, to the detriment of the economy as a whole and, in the long term if not in the short term, the poor majority in particular. Furthermore, in order to enforce price controls, it is often necessary for the government to intervene directly in the physical distribution system for both inputs and outputs. Distribution controls instituted under price controls (such as

[1] The concluding section of this paper on "Implementation" briefly describes resources that Missions may draw on to assist in policy analysis and related program design.

[2] It is useful to distinguish subsidies from price controls. Price control is a *regulation* that controls (or restricts) the price that may legally be paid or received for some good or service. A subsidy is a type of *fiscal outlay* to a firm or household.

rationing) frequently are costly and result in inefficient allocation of resources.

Similar pricing and distribution policies occur in many other markets, such as the markets for the factors of production (land, labor, and capital), markets for manufactured goods (especially those that enter international trade), markets for services (such as electrical power and transport), and the market for foreign currencies. However, pricing and subsidy policies that affect food and agriculture directly are of particular interest to A.I.D. because of this sector's important role in the Agency's policies and programs.

This paper first provides an overview of the economy-wide aspects of pricing and subsidy policies. It then discusses desirable policy reforms in three areas directly related to food and agriculture (food products, agricultural inputs and agricultural credit).

A policy of minimizing governmental intervention in pricing and distribution, using market forces to establish practical prices and allocations, and avoiding public-sector displacement (or preemption) of private firms in distribution of goods will not only reduce the fiscal costs of subsidies but will also allocate resources more efficiently than under the various controls that have been instituted in many LDCs. However, there are some areas where the involvement of the government, including subsidization or direct allocation of goods, may be useful. These are usually cases where, in order to obtain efficient results, individuals find it advantageous to coordinate their activities through collective action and organizations such as governmental agencies and private cooperatives. For example:

- Although some types of adaptive research and development of new products are effectively undertaken by the private sector, in general it is difficult for individual investors in agricultural research to retain adequate returns from the knowledge of new agricultural techniques which the research generates. Therefore, it would not be efficient to rely entirely on individuals' funding of agricultural research. The appropriate amount of agricultural research can be funded only by using private farmers' organizations (where possible) and the government to collect resources;
- Given that in the short term special food programs are necessary to reduce severe undernourishment and to assure healthy development of young children, this goal may be more effectively pursued by funding targeted food programs through contributions from private voluntary organizations and/or from the government, rather than solely through uncoordinated individuals' contributions;
- The fixed costs of large surface-water irrigation systems are frequently financed through contributions from private water-users' associations and/or from land taxes, rather than through individuals' irrigation fees only. Although this may appear to be a subsidy to water users, it can be an efficient method of finance. Charging individuals water rates sufficient to cover both fixed and operating costs would generally not result in either sufficient investment in irrigation capacity or efficient utilization of existing capacity.[3]

A.I.D. does not oppose such forms of governmental subsidization where they are appropriately designed and implemented. However, even though the government may provide additional incentives in the form of subsidies, such goods and services should be delivered through private organizations (including non-governmental cooperatives) if they have the potential to be more efficient alternatives to public-sector delivery mechanisms.

When the government does intervene in the economy, the most efficient form of intervention should be chosen and the intervention should not extend beyond what is needed to achieve the government's specific goals. Therefore, direct, explicit (or "transparent"), and limited subsidization that is tied to producers' performance, or to target groups' special, unmet needs, is generally to be preferred to indirect methods. Methods that attempt to provide benefits indirectly may not provide adequate incentives for production or may not provide the desired benefit to the target groups. Indirect methods may also have unintended effects that are counterproductive or that benefit groups who are not in need of assistance. They are also more difficult to monitor and to evaluate, and therefore are more likely to be continued beyond their intended and useful life than if they were explicit and transparent.

For example, to develop road transportation the government should first consider directly financing the maintenance and construction of roads and reducing regulatory burdens on trucking. Indirect measures, such as artificial reductions in the price of petrol, or restrictions on competing railways, might encourage shippers to switch from rail to petrol-powered trucks. However, these effects would be indirect, uncertain, and difficult to evaluate. The most direct effects of price controls and other restrictions would be instead in the supplies of petrol and of railway transportation. These direct effects would likely be counterproductive from the point of view of developing the overall transportation system, including road transport.

[3] Similar arguments apply to roads, bridges, and so forth. In cases like these, it may be useful to keep in mind the distinction between a subsidy and a governmental investment. A subsidy is gratuitous payment to a firm or a household. (It is gratuitous in the sense that no goods or services are rendered to the government that provides the subsidy, although as a result of the subsidy, goods or services may be rendered to others, even if not in consideration of, or equal in value to, the subsidy). Governmental investment is the purchase or production of a durable good by the government.

II. Economy-Wide Considerations

It is a basic A.I.D. policy to assist host countries in the creation and development of free, competitive markets to allocate resources efficiently, rather than to support policies that attempt to regulate prices in order to affect the distribution of income among the economy's broad sectors. If income redistribution is viewed as a desirable goal, it is best accomplished by other means. However, governments in both developing and developed countries are tempted to seek to provide immediate increases in the standard of living in several sectors simultaneously, or production incentives for several sectors simultaneously, by shifting spending power from sector to sector through subsidies or price controls.

For example, consider how the following set of hypothetical policies might be advocated (each policy perhaps by a different sponsor), even though the whole set would not necessarily be adopted.

- Because the government seeks to placate the urban population, the consumer's price of food is held down;
- Increasing demand for food necessitates promotion of food production by raising the farm-gate price of foodgrains and by lowering the prices of agricultural inputs;
- Non-agricultural industries are promoted by sharply raising prices of their outputs (perhaps by raising tariffs or non-tariff barriers on competing imports) and by lowering prices of their inputs, especially imported capital goods;
- Because of expanded subsidies, revenues from taxation of domestic sales cannot meet the government's needs, and therefore exports are taxed; and
- Because there is a shortage of export earnings for necessary imports, such as capital goods and agricultural inputs, exports are promoted through subsidization or exemption from taxation.

Aside from the problems these policies have individually, the set taken as a whole is self-contradictory. For example:

- Fiscal transfers that benefit net buyers of food as a group necessarily make production of food by net sellers less remunerative.
- Fiscal transfers to the farm sector necessarily reduce the resources and incentives available to manufacturers.
- Protection of the manufacturing sector from imported competition necessarily increases the cost of manufactures to firms and households, especially in agriculture.

Since resources are limited, it is impossible to raise the standard of living in *every* sector at once or to provide production incentives for *every* sector simultaneously, merely by shifting incomes or resources from sector to sector. The limits to the amounts of resources available imply that every action has an "opportunity cost", the value of the best alternative foregone for lack of additional resources. The price-system is best used to measure these opportunity costs, in order to identify the best of the alternative courses of action and thus to maximize the resources' productivity. In an ideal (*i.e.*, hypothetical, if not perfect) economy where each good's price is determined by relatively free and competitive markets, the money-cost of a good could be used as a relatively accurate measure of the market-value of the good's cost in terms of alternative goods, *whatever* those alternative goods would have been. Without such a means of measurement, it is very difficult to see how one could take account of costs. This is a basic rationale for assisting in the creation of free, competitive markets.

The scarcity of available resources is sometimes disputed by those who argue that the whole set of policies described above could be financed through expansion of credit and implemented through use of unemployed resources or by expanded foreign aid. On the contrary, however, the dominant strands of research on economic policy in developing countries demonstrate that pervasive attempts at price control and subsidization induce misuse, rather than greater use, of available resources.[4]

III. Pricing and Subsidy Policies in Three Sub-Sectors

This section examines pricing and subsidy policies toward food, agricultural inputs, and credit.

A. Food

1. *The Objectives of Food Pricing and Distribution Policies*

A.I.D.'s basic objective is to promote sustained, broadly-based economic growth in the countries it assists. Therefore, A.I.D. supports food pricing and distribution policies with the following objectives:

[4] The misuse of resources caused by external trade policies has been studied more thoroughly than that in any other sector. Perhaps the best summary of findings is that of the multi-country study supported by the OECD's Development Assistance Committee: *Industry and Trade in Some Developing Countries,* by Ian Little, Tibor Scitovsky, and Maurice Scott. See also the various volumes of *Foreign Trade Regimes and Economic Development,* a more recent multi-country study under the general editorial leadership of Jagdish Bhagwati and Anne Krueger, financed by A.I.D., which studies the inter-relations of exchange control, foreign trade regulations, and economic development. The frequently negative contributions of policies relating to money and finance have received increased attention in recent years. See Ronald McKinnon, *Money and Capital in Economic Development,* and Edward S. Shaw, *Financial Deepening in Economic Development.* The economic implications of the political culture created by inefficient pricing and distribution policies is the subject of Anne Krueger's article, "The Political Economy of the Rent-Seeking Society." (See the end of this paper for full references.)

- to give domestic producers the incentive to produce as much output as is justified by costs, the demand for food, and considerations of food security;
- to distribute food at minimum cost in conformity, by and large, with demand; and
- to alleviate undernourishment, especially of vulnerable groups (such as children and pregnant and lactating women).[5]

Many price and distribution controls found in LDCs do not effectively pursue these objectives, or they have consequences counter to those intended. In some cases this may be because the effects of those policies are misunderstood. In other cases, the objectives themselves may be called into question. For example, price control sometimes has the objective of lowering the cost of food to middle- and upper-income consumers. However, it may be doubted that controls actually do increase those groups' standard of living compared to what it might be under other policies. In any case, the objective of subsidizing the consumption of these particular groups at the expense of the rest of the population may legitimately be questioned by a donor when foreign assistance is used. Another example is a policy of prohibiting cross-border trade in food in order to achieve food self-sufficiency. Such "self-sufficiency" may turn out to imply *greater* scarcity and insecurity in the supply of food than if the economy used trade cautiously but more efficiently. Therefore, the objective itself could be defined more carefully, and policies adjusted accordingly.

The following sections will expand on the problems of existing food policies in developing countries and on the policy reforms that A.I.D. supports.

2. *Targeting Net Benefits from Consumer Food Subsidies*

Urban food consumers in LDCs often constitute a relatively large, concentrated and politically vocal and influential group. A natural goal of most LDC governments is to support urban food-consumers' desires for a higher standard of living. However, attempts to use price controls and subsidies to lower the cost of food to such large portions of the market for food as the main urban groups can be largely self-defeating. The cost of food can be shifted away from the urban consumer only to a limited extent before the burden imposed on domestic agriculture or on the foreign exchange budget (including foreign aid) seriously impairs the supply of food (and other goods) to the urban population. Past this point, the cost of a large subsidy to the broad urban population will largely be borne by the urban population itself in various ways: increased direct taxes, higher prices of non-food items as a result of higher taxation, higher prices as a result of inflationary finance, the opportunity costs of the diversion of governmental resources (including foreign aid) from programs that would have benefited the urban areas, and the inconvenience and possible deprivation resulting from food shortages and rationing (due to both over-expanded demand and production disincentives posed by reducing the returns to producers). Thus, the urban population's *net* benefit from broad subsidization of food consumption may well be substantially less than the reduction in their nominal expenditure on the controlled food items. Over the long term, when inefficiencies introduced into the structure of production as a result of price controls and subsidies have had their adverse effects on overall economic growth, this net benefit and its political dividends may well become negative.

Even in a broad program, there may still be subgroups within the urban population for whom the net benefits are a substantial increase in income. However, the small group that escapes the costs of a broad food distribution program could as easily be a relatively well-off group as it could be a group with special nutritional needs. Furthermore, any such result would come about largely by chance. In order for a program to provide beneficiaries with an assurance of positive net benefits, the program would best be targeted to a relatively small group. In such a targeted program, benefits would be concentrated on a small and needy group while total costs would be relatively small and spread relatively widely.

Therefore, the objective of A.I.D. policy is to employ food and other assistance resources to support food-distribution programs that are effectively targeted to small portions of the population with special and substantial unmet nutritional needs.[6] A.I.D. Missions should attempt to orient assistance in this direction as far as possible. Any support from A.I.D. to broad and untargeted food subsidization programs should be justified by a careful analysis of benefits and costs actually accruing to a specific group with unmet nutritional needs, since the effects on nutritional status cannot otherwise be assured.

3. *Price Control on Consumption*

In the long term, a basic goal of A.I.D.'s assistance is to enable the poor majority in developing countries to afford a more adequate diet. Generally, the most effective method of doing this is to increase the productivity and employment of the poor in agriculture (and other industries). This in-

[5] Given the limits on available resources, many countries will be able to reach the third objective only partly in the short term, even with external food aid.

[6] Methods of targeting food programs to undernourished groups are discussed in A.I.D.'s "Nutrition" Policy Paper, May 1982. They are also discussed in the A.I.D. Policy Discussion Paper, "Food Aid and Development," July 1981. Administrative problems of targeted food programs will be dealt with further in a proposed review of Title II programs.

creases both the supply of food and the effective demand by the poor for food, with no need for price control. Efficient pricing is a useful instrument in increasing productivity and employment.

An objective of A.I.D. food and agricultural development policy, therefore, is to encourage host governments to minimize direct manipulation of the market food prices paid by consumers. Because food markets when unregulated can generally be relatively competitive, market prices can be used to guide consumers to the lowest-cost sources of food.[7] In contrast, an arbitrary reduction of the price of a specific food commodity will stimulate demand for that particular type of food. To meet that demand, resources must be shifted into production or import of that food and away from lower-cost substitutes. Given the limited supply of resources (as well as the limited availability of foreign aid), the results are reduced availability and higher costs of food in the aggregate.

Furthermore, programs of subsidized food distribution supported by A.I.D. should minimize interference in pricing. Where it is administratively possible and economical to subsidize undernourished groups through cash grants or distribution of parallel monies such as food stamps, allowing the beneficiaries to purchase their own additional food from existing private-sector markets at unregulated prices, this mechanism should be preferred. If this is not possible and some degree of price control on sales to the target group must be used instead, the degree of control should be minimized:

- by controlling the price of only a limited portion of the food bought by each member of the target group (if administratively feasible), so that the beneficiaries will have more purchasing power but at the same time will be guided by market prices to choose truly economical combinations of different foods for their diets; and
- by leaving the remainder of the food market free of price control.[8]

[7] Promoting efficiency in food markets is briefly discussed below.

[8] To give a hypothetical, numerical example of this approach, suppose that the average household in the target group buys twelve kilos of some grain a week at a price of three rupees each in an uncontrolled market (at a total expenditure of thirty-six rupees), and that the program goal is to raise purchasing power over this grain by eight rupees. This could be accomplished by instituting price control and setting the controlled price at two-and-half rupees, on the assumption that the typical response would be to expand consumption (given the lower price) by four kilos to sixteen a week, as a half-rupee saving on each of sixteen kilos amounts to eight rupees. This plausible consumer behavior would result in a new total expenditure of forty rupees on this grain, implying that four rupees of expenditure on other goods (including other foods) has been diverted to purchases of this particular grain because of its relative (but artificial) cheapness. This bias in demand, with its attendant excess cost of supply (if indeed such an adjustment in supply is possible), can be avoided and the same eight rupees' benefit extended if the policy were instead to reduce the price of *just the first eight kilos* bought by each household weekly to two rupees each, leaving the ninth and further units to be bought at uncontrolled prices. Since the price of extra kilos of this grain (beyond the twelve kilos bought without the price reduction) is not artificially depressed by this alternative policy, no bias in demand would be created. A plausible consumer response would be to increase consumption of this particular grain by only two kilos to fourteen a week, at a total expenditure now of only thirty-four rupees (eight times two plus six times three, assuming the change in the uncontrolled price to be negligible). Thus, the benefit of eight rupees would be (efficiently) distributed over not just this particular grain but also, to the extent of two rupees out of the initial thirty-six, to other goods as well (including other foods), depending upon the true costs of the various goods.

4. *Producer Price Policies*

A variety of considerations may prompt the government to intervene in the private process of setting farmgate prices for foodstuffs by fixing prices at artificially high or low levels. Among them are:

- the need to finance some of the cost of consumer subsidies at the farmers' expense by procuring supplies at reduced farmgate prices;
- the desire to raise the incomes of the farm sector or of certain farm groups (especially where farmers have organized and become politically active);
- the desire to increase national output of foodstuffs either to raise national income or to achieve food security through greater self-sufficiency; and
- the desire to reduce the risk faced by farmers by reducing the fluctuations of prices around their long-term trends.

A.I.D.'s basic goal, broadly-based economic growth, is not consistent with the use of inefficient price controls to pursue either of the first two goals for changing the distribution of income. Economic growth can best be encouraged by using the price system to allocate productive resources efficiently, instead. Where changes in income distribution are desired, they should be pursued in ways other than price control. When an inefficient policy is the source of low income in one sector, the preferred course is to reform that policy, rather than to attempt to offset its effects with another inefficient intervention that would only tend to depress overall national income further. A.I.D. Missions should, therefore, work to avoid a multiplication of inefficient controls, in which each control is adopted to offset the effects that the others have on income distribution.

Both the latter two goals of producer price-policy, briefly stated as stability and security, are ultimately related to increased food production and farm income. There is a perception shared by

farmers and governments, both in LDCs and elsewhere, that the process of private trade and price-formation does not serve these goals adequately. However, the range of governmental interventions that has resulted includes some rather extreme measures, such as uniform administered pricing ("pan-territorial pricing") and nationalization of the grain trade. More moderate alternative policies sometimes chosen include limited governmental purchases at support prices and restrictions on inter-regional or international trade in food.

Two underlying conditions affecting agriculture support the perception that private trade and price-formation are faulty. First, fluctuations in available agricultural output induced by natural causes (such as weather, seasonality of production, and wastage) interact with relatively stable demand to cause greater year-to-year and intra-year fluctuations in agricultural prices than there are in the prices of things that farmers buy. Second, agricultural production is more diffused (over large numbers of farms) than is production in other industries and, more to the point, than is the food trading sector. Individual farmers, therefore, face an economically exceptional set of marketing problems and at the same time are relatively disadvantaged in dealing with these problems organizationally.

When private trade is competitive, however, there are strong tendencies for the process of price-formation to address the farmers' problems. First, under competition a firm's survival and profits depend on keeping costs as low as or lower than those of other firms. As a result, the secular level of farmgate prices will be held as high as is permitted by the underlying consumer demand for food. Second, price differentials across space and (though difficult to predict) across time are powerful inducements to "buy low and sell high", and thus to reduce any price differential, such as a seasonal differential, that is not already smaller than "carrying costs" (transportation, storage, interest, and so forth.)[9]

In theory, because small-scale traders can be cost-competitive, the food-trading sector has the structural capacity to be highly competitive. In fact, competition in this industry is common and the results of competition between even a relatively small number of traders compare quite closely with the theoretically expected results given large numbers of traders. Where competition is lacking, the underlying ability of small- to medium-scale traders to operate cost-competitively should allow the government to promote it. (Too often governmental controls only confer privileges that, intentionally in some cases, reduce rather than enhance competition.)

The government should promote competition in the food-trading sector in various ways: by reducing regulation in some instances, by standardization of measures and quality designations, and by providing infrastructural inputs like transportation and communication systems where they are not adequately provided privately, for example. A.I.D. can support this effort especially through training and technical assistance to the trading sector.

For the government to go further than these (already formidable) measures would expose it and the economy to the risk of excessive costs and inefficiencies that may be directly counterproductive to the goals of increased stability, security, and output. Pan-territorial pricing, for example, is likely to raise the aggregate cost of food production by eliminating the competitive disadvantage of distant regions that would otherwise be subject to price-discounts to offset transportation cost differentials (and equally by eliminating the price-premium incentive to the more favorably situated farms).

More commonly advocated on the basis of experience in the U.S. is a system of limited governmental purchases at pre-announced support prices. Such a system can be organized in a variety of ways, and may be designed to confine price variations within a narrower range or to raise the average price. The difficulty with governmental attempts to narrow price variations is that, unless the government is a better predictor of future prices than are farmers and private traders, the government's effort will be unprofitable and thus expensive and, more importantly, will exacerbate rather than reduce fluctuations in prices over the course of procurement and disposal of stocks.

One problem with raising average farmgate prices of food is that increased food output may come at the expense of output of exportable cash crops. Another difficulty with raising the secular price level is that it ignores the effective level of demand and leaves the government holding stocks of food, which can be extremely costly. The U.S. Government's solution to this problem has been to bear this cost out of its huge income and to become a major food donor both domestically and overseas. This is not, however, a practical option for governments in LDCs, which are often recipients of food aid rather than donors.

Nonetheless, a government might decide to accumulate a certain amount of food, both in order to support farm prices and incomes at certain times and to guard against the simultaneous incidence of a poor harvest and scarcity of both im-

[9] It is *possible* for private traders to exacerbate price instability by driving prices up untenably high through purchasing for inventory, and then driving prices down when the inventory is marketed. However, although this is possible, it is not profitable. Private firms that tend to buy high and sell low (and there have been many of them) are short-lived and not representative of the bulk of the food trade, which is profitable and survives.

ports and food aid. Complex issues arise, however, regarding the cost of such reserves compared to those of alternatives such as financial reserves and international programs such as the cereal import facility operated by the IMF. Governmental food reserves are not necessarily the best alternative.[10]

B. Agricultural Inputs

As part of overall food and agriculture policy, many LDC governments have promulgated economy-wide price controls on agricultural inputs such as fertilizers. The intended purposes of these controls are:

- To compensate farmers for income lost due to price controls or taxation in markets for agricultural outputs;
- To popularize the use of new inputs in order to increase productivity; and
- To lower the cost of production of food in order to lower the cost of food to consumers.

In addition, the input distribution system is frequently regulated or operated by the public sector. Part of the purpose of governmental distribution control is to ensure that benefits from price controls (calculated before taking the controls' fiscal burden into account) are distributed to the intended beneficiaries (*e.g.*, small farmers), and that inputs are not diverted from intended users through the black market. Producers and distributors of agricultural inputs are subsidized to permit sale to farmers at prices set below costs. Athough some farmers may benefit from controlled prices, the subsidies are usually not paid directly to the farmers themselves.

It is A.I.D. policy to encourage the freeing of both agricultural output and input prices, so that output prices compensate farmers adequately without artificial reduction of input prices, and so that input prices are sufficient to support development of an effective input supply system.

With regard to inputs supplied to farmers by A.I.D.-supported agricultural projects, it is frequently proposed that the project subsidize the inputs that farmers would not initially be willing to buy at full cost. It is A.I.D. policy that such subsidies under A.I.D.-supported projects be offered only under certain conditions, which are specified below.

These policies are elaborated in the following sections.

1. *Income Compensation*

Economy-wide price and distribution controls achieve at best only partly the objective of income compensation for farmers, and even then only for some farmers. Farmers will receive benefits proportional to the amount of inputs they buy at controlled prices. This gross benefit is therefore larger for larger farmers and for farmers who use advanced techniques requiring relatively large amounts of cash inputs. Farmers who use relatively few cash inputs because they have little land, because they are not technically advanced, or because they are not favored by the controlled distribution system will receive little benefit if any.

Against this gross benefit must be set the costs that farmers bear as a result of price and distribution controls on inputs. Since only part of the cost of production and distribution of inputs is usually covered by controlled prices, the remainder must be financed by the government's subsidies. The source of funds for these subsidies depends on the methods of governmental finance.[11] Greater taxation could directly lower some farmers' after-tax income, and inflationary finance through expanding the availability of credit in the aggregate could reduce farmers' real income by raising the cost of things they buy. Governments are also tempted to lower official procurement prices of farm products when under fiscal stress, so that some of farmers' losses of income from depressed *output* prices can be attributed directly to the fiscal costs of subsidies to suppliers of agricultural *inputs*. An input program's net impact also depends on which alternative programs (such as tax reduction or infrastructural investment) the government would undertake if it reduced expenditures related to agricultural input controls.

In addition, to the extent that price and distribution controls on agricultural inputs do not fully compensate input producers and distributors, the amount of inputs available will tend to decline, reducing the profits of those farmers thus excluded from access to inputs. Furthermore, blackmarketing may deprive farmers of the benefit from reduced input prices.[12]

As a result of these costs, the *net* benefit from price and distribution controls will clearly be negative or zero for most farmers who use little or no controlled inputs. Farmers who use controlled inputs intensively and who are privileged to buy them directly at controlled prices are the group most likely to receive a positive net benefit from controls on *inputs*. This benefit will tend to offset losses from controls on *output* prices, but even for these farmers the offset is unlikely to be complete.

[10] Food security itself is a complex matter which will be dealt with in a future A.I.D. policy paper.

[11] Use of counterpart funds generated by foreign aid to finance the local costs of such a subsidy generally only diverts those funds from uses such as other agricultural programs, and thus ultimately has opportunity costs for farmers as large as or larger than other means of finance.

[12] All these offsetting costs to farmers as a result of input controls are analogous to offsetting costs consumers bear as a result of food price controls, some of which were discussed in the previous section.

In fact, reductions in input prices must be proportionally much larger than reductions in output prices before a net benefit is realized by the farmer from the overall set of controls.[13]

Finally, to the extent that the farm sector as a whole is compensated (even though some farmers gain and some farmers lose), the net benefit of the non-farm sectors (who are by definition net consumers of food) is reduced from what it would be otherwise, because they are the ultimate source of any compensation for farmers. Complete compensation of the farm sector means that consumers as a group would receive *no* net benefits from the package of price controls, thus obviating the original rationale of the whole program. In fact, the process of shuffling and re-shuffling costs and benefits introduces administrative costs and inefficient distortions which create an overall net loss for the economy.

Therefore, it is A.I.D. policy to support the decontrol of output prices, thereby eliminating the need for compensation of farmers, rather than to compound the inefficiency of the intervention in output markets by adding other interventions in the input markets.

2. *Popularizing New Inputs*

The second and third purposes of input controls, raising food output and lowering food prices by lowering costs of food production, may be taken together because they both depend on expanding the use of inputs and thus on expanding the supply of inputs. The relation between pricing policy and input supply can be examined in two different contexts: (a) distribution of inputs within agricultural projects, and (b) economy-wide price control. The difference between these two contexts is that input supply may be assured in a project, but is generally not assured by economy-wide price control.

a. *Pricing Inputs within Agricultural Projects*

In order to provide farmers knowledge and experience with new techniques, many projects must induce farmers to use new inputs. Initially, farmers may not be willing to buy these new inputs at market prices that cover the inputs' full costs. One approach to developing farmers' demand for new inputs is to distribute pre-arranged supplies of the inputs directly to farmers at whatever prices the farmers are initially willing to pay, or even for free. If this approach is followed, the project will either have to buy the inputs itself or it will have to subsidize the input distribution system.

This approach can be consistent with A.I.D. policy, even though it may involve an element of subsidization, *providing* it meets the following tests.

- Prices to farmers should be no lower than is required to induce their participation. The purpose of these projects is to increase farmers' productivity and income in the long term by increasing the farmers' knowledge and skills, not to increase farmers' consumption in the short term by underpricing inputs that they would willingly have bought at higher prices.
- Prices to farmers should rise in steps during the project as the farmers' willingness to pay is increased by learning about the inputs. (This is especially important where the life of the project is several years or longer, and where there is a significant gap between the initial price and the suppliers' costs.) Before completion of the project, prices should be at the levels that would be charged by efficient, competitive, private input suppliers.
- After completion of the project, the input supply system should be able to supply farmers' demands dependably. This implies that the system not be dependent upon fiscal subsidies, but instead that it be self-sustaining on the basis of full-cost pricing.
- The use of inputs should be economically justified. A cost-benefit analysis should be done to show that the benefits from increased use of inputs exceed the full costs of inputs (not just that portion of costs paid by farmers).
- Subsidization should be cost-effective compared to other methods of assuring farmers that they will suffer no loss from participation. If, for example, an insurance scheme that guarantees a certain minimum income for the (temporary) duration of the project can generate the same participation and learning at a lower cost to the project than subsidizing input distribution, then such a scheme is more cost-effectrive than input subsidization. put subsidization.

---

[13] For example, assume that (1) the free-market cost of cash inputs is one-third of the free-market value of the entire crop, (2) one-half of the entire crop is marketed, and (3) one-half of the fiscal burden of the subsidies paid to producers and distributors of the inputs is ultimately borne by the farmer. Then a *sixty* percent reduction in the total cost of controlled inputs is required to offset entirely a *twenty* percent reduction in the price of farmer's outputs, assuming no change in marketing or input use.

Numerically, if the crop is worth $600, so that the marketed half is worth $300, then a twenty percent reduction in output price will reduce cash income by $60. If the controlled inputs' free-market cost is one-third of $600, that is, $200, then a sixty percent reduction in price would save the farmer $120. Consistent with assumption #3, however, half of that $120 is lost to higher taxation and higher prices of other goods the farmer buys due to such factors as, for example, excise taxes and inflation required to finance the input subsidy. These losses leave a net gain from *input* control of $60, which merely offsets the loss from *output* control.

A key problem likely to be encountered in using input subsidies within agricultural projects is that it may be difficult to prevent a temporary, project-related subsidy from becoming a permanent, economy-wide policy of price control. As elaborated below, economy-wide price controls, even if compensated by subsidies, tend to reduce the effectiveness of the input supply system (thus violating the third requirement above). In some cases, it may be necessary to find a method other than subsidizing inputs (such as insurance schemes, as in the fifth requirement above) to carry on projects without risking damage to the input supply system. If the input supply system is already unable to function adequately because of controls, it may in some cases be prudent to delay implementing agricultural projects whose long-term benefits depend on input supplies, until policy is changed to permit the supply system to function adequately.

b. *Economy-Wide Price Control*

Superficially, lower input prices mean lower costs of production and thus lower prices to consumers. However, without the increased productivity that stems from increased use of inputs, these connections do not hold. The true costs of production are the alternative goods that resources could have produced had they not been used for agricultural inputs. Price control and subsidization by themselves do not lower these costs; they merely shift the costs' financial burden onto the fiscal system, and ultimately back onto the public. The public as a whole, therefore, ends up no wealthier and no better able to afford food as a result of price control.[14]

Economy-wide price control and subsidization can, however, severely handicap the input production and distribution systems, because subsidization is a poor substitute for the sales revenues lost due to price control. The fiscal process is affected by a variety of influences that may conflict with the financial needs of the input supply system, and it generally has a poor record of delivering subsidies at the times needed to serve the very time-bound agricultural sector. In some cases, the government may allocate funds only after a financial crisis has arisen in the input supply sector. Furthermore, subsidies may not give suppliers appropriate incentives, especially if they are allocated according to suppliers' financial losses. Indeed, such subsidies may create perverse incentives to relax efforts to minimize costs. In contrast, dependence upon sales revenues gives suppliers the incentive to improve their performance, without encouraging excessive costs.

Price control's effects on both the supply system's financial strength and its incentives may well result in reduction in the overall supply of agricultural inputs.

On the other hand, *if* the government makes inputs available to the full extent of demand generated by very low prices (which are sometimes only twenty percent of cost), the result will be over-use of inputs, which implies higher real costs of supplying food.[15]

Therefore, A.I.D. Missions should encourage governments not to disguise the true costs of agricultural inputs through economy-wide price control. Instead, governments should permit the national input-supply system to be efficiently financed through the system's own sales revenues rather than forcing it to depend on unreliable fiscal subsidies.

3. *Excess Demand and Allocation Problems*

Price control creates excess demand, which in turn creates serious problems in allocating agricultural inputs. Any buyer who pays the controlled price for an input can profit, whether he or she is a farmer or not, by re-selling the input (given a little ingenuity and assuming that the transaction cost of re-marketing does not exceed the difference between the market-clearing price and the controlled price). Indeed, price-control creates an artificial scarcity in which buyers are often able to re-sell inputs at prices higher than the market-clearing price. As a rule, the benefit of lower-priced agricultural inputs accrues to their *buyers* and not necessarily to their users, who may be different groups of people.

Given that re-sale cannot effectively be eliminated, the government is usually forced to control the distribution of inputs in order to provide the benefits of price control to the target groups. However, even a well motivated rationing authority faces a delicate problem of to whom among the excessive number of legitimate demanders in the target groups to allocate the available inputs. No choice open to the rationing authority delivers inputs to productive users and benefits to target groups better than would be done by a combination of direct income subsidization of target groups, a free market in inputs, and provision of information and technical assistance to the inputs' prospective buyers.

[14] As suggested above, although increased productivity and food supplies will lower consumer prices over time without price control, artificial price reductions may stimulate purchases of a specific good beyond the level that is most efficient, given national income.

[15] For example, fertilizer that is imported for $100 and sold to a farmer for $20 would willingly be used if it produced $40 worth of additional crops, assuming that a two-to-one ratio (*i.e.*, $40/$20) adequately compensates the farmer for additional costs and risk and thus raises net profits (and the farmer's welfare). But, even if cif import prices of food are *twice* domestic prices, it would still cost only $80 to import the same amount of food. On this assumption, the real cost of this food would be 25% higher than if imported directly ($100 compared to $80). Furthermore, food produced with imported fertilizer is no more secure from the risks of foreign trade than is food directly imported.

Moreover, the whole process of rationing diverts personnel from other tasks that are necessary to assuring timely delivery and other services that real users of the inputs need. Indeed, excess demand for inputs sometimes has the result that the inputs are delivered without needed services or even in an adulterated form. When the distribution system is licensed and regulated, as is frequently the case under price controls, there is no scope for competition to force suppliers to provide retail services or to maintain product quality. In the extreme, the controlled supply system may adjust quality in such a way that what many farmers get is worth no more than the controlled price they pay. Alternatively, supplies may be allocated through bribery, which also deprives intended beneficiaries of some of their benefits (besides having deleterious effects on administration and politics).

Therefore, it is A.I.D. policy to encourage host governments to dismantle price and distribution controls on agricultural inputs. A.I.D. Missions should support alternative policies that help to develop and to support a competitive private input distribution system that relies on market mechanisms to allocate inputs efficiently and to maintain inputs' quality while providing timely delivery and needed services to farmers.

C. Finance[16]

1. *The Role of Financial Services*

The basic role of financial institutions is to lower the transaction costs of matching savings with investments. Aside from the direct cost-savings, this increased efficiency induces an increased flow of funds from savers to borrowers. The value of the financial transactions thus brought about is the increased productivity with which real resources are used when they are bought by borrowers of funds instead of by depositors of funds. Some of this benefit accrues to borrowers, whose rate of return on the real resources they buy with borrowed funds is higher than the rate of interest they pay on those funds. Some of the benefit accrues to depositors, whose rate of return on the real resources they would have bought would have been less than the rate of interest they receive on their deposits. The remainder of the benefit accrues to financiers themselves, from the difference between the rates of interest on loans and deposits (the "spread"), less operating costs.

Some credit projects underemphasize this role of financial institutions. Just as in some circumstances a simple, massive transfer of food into a country can reduce farmers' incentive and financial ability to produce food, simple massive transfers of credit by a project can reduce the incentive and ability of financial institutions to "produce" financial resources by mobilizing and aggregating the savings of individuals. This is illustrated by the example of a project that used national and local financial institutions to provide agricultural inputs and capital goods to farmers. The project's evaluation calculated that additional crop production net of additional input use yielded a relatively high rate of return on the agricultural investments financed under the project. On this basis the evaluation concluded that the credit project was successful. Yet, the evaluation provided no evidence that the project had improved the capabilities of the financial institutions to mobilize or to allocate indigenous financial resources. On the contrary, the evaluation documented the fact that external concessional resources were in part merely substituted for indigenous funds that the institutions had previously used. Therefore, the project did little to develop the ability of the financial system to sustain agricultural investment independently of outside assistance. Indeed, from the point of view of *financial* development the project may have been counterproductive.

2. *Financial Policy*

A.I.D.'s primary purpose in the area of credit and finance should be to create and to support a system of financial institutions that effectively mobilizes and allocates private indigenous financial resources. The financial system should be encouraged to mobilize as much savings as the economy's borrowers are willing and able to pay for. Financial institutions should, therefore, be free to set interest rates for loans and deposits high enough to clear the market between borrowers and savers. De-control of interest rates would also allow a spread between deposit and lending interest rates sufficient to make financial institutions self-sustaining and to eliminate the need for subsidies.

Furthermore, de-control of interest rates would eliminate a variety of other ill effects, such as the following.

- Reduced interest rates on loans benefit larger and better-off borrowers in proportion to the amount they borrow. Larger borrowers also stand to gain more by defaulting. (The ultimate effect on the distribution of wealth depends not only upon who receives the loans and who defaults, but also upon who bears the costs of defaults and reduced rates of interest: *e.g.*, savers and taxpayers.)

[16] This section draws on extensive research on finance and credit policies in developing countries, including papers prepared for the A.I.D. Spring Review of Small Farmer Credit and subsequent work at Ohio State University and elsewhere. A.I.D.'s policy in this area will be stated more fully in the forthcoming A.I.D. Policy Paper, "Financial and Capital Market Development."

- Since interest is generally a small portion of cash costs in agriculture, reduced interest rates on loans seldom reduce production costs enough to have a substantial impact on a farmer's decision to adopt a novel or risky technique.[17] On the contrary, evidence shows that even small farmers are willing to borrow at substantial rates of interest to make investments in proven and profitable new techniques, provided that credit and repayment are conveniently scheduled. Since interest-rate controls tend to suppress financial intermediation and the supply of credit, such controls actually tend to reduce adoption of those new techniques that require additional credit.
- Interest-rate controls hide the fluctuations of market-clearing interest rates and thus obscure the true scarcity of credit in the economy.

Interest-rate controls are sometimes adopted in connection with targeted credit allocation programs. Aside from the point noted above that reduced interest rates are seldom necessary to induce target groups to borrow, the control over credit allocation itself has adverse effects, such as the following.

- Governmentally mandated loans often burden financial institutions with both increased administrative costs and reduced loan recoveries. Administrative costs of mandated loans may be higher than those of normal commercial loans when, as is often the case, a set of borrowers (*e.g.*, small farmers) is specified with which the institution is (at least initially) ill equipped to deal. Loan recoveries may decrease for two reasons: (a) credit is pushed into riskier areas where borrowers are more often unable to repay; and (b) targeted borrowers may be less inclined to repay their loans. They may feel that the loan is essentially a governmental grant or that the financial institution will be unable to enforce any penalty, such as withholding credit in the future.
- To reduce costs in the face of these problems, financial institutions frequently have to cut back their levels of service, especially to smaller borrowers who are more expensive to deal with per dollar lent. As a result, small borrowers find that transaction costs such as travel, time spent waiting, and fees, rise to offset much or all of the expected savings from low interest rates.
- As the combined result of low deposits, excess demand for cheap loans with the potential for default, and increased administrative costs, financial institutions frequently become inclined to ration credit according to personal political influence and administrative convenience, rather than according to the borrower's productivity or need. Small farmers and other small businesses are likely to be discriminated against in the competition for loans under these circumstances, even though lending to them is mandated.

A.I.D. Missions therefore should support elimination of controls on interest rates, so that rates will be set at market-clearing levels through financial intermediation, rather than at arbitrary levels by governmental controls. Both loans to final borrowers and the funds provided by host governments to financial institutions for on-lending under A.I.D.-supported projects should bear rates of interest that are comparable to market-clearing rates of interest for non-concessional sources of funds. Some of the interest yield to the government under such programs could be set aside for technical assistance to the financial institutions or to the sub-borrowers for facilitating the credit transactions. (The same result could be achieved by requiring the financial institutions themselves to set aside from the market interest payment, all of which would otherwise go to the government, a portion reserved for specified purposes of institutional development or services to sub-borrowers. However, the interest payment to the government should not be reduced simply as an unbudgeted subsidy to the financial institution.) Otherwise, technical improvements to financial institutions can be funded by grants or loans that are budgeted separately from the funds made available for on-lending. This latter method may be preferred if it is desired that the institution-building activities should proceed before the on-lending activities can generate revenues.

Missions should also endeavor to assist financial institutions by finding innovative, cost-effective methods by which they can eventually serve target groups on a self-sustaining basis. Alternative pilot approaches may be supported through training, technical assistance, and modest financial assistance. Such efforts should examine a range of policies and characteristics of credit programs and practices that input upon target groups such as small farmers (*e.g.*, traditional collateral requirements).

Where it is not possible to persuade a government to eliminate interest rate controls or credit rationing in one step, Missions may provide support to or through financial institutions on the basis of significant measures being undertaken by the government to reduce controls where they adversely affect the mobilization or allocation of credit.

However, the importance of interest rates should not be overlooked even in the short to medium term. A credit fund that prices its loans only five percentage points below the rate of inflation and that sustains only a nine percent default rate on principal will still shrink to one-half its initial purchasing power by the end of a five-year project (if the whole fund is continuously loaned out).

[17] If an expensive, long-lasting capital good is a major part of the technical package, interest will be a larger portion of production costs, and reductions of interest rates will have proportionally more importance. Such investments are, however, rare for small farmers in LDCs.

IV. Implementation

A.I.D.'s policy regarding pricing and distribution policies related to food and agriculture has implications for two aspects of A.I.D.'s programs:

- analysis and formulation of recommended economy-wide policies for consideration by host governments; and
- pricing and distribution components of A.I.D.-supported projects.

Two projects coordinated by the Science and Technology Bureau (S&T) will facilitate Missions' access to technical assistance in analysis and design of policy-related programs. An "Agricultural Policy Analysis" project is being designed both to assist Missions in policy analysis and to assist the development of better policy-making institutions in host governments.[18]

The Rural Savings for Capital Mobilization Project, designed by S&T's Rural Institutions Divisions (S&T/MD/RI), will assist Missions in establishing, testing, and implementing improved approaches to rural savings and credit, as well as in performing, and in strengthening the capacity to perform, analysis of interest-rate and credit-allocation policies, both in A.I.D. Missions and in host governments.

In addition to support through these projects, a forthcoming A.I.D. Policy Paper on "Approaches to the Policy Dialogue" will provide general advice and guidance to Missions on the conduct of discussions with host governments regarding economic policies.

In the area of pricing and distributional aspects of A.I.D.-supported projects, the present paper contains general guidance as to the goals that Missions should pursue. Implementation may require some Missions to increase their access to expertise in analysis of economic policies. Missions may wish to consider increasing the number of their personnel positions in such designations as "Program Economist" and "Agricultural Economist". A.I.D. has recently emphasized recruitment of economists and agricultural economists for its Foreign Service, as well as under Joint Career Corps appointments, which should allow more Missions to fill such positions with the appropriate skills.

Project design in the areas of concern of the present paper will also be assisted by the forthcoming evaluations of projects in the Agricultural Services Sector, to be conducted by A.I.D.'s Evaluations Office (PPC/E). This series of evaluations will investigate the effectiveness and sustainability of agricultural development programs in the provision of inputs, equipment, and credit, and in improving marketing channels for crops.

[18] Of related interest is the "Evaluation of Agricultural Sector Planning Activities in Latin America and the Caribbean," July 1982, commissioned by the Latin America Bureau's Rural Development Division (LAC/DR/ARD) to review the results of A.I.D.-supported projects in that region.

References*

1. Abt Associates, "Evaluation of Agricultural Sector Planning Activities in Latin America and the Caribbean," (Report submitted to LAC/DR/ARD), July 1982.
2. A.I.D., **Spring Review of Small Farmer Credit**, June 1973.
3. A.I.D. Policy Discussion Paper, "Food Aid and Development," July 1981.
4. A.I.D. Policy Paper, "Economic Policies of Developing Countries and the Effectiveness of U.S. Economic Assistance: Approaches to the Policy Dialogue," forthcoming.
5. A.I.D. Policy Paper, "Financial and Capital Market Development," forthcoming.
6. A.I.D. Policy Paper, "Food and Agricultural Development," May 1982.
7. A.I.D. Policy Paper, "Nutrition," May 1982.
8. Bhagwati, Jagdish and Anne Krueger (general editors), **Foreign Trade Regimes and Economic Development** (11 vols.) (Cambridge, MA: Ballinger Publishing, 1978).
9. Krueger Anne O., "The Political Economy of the Rent-Seeking Society," **The American Economic Review** 63:3 (June 1974), 291-303.
10. Little, Ian, Tibor Scitovsky, and Maurice Scott, **Industry and Trade in Some Developing Countries** (New York: Oxford University Press, 1970).
11. McKinnon, Ronald I., **Money and Capital in Economic Development** (Washington, D.C.: The Brookings Institution, 1973).
12. Shaw, Edward S., **Financial Deepening in Economic Development** (New York: Oxford University Press, 1973).

*This list simply provides more complete references to documents cited in the paper. It is not intended to be an exhaustive list of the important literature dealing with pricing and related policy issues in food and agricultural development.

II.A2 (TM 1:40)
8/20/87

POLICY DETERMINATION

Agency for International Development

PD-13

May 9, 1986

LAND TENURE

PD-13
May 9, 1986

A.I.D.

POLICY DETERMINATION

LAND TENURE

I. Introduction

This Policy Determination (PD) sets forth A.I.D. policy regarding assistance to LDC programs and projects in land market development, land tenure security and related activities.

A. A.I.D.'s Interest and Objective in Land Tenure

A.I.D.'s primary objective is to promote broadly-based economic growth in less developed countries (LDCs). To achieve this, A.I.D. supports efforts to intensify the economically viable use of existing land resources devoted to agricultural production, and to bring into economically viable production those resources which currently lie dormant.

Land is a fundamental factor of all agricultural production. In LDCs whose economies are primarily agricultural and where capital is scarce, land plays an especially important role as a determinant of employment and income. This policy determination is specifically concerned with programming A.I.D.'s resources to support increased productivity of land as a factor of production in a context of equality of opportunity for access to land. It expands on the basic policy guidance on food and agriculture set forward in the Agricultural Development Policy Paper (1978) and the Food and Agricultural Development Policy Paper (1982), and complements other A.I.D. policy documents related to allocation and efficiency in the capital and labor market (see Policy Papers on Private Enterprise Development, [Revised 1985], Employment and Intermediate Financial Institutions [forthcoming]).

People are at the center of farming; people are affected by circumstances of land tenure. A.I.D. seeks by this policy determination to identify those

elements of land tenure policy which will expand the abilities of individual farmers (both male and female) throughout the world to control their destinies and be rewarded with the fruits of their labor, thereby providing incentives to increase agricultural productivity.

As with other inputs to production, agricultural land is used most efficiently when its value is market-determined and when those who control the resource experience a real economic loss by not using the asset productively. Consequently, A.I.D. supports those LDC policies and programs which lead to a general, country-wide reliance on market forces in the valuation and distribution of land ownership and land use rights. A.I.D. will also support programs that broaden the opportunity for access to agricultural land, promote tenure security and stimulate productive uses of land to ameliorate the barriers to market entry that exist in some LDCs.

The nature and pattern of land ownership and use rights fundamentally influence whether land is put to its most productive use. When investors' choices are limited by the political or policy structures of a LDC, land may be held primarily for its value as a secure asset, not for its value as a factor of production. Thus, land ownership may be concentrated in the hands of individuals whose principal motivation is not to utilize the land to its full economic potential. Such a result, protected and sustained by market-restricting economic policies, denies the majority of rural dwellers equal opportunity to obtain land and put it to its most productive use. When government policy supports a land market system in which information is widely available, and other barriers to entry are removed, land is more likely to be sought for its productive value. In addition, a functioning capital market and a secure private sector may diminish the economic incentives for large, under-utilized landholdings by making such holdings relatively less attractive investments.

Clear and secure land tenure supports the transformation from traditional subsistence agriculture to modern commercial agriculture. When ownership or use right to a parcel of agricultural

land is unclear or insecure, that land may be left to lie fallow or may be worked only for immediate or near-term gain--often with adverse consequences for the productivity of the land over the long run by those who maintain temporary occupancy. Significant increases in agricultural productivity of land are more likely to occur when the owners or users of land feel secure in their ability to obtain sustained benefits from investments in the land. Consequently, A.I.D. will support LDC policies and programs which improve the security of land tenure, provided they do not merely legitimize a land tenure system which discriminates against small farmers and the landless and their opportunity to obtain or utilize land and earn a fair return on their investments of labor and capital.

In other words, both functioning land markets and provision of more secure and stable land tenure must join to stimulate agricultural production that extends equal opportunity to own or use land to the majority of the rural population in LDCs.

B. The Parameters of A.I.D.'s Assistance

The Foreign Assistance Act (FAA) of 1961, as amended, provides the statutory authority for A.I.D.'s support of land tenure activities. Section 102, in part, states that"...the principal purpose of bilateral development assistance is to help the poor majority of people in developing countries to participate in a process of equitable growth through productive work and to influence the decisions that shape their lives, with the goal of increasing their incomes...," and that one criterion by which developing countries' movement toward these objectives is to be measured is the "increase in agricultural productivity per unit of land through small-farm, labor intensive agriculture." Further, Section 103(b)(1)states that "the establishment of more equitable and more secure land tenure arrangements" is one means by which the productivity and income of the rural poor will be increased, which in turn is the purpose for which assistance is provided under the authority of the FAA. Other statutory authorities, such as Sec. 620(g), also apply to A.I.D.'s land tenure-related programs.

II. Background and General Policy Guidance

In traditional societies producing at or slightly above subsistence and experiencing no population pressure of consequence, the pattern of land tenure usually has not been a significant economic concern. Under such circumstances land is not a scarce resource and thus has little value. However, in most LDCs land has become a scarce factor of production due to the pressure of population and, in some cases, declining productivity of the land base under traditional cultural practices. The continuation of traditional, low-yield agricultural practices in the face of increased demand for food and other agricultural commodities has eliminated, for the most part, LDC reserves of "new" land. To meet the increased demand, traditional extensive agriculture must give way to improvements that increase agricultural productivity. As a result, the opportunity to obtain or use land, and the security and equity of land tenure arrangements, are of increasing concern.

In some societies, traditional methods of defining land boundaries, of ensuring security of tenure and of transferring ownership or use rights may be adequate or may be capable of adjustment to more intensive use of the land. However, in each case, a government must ensure that prevailing systems of tenure security and property transfer are responsive to the economic and social needs of development. An effective system should allow the market to establish the value of land and ensure equality of opportunity among producers to obtain ownership or use rights to land, which will stimulate the transfer of land to more productive users. The system need not be formally structured or codified, nor need it be based on deeds or written conveyancing instruments, but must be universally recognized as legitimate and not subject to subordination by competing formal systems.

A.I.D. is prepared, in selected cases and as resources may be available, to assist developing countries to improve market-based land tenure systems so that producers are able to obtain land or adjust the amount of land utilized in their production processes. Such assistance should be made available to a LDC as part of a larger program of policy dialogue to promote

market-determined decisions for goods and services related to economic growth.

A market-based land tenure system as defined in this policy determination has the following characteristics:

- Transactions occur between willing buyers (lessees) and willing sellers (lessors).

- Transactions occur for economic gain and not primarily for non-economic considerations which have as their purpose the establishment or maintenance of a discriminatory pattern of land tenure based on social or political factors.

- Land tenure is sufficiently secure so that arms-length transactions can occur.

- Land tenure is sufficiently secure so that land may be used as collateral for the purpose of obtaining capital.

- Entry into the market for land is unrestricted by legal or administrative barriers that artificially limit the number of buyers (lessees) and sellers (lessors).

  (However, temporary, transitional limitations may be desirable to protect the rights of economically disadvantaged or underprivileged groups.)

- Limitations on use of the land may be imposed by zoning laws which reflect the society's interest in the pattern of land use, protection of the environment and other legitimate external factors.

- Knowledge of the opportunity to buy or use land is widely disseminated, as is knowledge of the transaction process.

- Joint ownership arrangements (e.g., families, partnerships, corporations, cooperatives, employee stock option programs, etc.) are sufficiently well defined so that one or more of the partners within the joint ownership is able to withdraw assets in accordance with a plan understood by the other joint owners.

- The reservation of land for community ownership or management does not significantly impinge upon an individual's right to own or use land alone or in association with others.

As an economy grows and becomes more complex, the legal, administrative and market systems related to viable and responsive land tenure arrangements should also develop. In middle and upper income countries the systems will typically include written and recorded deeds which convey specified ownership and use rights enforced by the legal system, property boundary markers set by cadastral survey and an active private sector furnishing services to facilitate all phases of property transaction including finance.

In less developed economies, transactions in land based on fair market values and tenure security could be effective without the relatively costly systems associated with formalized land markets found in wealthier countries. For example, recognized boundary markers may replace cadastral surveys and public acknowledgment of transfers may substitute for written instruments. Therefore, in seeking to implement this policy determination, A.I.D. will focus on cost-effective systems and institutions which support tenure security and market-driven transactions in land ownership and use rights. In some cases this policy may direct A.I.D.'s efforts to extending, modifying or codifying indigenous tenure systems rather than introducing or fostering more formal, complicated and expensive systems.

Assistance to establish or improve land tenure arrangements should not be reserved for those situations in which constraints in the market for land are an important contributor to political and social unrest, due to the concentration of ownership or benefits in the hands of a few and a denial of the opportunity to own or use land for the many. Assistance to improve land tenure arrangements should be considered whenever it is programmatically and economically justified in support of economic development. Missions should review the conditions of land tenure and the market for land in the host

country and seek methods of encouraging more equity and productivity in the use of this resource before constraints contribute to social and political polarization.

III. Land Tenure-Related Programs

Several interventions to improve tenure security are candidates for A.I.D. support. These include land market development via land titling and other means, land settlement, land consolidation and improvement in the terms of rental or other tenancy arrangements. It is important, however, that the overall policy environment, particularly in the agriculture sector, be considered and constraints addressed as a Mission considers one or more of these interventions. In general, interventions discussed here rely on a gradual approach to the establishment of competitive markets and tend therefore to be more politically acceptable. These gradual approaches may be preferred options in countries not yet experiencing polarization as a result of inequities in opportunity to acquire and use land.

In all activities, Missions should be conscious of the differential access by men and women to land, and should ensure that programs have a positive impact on the tenure security of the actual farm operator. Further guidance on this point may be found in A.I.D.'s Policy Paper on Women in Development.

A. Land Market Development

Areas that have the highest potential for development of a land market based on a modern titling and registration system are those characterized by a growing informal market in land and a widespread perception of insecure or limited access to land. Under such circumstances, a program to enhance market functioning should include attention to three critical attributes:

- wide availability of information on potential land for sale and its value;

- up-to-date records of ownership and transactions;

- legal sanction of private contracts and legal and administrative means of enforcement.

To the extent that these attributes are absent and not capable of being introduced, the potential is great for modern land titling actually to slow the development of markets, increase insecurity, reduce production and exacerbate inequities. Further, the establishment of modern titling systems involves significant costs, especially for dissemination of information and administration, which raise transactions costs for participants in the system. Missions should weigh these costs against the potential benefits of the establishment of a modern titling system prior to entering into such a program.

In some cases, traditional systems of tenure security, which may be less formal, will provide an adequate basis on which to encourage a competitive market in land. Missions should examine existing systems to ascertain the extent to which they may be modified or codified to allow the benefits (e.g., use of land for collateral, alienability, heritability) that derive from a formalized titling system to flow from a less formal system. For example, informal mechanisms in many countries provide for community recognition of rights in land. In some cases, an improvement in market performance could result merely by giving formal sanctions to the informal arrangements.

Traditional communal tenure and multiple use rights present special challenges to the development of commercial land markets. In traditional communal tenure (as distinct from joint holdings created under modern titling systems) a group that is usually based on common kinship or residence exercises effective control over the agricultural resources in a given geographical area. Within that area, then, individuals generally have secure use rights and decision-making authority over specific parcels in a manner governed by the norms of the group. Land that is communally owned need not necessarily be converted to individual ownership as its value increases, but mechanisms must be found whereby the benefits of the

modern sector systems (e.g., use as collateral) can be extended to such tenure systems, and whereby the communal land use will reflect the true market value of the land.

With regard to multiple, overlapping use rights, some circumstances (such as a radical change in land use) are discussed in the following section on land settlement. In other situations, however, there may be a need to codify existing rights by all groups with an effective claim on the land, so as to protect rights that are in jeopardy and to allow for market transactions to occur among individual or group rights holders. For example, Wade[1/] has documented a case in which herdsmen bid for rights to graze their animals on a village's fields after harvest. Each side is negotiating on behalf of group rights. On the other hand, where one use is, or is emerging as, dominant, rights may be partitioned or provision made for one user to compensate the other for rights taken.

Missions are encouraged to seek alternatives in land market development that incorporate traditional land tenure rights, including communal and multiple tenure. In some instances, these approaches will provide for a relatively rapid transition to individual tenure, as in areas of new land settlement in which some rights will be extinguished; in other cases alternatives to individual ownership or use will be secured as the norm.

The development of a competitive, broadly accessible market in land will ordinarily require a programmatic approach that addresses legal, administrative and financial as well as technical aspects. Once an adequate legal framework is in place, a program of incentives may be desirable to stimulate entry into the market. This program may include the establishment of a secondary mortgage market or a

---

1/Wade, Robert. "Common Property Resource Management in South Indian Villages." Paper prepared for the Common Property Resource Management Conference organized by the National Academy of Sciences, April 21-26, 1985.

financing mechanism for potential borrowers who represent a larger risk than typical commercial borrowers. It may also include assistance in administering tax laws designed to promote the most productive use of agricultural land.

Policy changes related to pricing may also be required. Artificially depressed agricultural prices drive down land prices and discourage sales where owners have reason to hope that more realistic prices may prevail in the future, thus encouraging speculative landholding. Conversely, prices for inputs and commodities that reflect true market values may encourage landowners to put under-utilized land to use or to offer it for sale. However, for some large landowners, the monetary value of revenue generated from land may be insufficient to offset potential loss of social status, political power and other non-financial benefits. The latter types of motivations should be assessed in the design and implementation of any land market development program.

Differential taxation of under-utilized agricultural land has frequently been suggested and occasionally tried as a mechanism to stimulate more productive uses of the land. However, there are several problems with this approach. First, use of a single instrument (land taxes) to achieve two objectives (raise revenue and stimulate increased use of particular lands) usually achieves only one of the objectives at best. Second, the administrative requirement of a tax designed to stimulate production, if it is to remain equitable, invariably exceeds the administrative capabilities of even the most capable tax system. Consequently, assistance to improve land tax administration should avoid the introduction of specialized taxes if the purpose is to stimulate the productive use of the land; but such assistance is acceptable for administration of non-discriminatory land taxes.

B. Land Settlement[2/]

In some LDCs there exist government-owned lands that might be suitable for settlement. In a few countries

---

2/ Includes resettlement.

the government, under the aegis of a land bank or agrarian reform agency, has established a fund for the purchase of tracts of unused land to be distributed to voluntary settlers. In others, the eradication or control of disease such as onchocerciasis or trypanosomiasis may allow settlement of previously unusable lands. In such instances, Missions and host governments might consider adapting the Homestead Act approach used in developing the Western United States.

In most cases, however, there will be pre-existing claims to land that must be honored, even in very remote areas designated for settlement. These claims may be multiple and overlapping, based on seasonal, topographical or social determinants. Missions should assure that all such claims are satisfactorily accommodated, either through compensation or equitable inclusion of prior claimants.

Settlement schemes may be a viable alternative to redistributive land reform, but they are also sometimes inappropriately proposed by governments as alternatives to larger-scale reforms. In these cases, the schemes may not be well planned and may be executed too hastily. New land settlement generally does not affect a large percentage of a LDC farming population, and cannot provide a sufficient response to widespread inequality in the opportunity to obtain and use agricultural land. In instances that conform to this description, other interventions with wider impact will be preferred. Missions are required to address this issue before including support for agricultural land settlement as part of a country strategy.

It may also be the case that "new" lands are inappropriate for settlement because of their fragility. Care must be taken that settlement schemes do not result in serious environmental degradation and that they establish safeguards to protect biological diversity [see particularly A.I.D. Policy and Program Guidance on Humid Tropical Forests (84 State 328482)].

Recent literature on land settlement[3/] suggests that a least-cost approach to the support of settlement activities is preferable. The disruption caused by the move to a new area, and development of the requisite infrastructure and services usually means that economic activity will not reach its full potential for a number of years. Complete development of the regional economy may take a generation. A least-cost approach to the initial settlement activity also encourages settler independence from the outset.

C. Land Consolidation

There may be instances in which fragmentation of land has occurred, due either to certain biophysical constraints or to inheritance practices. Generally, such fragmentation is a risk aversion strategy in response to specific agro-climatic conditions using conventional technology. Under such circumstances, land consolidation is not likely to be an appropriate measure to increase agricultural productivity, nor will it be perceived by beneficiaries as enhancing tenure security.

Under certain circumstances, fragmented landholdings may be candidates for a program of consolidation. Introduction of new technologies, or changes in tenure patterns for other reasons, may make consolidation practical or desirable and may lead to increased productivity. In most of these cases, a pattern of consolidation will be occurring informally (e.g., several farmers will rent a tractor to plow contiguous plots, or families will be pooling separate holdings and other resources). Agricultural productivity may be enhanced by encouraging such trends through a systematic program. If a valuation system for the

---

3/ See for example:
Scudder, Thayer; The Development Potential of New Land Settlement in the Tropics and Sub-Tropics. A Global State-of-the-Art-Evaluation with Specific Emphasis on Policy Implications. A.I.D. Program Evaluation Discussion Paper No. 21 (PN-AAL-039). 1984.

World Bank. Agricultural Land Settlement: A World Bank Issues Paper. 1978.

land is established, it may be possible to effect exchanges in kind, in addition to the more usual sale-and-purchase mechanism. It should be noted that in order to retain the advantages of the consolidation, incentives must be built into the program to prevent a recurrence of fragmentation. For example, if a new technology overcomes prior biophysical constraints, an assured supply of inputs and services required to implement that technology must be available.

D. Tenancy

Tenancy refers to the terms under which an individual or group holds use rights to certain land for agricultural production for one or more crop seasons. It generally takes the form of an agreement, whether formal or informal, between two or more private parties, as in rental, sharecropping, or squatting.

Occasionally, the agreement will be between a private party and the government. The laws and regulations governing this agreement may need to be altered to assure that both farm owners and operators have incentives to invest resources in the land. Such alterations may include provisions for recording of agreements between lessors and lessees by a disinterested third party; clearer procedures for the enforcement of such agreements; establishment of mediation and adjudication services, including methods which avoid expensive legal procedures; brokerage firms that match prospective lessors and lessees and policies on credit and prices that favor a labor-intensive agriculture.

Legal and administrative reforms are inherently difficult to implement in LDCs, and without strong political will and enforcement measures they are likely to be ineffective.

IV. A.I.D.'s Interventions

Agency resources - ESF, DA, PL 480, and some local currency generations - are all eligible for consideration in projects or programs supporting development of competitive land markets, improving land tenure security and related activities. In

considering LDC requests for assistance, Missions should be guided by the following discussion of generic program areas:

A. Assistance for Policy Improvement

Land tenure arrangements in a LDC may pose a significant constraint to economic and social development. If a Mission determines that this is the case, it may choose to enter into discussions on this topic as part of its program of policy dialogue. These discussions need not lead to direct programmatic support, but essential policy changes may be required before related programs in the agriculture sector can be successfully undertaken. Missions should be guided by the Approaches to the Policy Dialogue Policy Paper (1982) on this subject.

All project or program assistance related to land markets and land tenure should be provided in a policy dialogue context. In countries in which distorting host country policies are a significant determinant of inequity in the opportunity to own and use land, A.I.D.'s assistance should be focused primarily on modifying such policies. In countries where the development of a competitive market in land is constrained more by institutional issues (e.g. cumbersome land registration procedures, lack of proper survey data, etc.) rather than government policy, Missions should nevertheless carefully monitor policy to ensure that it remains supportive of institutional improvements as they occur.

B. Development of Land Markets

Assistance to improve the functioning of land markets might include interventions that allow for land valuation, such as codification of customary law and practice, cadastral surveys, or development of appropriate title recording or registration methods. A key criterion for selection of appropriate intervention(s) is minimization of transactions costs to the individual. Otherwise, any system introduced may quickly fall into disuse. Other interventions may include assistance in the establishment of appropriate financial institutions for long-term agricultural

lending and financing for purchase, or purchase and resale (via a non-profit intermediary).

C. Program Design

Technical assistance in design of host country projects to develop a competitive land market, improve tenure security or implement other measures may be useful.

D. Ancillary Interventions

1. Support of Agriculture Supplies and Services. A.I.D.'s assistance may be programmed to ensure that the market has adequate stocks of essential inputs such as seeds, fertilizer, insecticides and related farm equipment. Such assistance may be especially critical if an established system of input supply and marketing which depended on a large landowner-cum-landlord is being eliminated by changes in land tenure patterns. Support for various aspects of irrigation may also be appropriate as titles become more secure and farmers seek to invest in higher productivity technologies. Extension services related to agricultural inputs, storage and marketing and irrigation are also appropriate for A.I.D. support. In the design and implementation of its projects, A.I.D. should emphasize private sector provision of both inputs and services.

2. Agricultural Credit. An important ingredient of success in all efforts to improve agricultural productivity is the assurance of available credit for farmers (or for the vendors of agricultural inputs so that they can sell to farmers on credit). In programs that alter patterns of tenure, such as settlement, the availability of credit is essential because most, if not all, of the owners or operators have no other source of capital with which they can finance needed inputs and consumption during the first growing season.

PD-13
May 9, 1986

V. Summary

In order to promote broadly-based economic growth in LDCs that are heavily dependent on agriculture, A.I.D. will support interventions in land tenure that intensify the use of existing land resources, or bring unutilized land into production in an economically viable manner. These interventions will focus on the establishment of competitive land markets and on enhancing land tenure security, but may include other related activities. All of A.I.D.'s available resources, including DA, ESF and PL 480 are eligible for consideration in support of these programs. Ancillary interventions, concerned with input supply, product marketing, technological change and agricultural credit may also be required in order for an intervention in land tenure to be effective. Missions should consider land tenure issues and their resolution as part of any program of assistance in agriculture.

M. Peter McPherson

M. Peter McPherson

May 9, 1986
Date

II.A4
(TM 1:40) 8/20/87

POLICY DETERMINATION

Agency for International Development

PD-15

September 13, 1986

ASSISTANCE TO SUPPORT AGRICULTURAL EXPORT DEVELOPMENT

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

THE ADMINISTRATOR

PD-15
September 13, 1986

A.I.D.

POLICY DETERMINATION

Assistance to Support Agricultural Export Development

A. Introduction

The goal of A.I.D. agricultural development assistance is to help the developing countries achieve food self-reliance, which represents a balanced approach to addressing the problem of hunger. Food self-reliance involves supporting (1) the production of agricultural commodities that are economically viable to produce, (2) more efficient food distribution, (3) expanded purchasing power, and (4) international trade.

Although A.I.D. encourages international trade as one important element of the development process, the Agency is concerned about potential injury to U.S. agricultural exports. A.I.D. does not intend to support production of agricultural commodities for export that are likely to have a significant impact on competing U.S. exports.

B. A.I.D. Policy

A.I.D. assistance fosters the food security objectives of developing countries. Long-run food security, as defined in A.I.D.'s "Food and Agricultural Development" Policy Paper (May 1982), is the ability of a country to assure a nutritionally adequate food supply to its population on a continuing basis. This can result from a combination of domestic production and importation of food on commercial terms paid with foreign exchange earnings. Comparative advantage provides the conceptual underpinning governing the decision of which commodities to produce, whether for domestic consumption or for export.

Food security defined in this way is consistent with a strategy of food self-reliance, rather than a strategy of food self-sufficiency. Food self-reliance recognizes that a country's food supply can be assured not only through increased domestic food production and more efficient food distribution, but also through expanded purchasing power and international trade, including intra-regional trade.

In this context, it is A.I.D. policy to avoid supporting the production of agricultural commodities for export by developing countries when the commodities would directly compete with exports of similar U.S. agricultural commodities to third countries and have a significant impact on U.S. exporters.

This policy supplements, but does not supersede, PD-71 which applies to three commodities (palm oil, citrus, and sugar) produced in the developing countries and exported to the U.S. or to third countries in direct competition with U.S. producers.

C. Implementation

To comply with Agency policy on this issue and with applicable statutory requirements, Missions will examine whether or not an activity designed to increase the production of a particular commodity for export can reasonably be expected to have a significant impact on U.S. exports of that or a similar commodity. Proposed activities, as well as components of on-going activities for which funds have not yet been obligated, that are likely to have a significant impact on exports of U.S. agricultural commodities to third country markets will not be funded.

A.I.D./Washington will regard the agricultural export dimension of all projects as an important policy issue when considering New Project Descriptions (NPDs) included in Mission Action Plans. Proposed projects likely to have a significant impact on U.S. agricultural exports to third countries will not be approved at the NPD stage. If a determination cannot be made on the basis of the information provided in the NPD, a Project Identification Document (PID) may be developed, but the PID will be reviewed in A.I.D./Washington, not in the field. This is consistent with current Delegation of Authority procedures regarding projects having special policy concerns.

Examination of the export dimension of on-going and proposed projects will include consideration of the following factors:

-- export potential of the commodity in question;

-- magnitude of production likely to result from the project;

-- likely export markets;

-- volume of U.S. exports of the commodity in question and similar commodities;

-- U.S. share of the world or regional market that could reasonably be expected to be affected by increased exports of the commodity.

M. Peter McPherson
Administrator

Sept 13, 86
Date

II.C (TM 1:34)
11/9/84

A.I.D. Policy Paper

NUTRITION

U.S. Agency for International Development
Washington, D.C. 20523

May 1982

II.C (TM 1:34)
11/9/84

A.I.D. Policy Paper

Nutrition

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

May 1982

TABLE OF CONTENTS

		Page
	Executive Summary	i
	Preface	ii
I.	Introduction	1
II.	Objective of the nutrition policy and its accomplishment	2
III.	Elements of the policy	2
	A. Problem identification	2
	B. Designing programs to address nutrition problems	4
	1. Agriculture and Rural Development	4
	2. Health	6
	3. Food Assistance	7
	4. Population	8
	5. Education and Training	8
	C. Targeting based on nutrition	8
	D. Evaluating nutrition impacts	9
	E. Complementing sectorai programs with nutrition projects	10
	F. Utilizing the private sector	10
	G. Improving host country policies	10
	H. Coordination	10
	Conclusions	11
	Selected Bibliography	12

Executive Summary

Estimates indicate that six hundred million people in less developed countries (LDCs) are in danger of not getting enough to eat. As a result, their productivity, health, and life expectancy are jeopardized. If the U.S. is to make progress toward helping LDCs improve agricultural production, economic performance, and human potential, nutrition must be included as a critical **input** as well as an essential **output** of development programs. Most of A.I.D.'s development assistance either **affects** health or food consumption or **relies upon** nutritional well-being to achieve development objectives. For this reason, it is of greatest importance to give increased attention to opportunities for improving the nutrition impact of sectoral policies, strategies, programs, and projects.

This policy paper reviews the justifications for U.S. investment in improving nutrition in LDCs and sets out some policy guidelines for A.I.D. programs. The objective of the nutrition policy is to maximize the nutritional impact of A.I.D.'s economic assistance. The policy recommendations are as follows:

- A.I.D. places highest priority on alleviating **undernutrition**—inadequate food consumption and biological utilization of nutrients.
- A.I.D.'s policy is to improve nutrition through **sectoral programs** in agriculture, health, food aid, population, and education as well as through direct-nutrition programs.
- This policy will be implemented through incorporating nutrition and food consumption as factors in decision making in sectoral strategies, programs and projects.

This can be effected through:

A. **identifying** projects based upon analysis of nutrition and food consumption problems; this is especially appropriate in formulating country development strategies.
B. **including** nutrition as a factor in project design:

1. in **agriculture**, through maximizing consumption effects of crop and technology selection, research and extension, and appropriate national policies.
2. in **health**, through primary health care which emphasizes growth monitoring of children, providing pre- and post-natal nutrition, supporting environmental health measures, and promoting proper infant feeding practices.
3. in **food aid**, through targeting appropriate rations to at-risk groups complemented by growth monitoring, health care, and nutrition education.
4. in **population** by complementing voluntary family planning services with nutrition programs whenever feasible.
5. in **education**, through promotion of basic education for women, nutrition education in the schools, training community outreach workers in nutrition, and advanced training for professionals and policy makers in LDCs in nutrition.

C. **targeting** sectoral projects to individuals or housholds at-risk of developing nutrition problems;
D. **monitoring** and **evaluating** nutrition impacts of projects that are likely to affect nutrition, food consumption, or food production.
E. **complementing** sectoral programs with nutrition projects to enhance nutrition impacts;
F. **utilizing the private sector**, especially the food industry, in food programs whenever feasible;
G. **encouraging** appropriate national agriculture, health, and nutrition policies to address nutrition and food consumption problems;
H. **coordinating** with LDC governments and other donors to achieve nutrition goals.

In seeking opportunities to integrate nutrition concerns throughout A.I.D.'s development assistance program, A.I.D. will focus on the factors that affect food consumption, nutritional needs, and health of nutritionally at-risk groups.

Preface

Since 1965, A.I.D. has been a leader in international efforts to improve nutritional status in LDCs. For instance, through A.I.D.'s pioneering work in nutrition planning and surveillance,[1] the multisectoral nature of the nutrition problem in LDCs has become increasingly clear. A.I.D.'s nutrition strategy of 1973[2] demonstrated keen foresight in emphasizing protein-calorie malnutrition[3] rather than the then-popular "protein-gap." A.I.D.'s nutrition strategy of 1977[4] introduced integrated preventive approaches to nutrition by focusing attention on household purchasing power for food. This approach was innovative not only in calling attention to the fact that all members of a household may be at nutritional risk (not just the women and children), but also in noting that nutrition problems involve more than aggregate food supply. A.I.D. has also been a major proponent of nutrition planning in developing countries and has been a leader in increasing the nutrition planning capacity of developing country policy advisors, through workshops and training sessions at U.S. institutions.

In the last decade, significant strides in nutritional science have caused A.I.D. to reexamine its nutrition policies and strategies. Major scientific and methodological findings have implications for nutrition programs.

— Measurement of children's growth in less developed countries (LDCs) has shown that until they reach 5 years of age, children in nearly all populations (excluding pygmies) have the potential to grow as tall as U.S. children. This means that children in LDCs are short not because of genetics but rather because of poor nutrition.

— A number of studies have shown that adequate dietary energy (calories) plays a central role in producing healthy, adequate birth weight babies. Supplementing marginally nourished pregnant women's energy intake improves pregnancy outcome significantly.

— Nutritionists and psychologists have shown that poor nutrition impairs cognitive and neurological development which in turn reduce learning capacity, attention span, and school performance.

— Studies on the effect of energy intake and iron status on energy expenditure have proved that undernutrition and anemia reduce work productivity. Improvement of nutritional status is matched by increased worker output.

— Investigators from many institutions have shown that most staple grains provide sufficient amounts of protein for human needs. Only for preschool-aged children fed entirely on staple grain and in some populations for which roots and tubers comprise nearly all of the dietary calories, protein content of the diet may be insufficient.

— Medical studies have shown that poor nutritional status impairs the body's immune system resulting in more frequent and longer bouts of illness and higher susceptibility to life threatening disease.

— Clinical nutrition studies have revealed previously unknown but essential components of the diet; for instance fiber, trace minerals and a balance of cholesterol and different fats have been found to be essential.

— The absence of a truly equivalent manufactured substitute for breastmilk has highlighted the unique role of breastfeeding in infant nutrition, even in the United States. In developing countries breastfeeding is essential to infants in low income households because breastmilk substitutes are often unhygienic because they are improperly prepared using unclean utensils and unsafe water.

A.I.D.'s policies in food and agriculture, health, population and food assistance have also changed, necessitating restatement of A.I.D.'s major policy objectives in nutrition to provide overall guidance for improving programming to meet these objectives.

---

[1] Nutrition surveillance involves collection and analysis of data on food consumption and nutritional status on a regular basis. The current work being carried on at Cornell University through the Office of Nutrition is a good example of pioneering efforts in tracking nutrition surveillance efforts and promoting the functional classification of malnutrition.

[2] **The A.I.D. Nutrition Program Strategy**, U.S. Agency for International Development, June 1973.

[3] Lack of protein and calories is sometimes called protein calorie malnutrition (PCM).

[4] "A.I.D.'s Responsibilities in Nutrition, "AIDTO Circular A-98, April 1977.

I. Introduction

Sound nutrition policies are essential to the overall development efforts of LDCs. One of the messages that the U.S. carried to the Cancun Summit (in October 1981) was that "increasing food production in developing countries is critically important—for some, literally a matter of life or death. It is also an indispensable basis for overall development." Despite enormous strides in agricultural technology in the last decade, however, people are still dying from starvation and extreme malnutrition.[5] Hundreds of millions are not getting enough to eat—thus rendering them vulnerable to disease and disability, and unable to work or learn to their full potential. If, as the U.S. emphasized at the UN General Assembly in September, 1981, "the individual is the beginning, the key element, and the ultimate beneficiary of the development process," then one of the first goals of development efforts must be to overcome the obstacles that stand in the way of individual initiative and potential. This paper examines a variety of policy initiatives that the U.S., other donors, and LDCs themselves can adopt to maximize the impact of development programs on nutritional status of citizens of the developing world.

U.S. foreign aid is based on a commitment to broad based economic growth in developing countries through "alleviation of the worst physical manifestations of poverty among the world's poor majority" including "starvation, hunger, and malnutrition" (Foreign Assistance Act of 1961, Chapter 1, Sections 101 and 103). Improving nutrition is vital to the overall goal of strengthening the economies of developing countries.

Nutritional well-being is a necessary and crucial *input* in the development process. Undernutrition—insufficient consumption, absorption, and biological utilization of food—can result in starvation and death in extreme circumstances, but is usually disguised as low stature and weight, low worker productivity, poor school performance, poor reproductive performance, or lethargy.

Undernourished adults have lower stamina, productivity, and attentiveness. They are sick more often and more seriously than well-nourished adults. *Undernourished women* give birth to smaller, less robust babies than well-nourished women. Low birthweight babies are at high risk of death before the age of one year. *Undernourished infants* have low disease resistance which may cause them to die from what would be minor diseases under better circumstances (measles case mortality in Guatemala in 1976, for instance, was 268 times that in the U.S.). Diarrhea and intestinal parasites (the most prevalent cause of illness in LDCs) are exacerbated by and in turn aggravate poor nutritional status of the child since the ability to absorb and effectively utilize nutrients is sharply reduced under these conditions.
Undernourished children have stunted mental and physical development that may later compromise school performance, physical capacity, and economic productivity. *Undernourished households* are less productive because of disease, human energy shortage, time losses to sickness and inefficiency, and loss of human life (high pregnancy losses and maternal mortality, high infant and child mortality, low life expectancy) *Undernourished individuals, communities, and societies* fall far short of their creative, physical and economical potentials because of losses to poor nutrition: health and education expenditures are wasted because many of the recipients of these services never reach productive age; human spirits are constrained by enervation; opportunities for national development are foregone because of undeveloped human capital; and internal security is fragile as a result of frustration or dissatisfaction with the inadequacy of one of the basic necessitites of life: food.

Better nutrition is also an essential *output* of economic development. Unless health, life expectancy, and vitality are improved as a result of economic growth, development has not achieved its true objectives. In the long run, A.I.D.'s assistance to developing countries should be reflected in improved nutritional status. This will not come about automatically, however. It will require a conscious effort to include nutrition as a basis for resource allocation in strategies, programs and projects.

Approximately 600 million people in developing countries do not have access to enough food to meet their nutritional needs. Only a small portion of those people are clinically malnourished. The preponderance of them are mildly to moderately undernourished. Others are poorly nourished on a seasonal basis. Still more are at the margins of adequacy such that major illness, increases in food prices, or decreases in real income could force them into nutritional deficit. Although the largest number of calorie-deficient people are found in Asia, it is in Africa where the largest proportion of the total population consumes insufficient energy (see table).

[5] Throughout this paper "malnutrition" is used to describe a spectrum of nutrition problems including underconsumption, overconsumption, and nutrient imbalances. "Undernutrition" is specifically inadequate consumption and biological utilization of food.

Number of people (millions) and share of population with calorie intakes below 90% FAO/WHO requirements in selected countries by region, 1973

	Millions of People with Calorie Deficient Diets	As a Percent of Regional Population %	As A Percent of Total Calorie Deficient %
LAC	92	37%	15%
Asia	448	49%	75%
NE	34	33%	6%
Africa	25	53%	4%
	599	46%	

SOURCE: Reutlinger and Alderman. The Prevalence of Calorie-Deficient Diets in Developing Countries. World Development 8: 406, 1980.

II. Objective of the nutrition policy and its accomplishment

The objective of this policy is to maximize impact of A.I.D. development programs on nutritional well being of poor people in LDCs. This objective will be accomplished in development sectors through including nutrition and food consumption as factors in decision-making and cost-benefit analysis concerning strategies, programs, and projects. It can be accomplished through any or all of the following mechanisms.

1) identifying projects based on analysis of the nutrition problem;
2) designing projects to overcome constraints to meeting nutritional needs;
3) targeting projects to nutritionally at-risk groups;
4) monitoring and evaluating impacts of projects on nutrition and food consumption;
5) providing technically strong nutrition programs to (a) backstop activities in all development sectors, (b) supplement sectoral efforts to ensure effectiveness in meeting nutrition goals and (c) complement sectoral programs with specific nutrition project activities to enhance nutrition impact;
6) increasing the indigenous capacity in LDCs to analyse and overcome nutrition problems through promotion of multisectoral nutrition planning and appropriate national policies.

III. Elements of the Nutrition Policy

The nutrition policy of the Agency for International Development is to improve nutrition and food consumption through sectoral programs in agriculture and health and through direct nutrition programs when they are suited to achieving Agency objectives.

Nutrition policy concerns the factors that affect human food consumption and nutritional requirements, focusing on the needs and resources of the household, including health considerations, economic demand, and food use. Reciprocally, agriculture policy pertains to the factors that influence the production of food and other crops and agricultural employment generation. Food policy, which technically links consumption-oriented nutrition concerns with production-oriented agriculture perspectives, tends to focus on prices, imports and exports, aggregate demand, and national food security, with relatively little attention to questions of nutritional needs or food distribution at the household level. A.I.D.'s Food and Agriculture Development Assistance Paper[6] details the ways in which agriculture production, food supply, and family incomes can be increased. The successful implementation of the Food and Agriculture Policy will not solve all nutritional problems, nor should it. Agricultural projects can positively affect nutrition through the mechanisms detailed elsewhere in this paper. Those nutritional problems which are not most effectively or appropriately dealt with through agricultural development must be solved through health or other sectors or through direct nutrition programs. This policy paper articulates the Agency's nutrition policies and discusses the ways in which activities in agriculture, health, and other development sectors can positively affect nutrition in developing countries.

A.I.D.'s policy emphasizes coordination among sectors and between the field and Washington to maximize achievement of nutrition goals.

Because most project officers are not nutritionists, it is essential that missions make best use of outside technical experts and improve their inherent field capacity through training and enhancing field staff with nutritional expertise.

Integration of nutrition concerns throughout A.I.D.'s program is best institutionalized in the context of project, program and CDSS reviews and by providing technical input to sectoral strategies. More particularly, if a project is likely to affect the food system, health, or household labor and time, then the potential for nutritional impacts should be given careful consideration. Special attention will be given to such projects in missions which identify food production and malnutrition as major problems in the host country.

A. Problem Identification

A.I.D.'s nutrition policy places highest priority on alleviating undernutrition—that is, inadequate consumption of food.

Undernutrition can be traced to *insufficient food supply, inadequate access to food, insufficient*

[6] A.I.D. Food and Agricultural Development Assistance, March, 1982.

purchasing power, inappropriate demand patterns (due to taste, tradition, perceptions), *inequitable distribution* of food within countries, *inequitable allocation* to individuals within families, and/or *poor utilization of food.*

Part of the problem is inadequate food supply—of the 36 lowest income countries in the world (those with GNP less than U.S. $370 per capita per annum) in 1977, eleven had a food supply that provided less than 90% of the estimated aggregate human energy requirements; nineteen other countries had between 90% and 100% of food energy needs available.[7] In subsaharan Africa, average per capita food supplies have actually been decreasing over the last decade, although elsewhere in the world per capita food supply has increased slightly. Therefore programs in agriculture and population are essential to solving the nutrition problem in the long term.

The imbalance between growth in food supply and population increase may explain undernutrition on a macro or national level, but many countries with apparently adequate aggregate food supplies have high incidence of undernutrition. Some countries which are net food exporters still have serious nutrition problems.

On the regional, household, and individual level, the nutrition problem relates to many factors in addition to food supply. *Physical access*—markets, roads, transportation, production for auto-consumption—often limits the availability of food within and between regions of a country. Futhermore, *economic access and purchasing power* are usually limiting factors for the rural and urban poor. High consumer prices, low income, low producer prices, and unreliable employment may limit economic access to food. In many cases *food availability has a seasonal component* as well—preharvest hunger is common in subsistence economies. For this reason, improved productivity, on-farm grain storage, food preservation, local food security and seasonal employment can affect nutritional status.

Intrahousehold distribution of food is another determinant of nutritional status. Frequently women and young children receive less or lower quality food while the men and economically active children are given significantly more and better food. In many cases this is due to economic pragmatism: if the wage earners are hungry, they cannot work as hard, they will not earn as much money and the family will be worse off.[8] This problem can be addressed through culturally appropriate nutrition education and through direct nutrition programs (e.g., home gardens).

In that women's income seems to be spent preferentially on food, A.I.D. might also take advantage of such existing household allocation behaviors to address nutrition problems by specifically including women in income producing projects. The ways in which household resources are allocated, who makes the decisions, and how these processes change over time are just now being studied[9] so that guidance in using such processes to improve nutrition will be generated from the field.

Undernutrition is also related to high food needs or excessive nutritional losses. Human food needs are above average in developing countries because of higher energy expenditures in work, and high proportions of growing children and pregnant and lactating women. Excessive losses are due to infectious disease, intestinal parasites, and diarrhea.

Addressing protein inadequacy and micronutrient deficiencies is also important.

Dietary protein, Vitamin A, iron, iodine, and some B Vitamins are lacking in some areas of the world and for certain population groups. Technological solutions to these problems are available, although actual delivery of the technology has proven administratively difficult in some cases. Deficiencies may be inherent in the local diet or may result from agricultural or economic changes. In some parts of the world, the

[7] If all people consumed as much energy as they needed (and no more than they needed), then a food supply equal to 100% of caloric requirements would be needed nationally. When some people consume more than they need and others consume less, however, estimates of required food supply must be inflated to compensate for skewed overconsumption. In developing countries it is estimated that 110% of dietary energy requirements is needed in the food supply to compensate for that nutrient wastage by overconsumers. In cases where distribution is very skewed, even 110% of energy requirements may be too low.

[8] Recent reviews of the literature have shown that inequitable distribution of food within the household is ubiquitous. But uneven intra-household food allocation is not the only problem. Other research has shown that even if many low income families did distribute food according to relative requirements of each household member, no one would get enough to eat.

[9] Evidence is just beginning to emerge on this point. Some studies have indicated that children of working women are less likely to be malnourished than children of non-working women. In Kerala, for instance, it was found that women's income was twice as important in determining children's nutrition status as men's income. In the Philippines women's labor force participation was positively associated with caloric adequacy among children in the lowest income group although consumption of Vitamin A was reduced. Women's working is not always best for children, however most poor women in LDCs do participate in some form of work outside the home. The positive association of women's income and nutritional status of their children is mediated by various aspects of the compatability of women's productive and nurturing roles (e.g., the availability of childcare, homemaking services, and labor saving devices).

staple diet is often too bulky to satisfy the nutritional needs of small children simply because their small stomachs will not hold enough food. For these individuals increasing the nutrients per gram of food—"nutrient density"—is of high priority.

A "modern" diet can rapidly replace a traditional one, sometimes with deleterious short-term nutritional consequences. With increasing income, for instance, some poor families buy higher status less nutritious foods: polished rice instead of brown rice, sweets and snacks instead of staple grains.

B. Designing programs to address nutrition problems

A.I.D.'s policy is to include nutrition as a factor in program and project design.

1. Agriculture and rural development

Agricultural and multisectoral rural development programs comprise the bulk of A.I.D.'s development assistance budget both because agriculture is a major source of national income and because most people in LDCs live in rural areas. Through agricultural and rural development projects, A.I.D. is simultaneously helping to improve the food supply, economic base, and employment in those countries. In order to assure that agricultural goals are achieved and that the benefits of development reach the poor, however, the nutritional needs of the rural population and the nutritional impacts of development programs must be taken into account.

To address nutrition concerns within A.I.D.'s agricultural program, it is necessary to know *how the food produced reaches the ultimate consumer and how the income generated is ultimately spent on food* and other commodities. Increased food production or higher income does not **automatically** mean better nutritional status especially in the short term. Problems of food distribution and storage, income distribution, intra-household control over resources, and alternative (non-food) claims on financial resources all affect the production/nutrition equation.

Rural households which are nutritionally at-risk are often those with few productive resources—land, water, labor, or capital. They produce only an occasional marketable surplus and pursue limited economic activities. They may also be least able or willing to take risks, either because they are physically inaccessible or because they have the lowest margin for absorbing setbacks. Hence, their market returns may be low, and the technology they use different from that designed for and relevant to commercially-oriented farmers. To improve the productive capacity and hence the nutritional well-being of farmers who are not currently market oriented will require a strong emphasis on development of appropriate institutions as well as agricultural research and technology that is responsive to their needs and risk situtation. Improving the productive capacity of more resource-rich and commercially-oriented farmers is also important for nutrition since these farmers are likely to be the primary producers of urban food supplies.[10]

Incorporation of nutrition concerns into agriculture programs necessitates a balanced allocation of resources among short-term production-oriented investment, investments in long-term human resource development, and medium-term investments designed to ensure access to factors of production and markets, particularly for those rural and agricultural households which are nutritionally at-risk. There are trade offs and complementarities between meeting production/employment goals and meeting nutritional goals which should be taken into account by the mission staff when making program decisions.

Agricultural projects should anticipate changes in food consumption which accompany changes in cropping patterns.

When the cropping pattern, labor or resource allocation, seasonality of harvests or income is changed by an agricultural project, alterations are usually made within the household to accommodate them. Many of these changes are benign—but where food habits are changed there is a potential for negative nutritional impact. At the very least, projects affecting these factors should monitor nutritional status or food consumption of the target population.

Additional labor requirements for a new or improved crop may cause a farmer to plant less labor intensive and less nutritious household food crops (for example, cassava is planted instead of yams because the former requires less labor and is less sensitive to timing of cultivation and harvesting).[11] By providing off-season employment or interharvest crops such labor/food supply conflicts could be avoided or minimized.

When cash crops are harvested once per year, householders may be cash short in the non-harvest season and unless they have planted a food crop, they may not be able to buy sufficient food for

[10] Innovations which keep costs of production down, no matter what the size of farm, will help to assure that the food supply is available at a reasonable cost, and will enhance overall purchasing power.

[11] This phenomenon happened in West Africa where the introduction of cocoa induced a change from yams to cassava because the women has less time to spend harvesting their subsistence crops.

their needs. Moreover, when a large number of farmers in a region convert acreage from food crops to cash crops, local food supplies may be limited and increase in price unless local transportation and marketing mechanisms are improved. Lower income farmers are particularly vulnerable to seasonal variations in food supply and income because a larger proportion of their income is spent on food and because they are most likely to have smaller food reserves. Therefore, attention should be paid to the institutions on which the household food systems depend.

The new cash crop farmer may not be able to purchase the foods in his traditional diet in the quantitites which used to be consumed from subsistence production. In order to fill stomachs, therefore, he may have to purchase less expensive and less nutritious foods. Also, when cash income replaces food income, there is a higher likelihood that non-food items will claim a portion of the household budget.[12] In commercial agricultural production projects, positive nutrition impacts can be enhanced through complementary nutrition components like nutrition education and home gardens.

Recently, attention has been directed at farming systems, particularly to the physical and temporal constraints to increasing productivity by smallholders. Because farming systems programs are inherently multi-sectoral in focus, they offer a good vehicle for adding nutrition activities where needed and appropriate.

Agricultural projects should anticipate nutritional impacts of labor requirements.

Human energy and time are frequently the scarcest resources in farm families, especially in subsistence and female-headed households. Even on commercial farms, labor is frequently scarce for peak cultivation and harvest activities. Some agricultural improvements are more labor intensive than traditional methods. For instance, new rice varieties require more time and energy to cultivate than traditional varieties. Where unemployment is high, such innovations can have positive effects on income and food consumption. On farms which cannot hire labor, energy- and time-saving technology in the form of low cost innovations which are also capital-saving (e.g., hand pumps, small-scale grain mills) can be vital elements of a strategy to improve nutritional status.[13]

Current A.I.D. policy emphasizes the importance of employment generation as a component of agricultural and rural development. For maximum nutrition impact, employment opportunities should be directed to high nutritional risk groups and spread evenly throughout the year, to assure steady income to meet food needs and discourage labor migration, or properly timed with seasonal food shortages (usually in the preharvest period) to raise income at a time that food deficits must be made up through purchases. At a minimum, wages should be commensurate with energy costs of the work. In one Latin American country it was found that the introduction of sisal into local agriculture pushed farmers into caloric deficit because their energy expenditures in sisal processing exceeded the amount of food energy they could buy with their wages. The new technology, in short, introduced an extra nutrition cost.[14]

On- and Off-farm employment can strengthen intrahousehold resource allocation patterns which improve nutrition.

When women's employment is encouraged, efforts should be taken to facilitate good child care and nutritional practices, including the encouragement of proper infant feeding practices. Frequently when rural women are employed outside the home, infants are cared for by siblings (often not much older than themselves) or elderly family members. The quality of care and food provided to the child may be inadequate under such conditions and the caretaker, often a young girl, may be missing out on educational opportunities because her services are needed at home. By providing work close to home, allowing infants to be brought to work, provision of child care facilities or services, and training caretakers in proper child care practices, potential negative effects could be minimized.

Evidence has been accumulating to indicate that *who* earns the income is almost as important as *how much* is earned. The adult male usually

[12] The impact of cash cropping on nutrition is a complex issue. Although increased income is the "long term" solution to the nutrition problem for most at-risk households, the improvement in nutrition is not automatic in the short term. Studies have shown that some income generating agricultural activities fail to improve nutrition. Frequently the benefits of additional income are undermined by time constraints of the mother, insufficient complementary health services, inadequate education of the mother resulting in poor food purchasing habits, contaminated water supplies, and seasonal or erratic receipts of income which cause money management problems in the household. Nevertheless, families frequently find it difficult to return to food crops once they have cultivated cash crops.

[13] Poorer households must use a larger proportion of their labor supply, (i.e., number of work days per family is higher than wealthier households) to satisfy their food needs. Women and children in particular have been shown to have significantly higher work loads in poor families.

[14] Gross, D. R., and B. A. Underwood. Technological Change and Caloric Costs: Sisal Agriculture in Northeastern Brazil. Am. Anthro. 73:725-740, 1971.

decides how his income will be spent and gives a portion to the female head-of-household for household necessities (mostly food) but the proportion of his income spent on food is usually lower than that of women's income. In addressing nutrition problems through employment generation, project designers should understand and take into account the ways in which different household members use their income. (See footnote 9).

Agricultural research should address food consumption patterns of at-risk groups and recognize their technological and capital constraints.

Increasing the nutritional content of crops through genetic manipulation is but a small part of the potential nutritional impact of agricultural research. Far greater nutritional improvements are likely to result from research improving productivity, reliability, and food processing characteristics of basic food crops which are grown and/or consumed by nutritionally at-risk groups and by incorporating certain technological and resource assumptions into plant breeding. Research on basic food crops like cassava and millet can have major implications for nutrition. Recent research on cassava, for instance, has focused on breeding a plant which can survive with very few leaves. Because cassava leaves are a major source of nutrients in the preharvest period in some cultures, the introduction of this new plant will enable farmers to eat both the leaves and the roots. Crops which require large amounts of fertilizer and water, those for which there are economies of scale, and those that require mechanization for cultivation, harvesting, or processing will not be well-suited to those farmers who cannot get credit and who have few available capital resources. Those are the same farmers who are probably poorly nourished and have the greatest nutritional need.

2. Health

Promotion of good health is essential to meeting the nutritional objectives of the Agency.

The interaction between nutrition and infection is well-known.[15] A poorly nourished individual has an impaired immune system which means not only that he is more susceptible to disease, but also that treatment may not be as effective. In addition, certain infections raise nutritional requirements, reduce nutrient absorption, or decrease appetite—all of which lower nutritional status. For these reasons, nutritional well-being is both a precursor and a product of good health.

Nutrition objectives should be addressed in the health sector through primary health care.

One of the main emphases of A.I.D. health policy is primary health care delivery and the nutritional aspects of good health are stressed. Preventive health care—immunization programs, environmental sanitation, parasite control, health and nutrition education, growth monitoring, prenatal care, and well-baby clinics, etc.—is the focus of A.I.D.'s health policy and an important element in its nutrition policy as well. It is extremely important, for example, to reach pregnant women and preschool children in order to avoid the permanent damage which can result from malnutrition in early life. Health care is necessary, although not sufficient, for good nutrition. Improving prenatal maternal nutrition can be an effective way of reducing infant mortality through increasing birthweights of infants and increasing maternal nutrient stores.

Growth monitoring is a low cost preventive health care measure with major nutritional significance.

Growth monitoring involves the periodic weighing of preschool children and using that information to target health care, health or nutrition education, family planning, or supplementary feeding programs to mothers of children whose growth is faltering.

Growth monitoring of preschool children carried out by community workers is an ideal way to break the downward spiral in health caused by repeated incidents of infection and malnutrition. It has been found that mothers usually do not know that their children are not growing properly until they exhibit the physical manifestations of clinical malnutrition.[16] Growth monitoring alerts the mother early that her child's health is deteriorating and enables the family to treat the problem while the solution is still within its means. In many countries, growth monitoring has proved to be effective and inexpensive. Because it depends on and tends to generate sustained community effort, growth monitoring can be a vehicle for institution-building and increasing utilization of primary health care and other basic services in the community. Proper timing of inoculations, preventive health care, proper weaning practices, home-based treatment of diarrhea (oral rehydration therapy), and family planning can all be encouraged through growth monitoring.

[15] Chandra, R. K. Immunodeficiency in undernutrition and overnutrition. Nutrition Rev. 39:225, 1981. Scrimshaw, N. S. et. al. **Interactions of Nutrition and Infection.** Geneva: WHO, 1968. (Monograph Series No. 57).

[16] Griffiths, M. **Growth Monitoring.** Washington: Am. Pub. Hth. Assoc., 1981.

It is the policy of A.I.D. to support breastfeeding and proper infant feeding practices.

Traditionally infants were breastfed for two or more years but now "modern" women bottlefeed their infants, often without knowing enough about the nutritional needs of infants. Babies fed barley water, cornstarch gruels, and diluted infant formulas, often prepared with unsafe water and contaminated utensils, may die before their mothers find out how to feed them properly. The more serious problem in rural areas is late introduction of complementary foods to breastfed infants. Proper complementary feeding of the weaning child is often a problem of dietary practices, home food preparation and preservation constraints, and other demands on women's time. A more multifaceted approach, going beyond breastfeeding promotion and food availability is therefore often required. Nutrition education, including encouragement of breastfeeding, improved child feeding practices, food fortification, and strong national nutrition policies, can avert these negative nutritional impacts.

Environmental health measures are another means of averting nutrition problems.

Other nutrition enhancing health activities are inoculations for common diseases (BCG, measles) and health education aimed at changing behavior or conditions that expose children to parasites and intestinal disease. Malaria, schistosomiasis, tuberculosis, and cholera are endemic public health problems which heavily affect nutritional status in many parts of the world. Controlling these diseases will also reinforce the nutritional impacts of improved food supply and consumption.

Provision of community water supply and installation of latrines should be encouraged as a part of the general development strategy in health project areas.

Parasites and gastrointestinal disease could be substantially reduced through improved hygiene. The preschool child's feces can be a major source of infections in the household unless the mother takes adequate precautions. Where water is not readily available, however, hygiene education may be less important than water supply. Therefore provision of an adequate water supply can be part of incorporating nutrition into health projects.[17]

[17] Intestinal parasites may consume up to 25% of dietary intake. Therefore eliminating parasites and infectious disease is a necessary element in solving nutrition problems. Unsanitary and inaccessible water supply has been shown to affect nutrition adversely in several countries. See A.I.D./PPC. Domestic Water and Sanitation Policy Paper, 1982.

3. **Food Assistance**

The Agricultural Trade Development and Assistance Act of 1954 (PL 480) provides for concessional sales of U.S agricultural commodities to LDC governments (Titles I and III) and provides food donations for famine relief, combatting malnutrition, and promoting economic and community development (Title II).

As a major resource transfer (Titles I and III), PL 480 can be used to support and encourage good development policies. (This is discussed in detail in the Food and Development Discussion Paper.[18]) In the area of nutrition, such policy reforms could include a functional national nutrition policy, nutrition monitoring systems, and manageable, well-targeted subsidized consumption system for the lowest income groups, or nutrition-responsive agricultural policies. The foods themselves can have nutritional impact if carefully programmed and targeted. If food aid had a disincentive effect on local agriculture it could adversely affect nutrition, so attention must be paid to this aspect of food aid. Furthermore, the food commodities can change tastes and cause shifts in demand for local and imported foodstuffs.

Nutrition improvement has been one of the major objectives of Title II in the past. To achieve this objective, significant changes in A.I.D.'s programs are called for, including better targeting, specifically to reach malnourished preschool children and pregnant and lactating women, appropriate ration sizes, and inclusion of nutrition education along with the supplemental food.

Title II, as emergency relief, has obvious nutritional and humanitarian importance, and it can also be used to overcome short-term household food supply shortages.

In some settings, Title II may be useful for household feeding or as a resource for health, education, family planning, and income generating activities. Title II is also one of the few means available to A.I.D. for overcoming urban malnutrition, a growing problem throughout the developing world. The Bureau of Food for Peace and Voluntary Assistance is currently reviewing the objectives and guidelines for more effective programs of Title II and will shortly be issuing guidance to the field on this issue.

[18] A.I.D./PPC, **Food Aid and Development: A Policy Discussion Paper**, Washington, D.C.: August 1981. Other papers and reports are being or will be prepared by the A.I.D. Bureaus for Program and Policy Coordination and Food for Peace and Voluntary Assistance.

4. Population

Nutrition both affects and is affected by fertility levels.

High rates of population growth tend to limit per capita development gains and overload the physical and economic infrastructure of LDCs. The direct impact of high birth rates, however, is most visible at the household level—in high ratios of non-productive to productive household members, and in the biological, physical, and temporal stresses on women caused by frequent childbearing. Infant mortality (often due to poor prenatal nutrition of the mother and postnatal nutrition of the infant) is considerably higher when birth intervals are short.

Programs which join provision of voluntary family planning with efforts to combat undernutrition can be cost-effective and culturally acceptable. In one Asian country, for instance, a growth monitoring and primary health care program has been added to the national voluntary family planning program, in large part because it is clear that further reductions in fertility may come only when parents believe that each child born will survive to adulthood.

Nutrition and family planning programs should be linked wherever possible.

Growth monitoring can be an important tool in linking nutrition and family planning programs, because the faltering growth rate of the infant indicates the need for introduction of weaning foods and the return of fertility in post-partum women. Breastfeeding reduces fertility the most when the infant is fully breastfed. Providing voluntary family planning services at a health clinic or food distribution program site will save time for the mother who seeks these services and encourage her to associate good health, nutritious food, and the conscious choice about family size. Coincidence of services can also be cost-effective by economizing on building, training and management costs, but care must be taken not to overload community workers who deliver these services.

5. Education and Training

Promotion of basic education will contribute to improved nutrition.

Although education is not considered to be a nutrition intervention **per se**, good nutritional status in children is frequently associated with literacy and educational attainment of the parents, particularly of the mother. In the long run, extension of basic education, particularly to females, will have positive impacts on nutrition in the household.

Nutrition education in schools can promote better food consumption in the family.

In the short term, schools can be an important avenue for improving nutrition, not only through nutrition education (e.g., home economics) but also through allied school activities (e.g., school gardens). Particular emphasis should be given to the nutritional value of local foods, purchasing foods to maximize nutritional value, storing, processing and preparing food to maintain nutritional value and hygiene education. At a minimum, schools must have basic sanitary facilities and water, since most of the content of nutrition and hygiene education involves food handling and personal and community sanitary practices. Efforts should be made to extend nutrition education to the rest of the family through nonformal education, mass media, and community demonstrations.

Training programs for community outreach workers should include basic nutrition.

In some countries, government and community outreach workers make periodic visits to the households of nutritionally at-risk groups. In setting up training programs for agricultural extension workers, social workers, medical personnel, and community volunteers, attention should be directed to how malnutrition affects the households they visit and how their activities can influence nutrition. Nutritional "first aid" and referral (e.g., in the case of oral rehydration) could also be taught. Although nutrition would be a small component of their training, its inclusion would greatly increase public consciousness of nutrition problems and improve informal nutrition monitoring of the community.

Advanced training in nutrition is needed in many LDCs.

Higher level training in nutrition is also needed. Development planners, economists, agriculturalists, educators, physicians and nurses, must be cognizant of the community's nutrition problems and of the possible nutritional implications of their work. There is a serious lack of nutrition planners in LDCs. If A.I.D.'s efforts in nutrition are to become self-sustaining, the countries must have a local capacity to assume responsibility for problem analysis and program implementation.

C. Targeting based on nutrition

A.I.D. policy is to target sectoral projects whenever feasible to households and individuals at-risk of developing nutritional problems.

Nutritional risk is the probability that someone will develop a nutritional problem. Women of

childbearing age, infants, and preschool children have traditionally been called "vulnerable groups" because they are at high nutritional risk due to their increased physical needs. In addition, certain *households* are more likely to have malnourished members than others, and these can be identified through a system of "functional classification," for instance by income groups, landholding, crop production system, or household composition. High nutritional risk has been associated with geographic isolation, small landholding, occupation (fishermen, landless workers), low or scheduled caste, household composition (polygynous and female-headed households), low income, and low socioeconomic status (illiteracy, unemployment). The classification itself varies from country to country.

The method used for targeting development programs depends in large part on the type of project proposed. Primary health care programs, for instance, deal with individuals or groups of individuals; hence it makes sense to give particular attention to those **individuals** at highest nutritional risk. Agricultural programs on the other hand, tend to focus directly or indirectly on **households, communities, or regions**, and therefore can use **functional classification** of these units as the basis for targeting.

To determine nutritional risk, it is necessary to link nutrition status or consumption data to individual or household characteristics. Frequently such data do not exist in a usable form for such analysis. Low cost small-scale surveys and complementary computer software can be used to determine nutritional risk rapidly and inexpensively for small areas. Pre-existing national data can frequently be manipulated to yield useful information for targeting also.[19] Consumer price indexes, for example, are frequently based on household consumption and expenditure surveys.

An example of the uses of functional classification is the Integrated Agricultural Development Project in Palawan, Philippines. Secondary data supplemented by a small in-depth nutrition study in the project area identified highland slash-and-burn farmers and fishermen as high-nutritional-risk groups. Subsequently, the project gave particular attention to those groups and emphasized food production for the upland farmers. Decisions about provision of roads and water were based partly on consideration of these at-risk groups, and specific nutrition components were added onto the general agricultural and rural development efforts to enhance their nutritional impact.

[19] To date functional classification has been used to identify nutrition problems in Costa Rica, El Salvador, Philippines, Zambia, Sri Lanka, Kenya and Haiti.

D. Evaluating Nutrition Impacts

It is the policy of the Agency to monitor and evaluate nutrition impacts of projects that are likely to affect health, food production or food consumption.

Most agricultural and health project officers are sensitive to nutritional considerations and identify alleviation of malnutrition as a legitimate project goal. Nutritional impacts are not always measured however.

Nutrition effects can be anticipated by systematically reviewing the ways in which a project might affect nutritional status and by instituting monitoring systems for those variables most likely to be directly affected. Some obvious factors affecting nutritional status include:

— food and nutrient availability at the individual, household, and community level, especially in the preharvest period;

— response of food purchases to price and income changes;

— allocation of food among family members;

— household nutritional needs;

— food preparation, processing, procurement and storage;

— food security at the household level;

— resources necessary for food utilization (fuelwood, water, time, human energy);

— cultural food practices and beliefs;

— environmental health and parasitism;

— purchasing power of high-risk households and cost of an adequate diet.

A cost effective way to measure nutritional impact is to carry out small cross-sectional surveys of food consumption of groups or nutrition status (usually height and weight of children) of individuals or households.

Nutrition status surveys of a statistical sample of children can indicate changes in nutrition over the life of project. Measures of food consumption of groups, if carefully done by experienced scientists, will also measure impacts of projects on target households. In one African country, monthly information on food production, land, labor use, and income of smallholders has been linked to intermittent surveys of nutritional status of preschool children to monitor nutritional trends. In an Asian country the community infant weighing program has enabled monitoring of project impacts in some areas. A.I.D. is currently supporting efforts in twelve countries

to set up nutritional monitoring systems which can be used to assess project impacts.

To estimate nutritional impacts of projects, it may not be necessary to measure changes in nutritional status directly or comprehensively, although that is preferable.

Nutritional impact can be roughly estimated using non-nutrition data. For instance, monitoring local prices of major basic foods (e.g., cassava or paddy rice) can provide a relatively sensitive measure of how low-income consumers are likely to be affected by supply changes, in areas where agricultural prices are not fixed. Supplies of foods in local markets and granaries, infant mortality rates (using a base population of at least 10,000), local wages, and incomes of at-risk households can also provide evidence of probable outcomes if the linkages between indicators and causes of undernutrition are well-understood and if the indicators are of reasonable quality.

These techniques need to be supplemented by knowledge of intrahousehold economic activities including production of commodities for home consumption. Understanding the social, cultural and institutional context in which projects are implemented can help a project designer avoid potentially negative impacts and maximize positive effects of development activities. In one area, a livestock management program was designed to encourage cattle owners to sell the animals at two years of age. The project originally ignored the fact that women milked the older cows, thus providing an important nutritional supplement to their children's diet. Modification in the project design made it possible to avoid what would have been an extremely harmful secondary impact of this income generation project.

E. Complementing sectoral programs with nutrition projects

Nutrition projects should complement sectoral programs to enhance nutritional impact when they are suited to meeting Agency goals.

Nutritional projects play an essential role in extending and refining A.I.D.'s efforts at alleviating malnutrition. Food fortification, nutrition education including non-formal education through mass media, food technology development, nutrition planning, and promotion of proper infant feeding practices, have formed the backbone of technical nutrition support in the past and should continue both to address nutrition problems directly and to complement more indirect projects. For instance, where agricultural programs are focused on raising household income, a nutrition education component should assure that the household has information on the nutritional implications of alternative uses of the new income and changes in the traditional diet.

F. Utilizing the private sector

In many cases, private sector initiatives can enhance public investments particularly in the areas of agribusiness, food processing, and fortification. The private sector may also hold the key to solving problems of urban malnutrition when they are due to inadequate food marketing and distribution systems. Where possible, private sector efforts should be encouraged. The recent effort by A.I.D. to provide technical assistance to food industries in developing countries through private sector representatives is illustrative of the types of collaboration A.I.D. seeks.

G. Improving Policies

A.I.D. supports inclusion of nutrition considerations in national policies.

A.I.D. continues to endorse multisectoral nutrition policies in host countries. National agricultural planners and policy makers should consider the effects of food and agricultural policies on regional and local food supplies, producer price stability, and food consumption, especially by nutritionally at-risk groups.[20] They should also be encouraged to set up nutrition monitoring systems to facilitate such analysis. Health policy should focus on preventive health care and inclusion of nutrition components in primary health care. Education and population policies should take into account the nutrition factor as an input to and product of successful sectoral strategies.

H. Coordination

Many bilateral and multilateral donors have programs designed to improve nutrition. A.I.D. actively seeks opportunities for coordination of nutrition activities within countries. Cofinancing different components of nutrition-related programs and complementarity among programs by different donors are strongly supported. A.I.D. encourages host country policies which effectively utilize all available private, public and voluntary organizations to meet overall development goals.

---

[20] A.I.D., in conjunction with the Nutrition Economics Group at U.S.D.A., has supported and will continue to support research and technical assistance to missions in this area.

Conclusions

A number of conclusions emerge from this review of A.I.D.'s nutrition policy and objectives. First, nutritional well-being is not only a necessary input in the development process; it is also an essential output. Hence, efforts to alleviate undernutrition are an integral element of A.I.D.'s overall development assistance program.

Second, the greatest lasting improvements in nutrition in LDCs are likely to result from changes which incorporate nutritional considerations in the design of programs in other economic sectors—especially agriculture, rural development and health. Hence, this paper has devoted a great deal of attention to policy issues in the design and implementation of agriculture, health, education, family planning and other development activities. Direct nutrition projects are an important complement to such activities.

Third, the United States has a key role to play in helping developing countries overcome their nutrition problems—through its multisectoral approach to economic development, its commitment to improving food security in the Third World, its strong research and development capacity in the biomedical and operations research areas, as well as its commitment to experimentation in search of more cost-effective approaches to improvements in basic services in LDCs. Furthermore, the U.S. food industry has much to share with LDCs in promoting a safe, nutritious, and reliable food supply.

Finally, in order to maximize the impact of A.I.D.'s development programs on the nutritional well-being of the citizens of developing countries, A.I.D. will give increasing attention, through research, analysis, experimental projects, and programs to improve host country and Agency ability to:

— identify nutrition problems;

— utilize the private sector whenever feasible to implement the policy;

— design projects to overcome or minimize constraints to meeting nutritional needs of the at-risk population

— target projects to at-risk groups;

— monitor the impacts of development projects on food consumption and nutrition;

— add nutrition components or programs to enhance nutrition impact; and

— strengthen the capacity of indigenous organizations to analyze and overcome nutrition problems.

Selected Bibliography

Intrahousehold Allocation of Food and other Resources and Impact of Women's Work on the Household

Nieves, I. A Balancing Act: Strategies to Cope with Work and Motherhood in Developing Countries. Paper presented at International Center for Research on Women Roundtable, 1981.

Protein Advisory Group of the United Nations. Women in Food Production, Food Handling and Nutrition, 1977.

Safilios-Rothschild, C. The Role of the Family: A Neglected Aspect of Poverty. World Bank, 1980.

U.S. Department of Agriculture: Consumer Economics Group. Intrafamily Food Distribution, Review of the Literature and Policy Implications, 1982.

Functional Classification of Malnutrition

A.I.D., Office of Nutrition. Nutrition Surveillance: Review of Progress. 1981

F.A.O. Introducing Nutrition in Agricultural and Rural Development, Case Studies. 1982.

Omawale. Nutrition Problem Identification and Development Policy Implications. Ecology of Food and Nutrition 9:113-122, 1980.

Effect of Agricultural Development on Nutrition

Eide, W.B. and F.C. Steady. Individual and Social Energy Flows in Jerome, N.F., R.F. Kandel and G.H. Pelto (Eds.) **Nutrition Anthropology: Contemporary Approaches to Diet and Culture.** Pleasantville, N.Y.: Redgrave Press, 1980.

Fleuret, P. and A. Fleuret. Nutrition, Consumption, and Agricultural Change. Human Organization 39 (3): 250-260, 1980.

Pinstrup–Anderson, Per. Nutritional Consequences of Agricultural Projects; Conceptual Relationships and Assessment Approaches. Washington: World Bank, 1981. World Bank Staff Working Paper 456.

Savane, M.A. Implications for women and their work of introducing nutritional considerations into agricultural and rural development projects. Food and Nutrition Bulletin 3 (3): 1-5, 1981.

II.D (TM 1:34)
11/9/84

A.I.D. Policy Paper

POPULATION ASSISTANCE

U.S. Agency for International Development
Washington, D.C. 20523

September 1982

II.D (TM 1:34)
11/9/84

A.I.D. Policy Paper

Population Assistance

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

September 1982

TABLE OF CONTENTS

Page

Executive Summary 1

I. Background 2

A. Population Growth in Developing Countries 2
B. Implications for Economic Development 2
C. Family Planning in the LDC Setting 3
D. Factors Influencing Fertility 3
(1) Health 3
(2) Education 3
(3) Income/Employment 4
(4) Urbanization 4
E. The Role of Modern Contraception 4

II. The U.S. Population Assistance Program 4

A. A.I.D. Policy Objectives 4
B. Population Program Assistance Activities 5
C. Specific Policies Governing U.S. Population Assistance 6
(1) Abortion 6
(2) Voluntary Sterilization 7
(3) Natural Family Planning 7
(4) The Relationship between Population and General Development 8
(5) Contraceptives 8

III. Factors Affecting Policy Implementation 8

A. Host Country Policies 9
B. Private Sector 9
C. Institutional Development 10
D. Technology Transfer 10

IV. Conclusion 11

V. Annex 11

Executive Summary

Assistance for voluntary population and family planning programs is an essential part of a cost-effective program of U.S. development assistance. Continued high rates of population growth significantly increase the cost and difficulty of achieving basic development objectives by imposing burdens on economies presently unable to provide sufficient goods and services for the growing population. Family planning assistance materially advances social and economic development; enhances individual freedom to choose voluntarily the number and spacing of children; and, provides critically important health benefits for mothers and young children.

Although only one of many challenges confronting less developed countries (LDCs), rapid population growth compounds the already serious and costly problems faced by LDC public and private sectors. Population and family planning policies and programs alone will not achieve economic miracles; they must be undertaken in conjunction with other economic and social measures to promote comprehensive development.

The need for voluntary family planning has never been greater. In the next twenty years, the world's population is projected to grow by almost 2 billion, and 90 percent of that growth is expected to occur in developing countries. There are already hundreds of millions of couples in the Third World, most of whom do not currently have access to modern family planning methods, who want smaller, healthier families. Twenty-five years ago only a handful of developing countries explicitly recognized the problems posed by rapid population growth; today over 60 LDCs, containing over three-fourths of the total developing world population, have adopted policies which address population growth.

A.I.D's experience in countries such as Thailand, Colombia, South Korea, and Indonesia demonstrates that a balanced program which provides modern contraceptive services and information, combined with strong community and family support for family planning, is the most effective way of helping couples achieve their fertility goals.

The underlying principles of U.S. assistance for family planning are voluntarism and informed choice. The implementation of A.I.D. assistance for population activities is governed by legislative requirements as well as A.I.D. policies. Specific legislation prohibits the use of U.S. government funds for abortion-related activities and requires all sterilization programs supported by A.I.D. to be shown to be truly voluntary. U.S. development assistance is not conditioned on the host government adopting a particular population policy; nevertheless A.I.D. actively seeks and responds to opportunities for policy discussions on voluntary family planning. A.I.D. intends to capitalize on the flexibility and innovativeness of the private sector as an important channel for the development and delivery of safe, effective contraceptives. A.I.D. also stresses the involvement of local institutions, and supports efforts to strengthen them.

The major focus of the U.S. program is voluntary family planning service delivery. The U.S. also supports dissemination of family planning information and education, including natural family planning; training for service providers; research on new contraceptive methods and improved delivery systems; and demographic and social science research and analysis designed both to improve voluntary family planning programs and to assist LDCs develop and improve their development policies and programs. U.S. population assistance supports the work of private voluntary and profit-making organizations and universities; multilateral and international population agencies; and LDC governments through bilateral agreements.

I. Background

A. Population Growth in Developing Countries

The 1982 world population is 4.6 billion and is growing at an increment of about 78 million annually. Ninety percent of this growth is occurring in less developed countries. Indeed, between 1980 and 2000, the number of women of child bearing age will grow by more than 60 percent or 480 million. The developing world's population of about 3.4 billion is growing at 2.1 percent annually; at this rate, it will double in 33 years. By contrast, the population of the developed countries will double in 116 years at the present rate of increase.

The world's rapid population growth is a recent phenomenon. Only several decades ago, the population of developing countries was relatively stable, the result of a balance between high fertility and high mortality. Life was a high risk proposition. Often, only one in two children survived infancy and early childhood. Epidemics, debilitating diseases exacerbated by chronic malnutrition, and extremely poor public health conditions all made early death an ever-present threat. Against these risks, fertility had to be high in order to assure that families survived. High fertility, far from being a problem, was a necessity.

More recently, developing countries have experienced extraordinary changes in their societies and economies, and the changes have been, for the most part, destabilizing ones—both demographically and socially. Death rates have dropped dramatically as nutrition has improved and the major causes of population-wide epidemics have been brought under control. Birth rates have also risen in some areas, as the traditional customs and taboos which tended to space and limit births have been dropped by the younger generation whose values and prospects differ from those of their parents. Populations began to expand rapidly as the traditional short and rather risky life expectancy gave way to one where the chance of staying alive had never been better.

B. Implications for Economic Development

Sustained economic development and the achievement of a decent life for LDC citizens can only occur when population growth no longer outpaces economic progress. The factors that can inhibit progress toward self-sustaining economic growth as well as frustrate individual and national aspirations include the following problems associated with high birth rates and rapid population growth:

- high dependency ratios;
- excessive exploitation of existing resources;
- low levels of household savings and investment which in turn can slow the development of markets for domestically produced and imported consumer goods;
- low labor productivity as the labor force expands more rapidly than the demand for new workers;
- inability to maintain, much less improve, basic services and human capital investments (health, education, technical training) which not only can diminish the future productivity of the country but can also result in both social and political instability;
- inability to take advantage of new technologies because the infrastructure and the financial and human capital necessary to make effective use of technological advances are lacking.

To speak of the impact of population growth in global terms alone, however, is to fail to appreciate the real impact on individuals, families and nations. The demographic transition (high to low rates of population growth) is characterized by unevenness, both between and within countries. The process of modernization, hastened in some countries by sound government policies, a vigorous private sector, and effective development assistance, has brought with it dramatic changes in many aspects of public and private life, among them a desire for smaller families and declining birth rates. In other less developed countries, or even in remote areas of countries which have enjoyed substantial economic progress, high fertility and lack of adequate resources may place severe strains on individuals, families and communities. In such circumstances population growth can inhibit improvements in living conditions and economic progress; at the same time, the options open to individuals to plan the number and spacing of their children may be circumscribed by lack of family planning information, education or services or by social and economic conditions which militate against understanding and effective use of modern family planning methods. Finally, especially in poor areas, the health and nutrition status of women and children is linked to their ability to regulate their fertility safely and effectively. Maternal mortality rises with the number of births and in-

fant mortality with births too closely spaced. Complications of pregnancy are more frequent among women who are very young or at the end of their reproductive years. While medical problems are associated with frequent and numerous pregnancies in all countries, in societies with wide-spread malnutrition and inadequate health conditions these problems are exacerbated. In turn, under such conditions, numerous and closely spaced births lead to even greater malnutrition of mothers and infants.

C. Family Planning in the LDC Setting

Developing countries vary considerably, not only in their socioeconomic settings and the type of infrastructures through which basic services, including organized family planning services, may be delivered, but also in their official policies on population. However, the vast majority of LDC governments support or accept family planning services, both as a means of lowering population growth rates and stabilizing the absolute size of the population, and as a means of improving maternal and child health through birth-spacing. Presently, over three-fourths of the people in the developing world live in countries with policies supporting the provision of voluntary family planning services.

The concept of spacing or limiting births is not new, nor is it Western. Traditionally, for instance in Africa, birth spacing has been ensured by long periods of abstinence or separation following a birth, and extended breastfeeding. Abortion and infanticide (or neglect of children leading to death) have been and continue to be means by which family size is limited in many places where modern family planning methods are unavailable. Modern family planning services provide a safe, effective and humane substitute for traditional methods which are no longer practicable or are less effective, safe or humane.

Demand for and effective utilization of family planning services tend to accompany progress in other development sectors. Among the factors that have been most responsible for the dramatic and rather rapid changes in attitudes about family size have been improvements in health, education, and employment opportunities (especially for women), and the ubiquitous phenomenon of urbanization. Additionally, modern family planning services, where accompanied by information and education about the concept and methods of birth spacing, contribute to increased demand for services.

D. Factors Influencing Fertility

Demographers agree that four direct biological factors determine fertility patterns: breastfeeding and lactation patterns, age at which sexual activity is initiated, contraceptive utilization and induced abortion. These determinants control the initiation of sexual activity, conception following intercourse, or births resulting from conception. A wide range of social, economic and cultural factors in turn influence fertility through one of these four "direct" determinants. Perhaps the most significant of these socioeconomic or "indirect" determinants are health, female education, employment/income and urbanization. The interaction between the direct and indirect determinants of fertility is complex; however, on-going research and the evidence from field programs are beginning to offer some rather specific programmatic suggestions.

(1) Health

One of the reasons for high fertility levels in LDCs is high infant and child mortality. Traditionally, as discussed above, couples in LDCs wanted and needed large families. Where 20-30 percent of infants died before their first birthday, parents chose to have a certain number of "insurance births" to assure that a critical number of children would survive to adulthood. As general health conditions improve and infant mortality declines, the need for insurance births is greatly reduced and interest in family planning increases.[1] The relationship works the other way as well; family planning helps to lengthen the time between births, which in turn promotes the health and survival of both mother and infant.

(2) Education

Education of females appears to have a profound effect on fertility, especially when girls are able to complete the primary grades. Where initial improvements in female enrollment result in less than primary school completion, fertility tends to rise with rising educational attainment. Although the pattern varies greatly from country to country and region to region, and exceptions can be cited, it appears generally to be the case that where additional schooling takes girls beyond primary school, fertility tends to fall as

[1]The initial result of lower infant mortality may be a higher number of living children per woman since more infants survive. Fertility declines follow this initial rise.

education rises. As women become better educated, enter the wage economy, and have some measure of control over their earnings, their role in the family and the community changes. Education broadens women's horizons and predisposes them to accept new ways and ideas. Preference for smaller families, use of family planning, and later marriage all appear to be more acceptable to women who have been educated beyond the primary level, and all are correlated with lower fertility.

On the other hand, the prospects for education and training of women and girls can often be thwarted by their own fertility. Delay of childbearing either through postponement of marriage or the birth of the first child can allow girls the chance to complete higher education or training. And, with a smaller family size there is less need for girls to stay out of school to care for younger siblings.

(3) Income/Employment

Employment of women, especially outside the home, increases the opportunity costs of raising children, makes a smaller family a more attractive option, and heightens interest in the use of family planning to achieve the desired family size. The role of income *per se* in bringing birth rates down is less well understood. As aggregate income rises initially so does fertility, but with further increases in income the trend reverses, and fertility begins to drop. The threshold at which the trend reverses varies from country to country, and unfortunately has not been well defined.

(4) Urbanization

Urbanization brings with it more education, higher net costs of children, lower infant mortality, greater access to modern sector employment for women, and easier access to contraceptives. The result is a consistently lower incidence of births among urban women, who have roughly 25 percent fewer children on average than do women in rural areas. Probably the most significant difference between urban and rural women is their use of contraceptives. Contraceptive use is a function both of the desire to space births or limit family size and the availability of and access to appropriate modern methods of family planning. In urban settings those factors affecting demand for, as well as supply of, modern contraceptives are likely to encourage voluntary family planning.

E. The Role of Modern Contraception

Of the four "direct" determinants mentioned above, contraceptive use has the greatest potential impact on fertility; indeed, in the absence of modern family planning services, some socioeconomic changes (e.g., improved child health and changing patterns of breastfeeding) may actually lead to higher birth rates. In short, modern contraceptives provide the means by which individual couples can achieve their desired family size most effectively, safely, and humanely.

Existing demand for modern family planning services is not currently being met by programs in the developing world. World Fertility Survey data from 29 countries indicate that 48 percent of married women 15-49 years of age want no more children. A study of 18 of those countries suggests that the average birth rate of 32.3 per 1000 would drop to 23.5 births per 1000 population if all unwanted births were prevented. To summarize, existing demand for family planning services is great and is likely to become greater as development brings about improvements in socioeconomic conditions throughout the developing world.

II. The U.S. Population Assistance Program

A. A.I.D. Policy Objectives

Family planning programs are an essential element of the U.S. development assistance strategy, and this Administration has reaffirmed a 20-year U.S. commitment to voluntary family planning efforts. The objective of the A.I.D. population assistance program is twofold: (1) to enhance the freedom of individuals in LDCs to choose voluntarily the number and spacing of their children; and (2) to encourage population growth consistent with the growth of economic resources and productivity.[1] The two parts of this objective are reciprocal. The ability to determine freely the number and spacing of one's children allows the individual greater potential to take advantage of opportunities for improving skills, seeking employment and increasing income. Experience has shown that when couples can freely determine the number and spacing of their children, they tend to have smaller families and population growth rates tend to decline. Further, when aggregate national wealth and

[1]Rural to urban migration and the problem of refugees are population related issues, but they are being addressed in separate policy papers.

population are in balance, individual families tend to have better prospects for education, employment and health. Such increased opportunities and improvements in the standard of living tend to raise individual and family aspirations, and couples tend to prefer to have fewer children whom they can educate and care for well, rather than many to whom they cannot offer these advantages.

The basic premises of U.S. population assistance are the following:

- individuals and couples should be able to decide freely the size of their families;
- voluntary family planning programs are needed and wanted by the citizens of the Third World;
- it is in line with U.S. strategic as well as humanitarian interests to help LDC governments achieve economic development, and to support their citizens' efforts to attain a better life for themselves and their children;
- sustained economic development and the achievement of a decent life for all LDC citizens can only occur when population growth no longer outpaces economic progress;
- the impact of development resources is maximized through coordination of policies and programs that broaden access to education and employment, especially for women, with the provision of modern family planning services; and
- the U.S. has unique strengths in this area of international development assistance.

A.I.D. support for family planning service programs is based on two fundamental principles: voluntarism and informed choice. A.I.D. does not support programs in which there is any element of coercion of individuals to practice family planning or to accept any particular method of contraception. In fact, A.I.D. supported programs must include a description of the effectiveness and risks of all major methods of family planning and an agreement either to provide other family planning methods if requested or to refer couples to programs offering other methods as appropriate. A.I.D. supports the provision of family planning methods within the medical and cultural context of each particular country.

B. Population Program Assistance Activities

The Agency for International Development has traditionally played a strong role in supporting population programs, consistently leading bilateral and multilateral donors in program initiatives and in funding. A.I.D's cumulative population assistance since the mid-1960's exceeds $2 billion, and constitutes about half of all population assistance provided to the developing world. On an annual basis, it is estimated that donor assistance and host country government (excluding China) expenditures for population programs total something over one billion dollars. For the past several years, A.I.D's population account has represented about 20 percent of these aggregate budgets.

A.I.D's allocation of population funds reflects Agency priorities in the population sector. Voluntary family planning service delivery and related supplies form the heart of the program and consistently absorb the greatest proportion of population assistance. Support for service delivery systems includes: commodities, training for physicians, paramedicals and fieldworkers and technical assistance in the design and improvement of services. Innovative field oriented research to improve existing delivery systems and to develop new "outreach" programs for delivering family planning and health services that are less expensive and more appealing are also important A.I.D. supported activities.

A.I.D. has led the way among donors in developing and disseminating the most widely used high quality contraceptive methods in the world today; the U.S. will continue to support the development of promising new contraceptive methods and improvement of existing methods, as well as research on the safety and effectiveness of contraceptives under actual conditions in developing countries.

Accompanying the provision of services is dissemination of information and education on family planning and population, both for individual users and also for government policy makers. Where requested by governments, the U.S. provides technical assistance to help analyze government policies which may affect the availability of, and the demand for, family planning services, as well as to analyze the impact of rapid population growth on other development sectors, such as food, health and energy.

The U.S. population assistance program does not operate in isolation from our other development

efforts, but takes into account the linkages between population, health, nutrition, education, employment and agricultural productivity. A.I.D. has led the way in developing and applying new ways to measure program impact and the degree to which fertility and the use of family planning services is influenced by women's education and employment opportunities, child health and other social and economic conditions. Based on our knowledge of the relationship between population and other development factors, we seek to make our total development strategy for each country one in which the objectives and activities in all areas, including population are mutually reinforcing.

Successful family planning programs tend to occur in countries where there is a strong commitment by the host government, an infrastructure with the capacity to deliver services throughout the country, and social and cultural acceptance of the concept of family planning. The largest share of U.S. population assistance is directed to countries where these three conditions exist. In countries, notably but not exclusively in Africa where awareness of the impact of rapid population growth on sustained economic development and of the need and demand for modern family planning services is more recent, A.I.D. works closely with host governments and private organizations to help them analyze and strengthen their policies and programs. Where infrastructures are weak or inadequate, A.I.D. supports activities to strengthen local service delivery institutions and also works with the private sector.

In recent years, A.I.D. has increased the proportion of population funds allocated to bilateral family planning programs, reflecting not only the Agency's commitment to integrate family planning programs into overall country development assistance programs, but also the growing interest of LDC governments to collaborate with the U.S. in developing strong national family planning programs.

Among A.I.D.'s major strengths in assisting LDC population program efforts are its strong field presence and its early and sustained leadership in developing innovative approaches to low-cost service delivery that are responsive to particular country requirements. A.I.D. has also been a leader because of its strong analytical orientation, whether in the testing of outreach systems for delivery of family planning services, in analysis and interpretation of survey findings to measure program impacts, in biomedical research or in developing overall family planning strategies. The very size of the U.S. supported family planning effort is also one of its strengths; the U.S. provides about half of the Development Assistance Committee (DAC) assistance for population and is the principal donor to the United Nations Fund for Population Activities (UNFPA) and the private intermediaries. This preeminence gives the U.S. a unique voice in encouraging high quality voluntary family planning services for interested couples throughout the world. AID's population program in the 1980s is rooted in this highly successful past.

C. Specific Policies Governing U.S. Population Assistance

Beyond the fundamental principles of voluntarism and informed choice upon which U.S. population assistance is based, specific legislative requirements and A.I.D. policies govern assistance under this account.

(1) Abortion

In accordance with authorizing legislation adopted in 1974, A.I.D. must not provide support for abortion services or a number of other abortion-related activites, such as the provision of abortion equipment, or the motivation of persons to practice abortion. In January, 1981, A.I.D. discontinued funding of research on methods of abortion as a means of family planning. Funding of all such research was terminated in 1981, although A.I.D. continues to gather descriptive epidemiological data to assess the incidence, extent or adverse consequences of abortion.

All A.I.D. funded population contracts and grant agreements with private and voluntary organizations (PVOs) and with host governments incorporate language to prohibit use of A.I.D. funds for abortion-related activities; PVO subgrant agreements also incorporate such prohibitions.

Such prohibitions include:

- Procurement or distribution of equipment intended to be used for the purpose of inducing abortion as a method of family planning.
- Procurement or distribution of Menstrual Regulation (MR) kits.

- Special fees or incentives to women to coerce or motivate them to have abortions.
- Payments to persons to perform abortions or MR procedures or to solicit persons to undergo abortions or MR procedures as a means of family planning.
- Information, education, lobbying, training or communication programs that seek to promote abortion as a method of family planning.
- Funding of biomedical research which relates to methods of abortion as a method of family planning.
- Training of individuals for the performance of abortion as a means of family planning.

(2) Voluntary Sterilization

Section 104(f) of the Foreign Assistance Act enacted in 1978 prohibits the use of U.S. funds for *involuntary* sterilization. It states:

> None of the funds made available to carry out this part may be used to pay for the performance of involuntary sterilizations as a method of family planning or to coerce or provide any financial incentive to any person to undergo sterilization.

A.I.D. Policy[1] governing the use of Agency funds for sterilization provides that A.I.D. funds can only be used to support voluntary sterilization activities if the following six conditions are met:

1) *Fully Informed Consent.* An explanation must be made to the client in his or her own language of the nature of the procedure, its risks and benefits, and its irreversibility. The client's witnessed signature or mark is required on the consent document, which must be retained for three years.
2) *Availability of Other Methods.* Other family planning methods must be readily available to insure that the client has a free choice of approved methods.
3) *Incentive Payments.* No A.I.D. funds can be used to induce clients to accept voluntary sterilization; also the cost of the procedure must be such that it does not favor voluntary sterilization over other methods.
4) *Quality of Services.* The medical personnel must be well trained and the surgical equipment should be the best available that is suitable to the field situations in which it will be used.
5) *Integration with Health.* To the fullest possible extent, voluntary sterilization programs shall be conducted as an integral part of the total health care services of the recipient country and shall be performed with respect to the overall health and well-being of the prospective acceptors.
6) *Country Policies.* A.I.D. funded sterilization programs should be carried out in full cooperation with host country officials, and particular care must be exercised to avoid undue emphasis on any ethnic, political or religious minority.

Regulations setting out requirements for informed consent are included as part of all grants, contracts and subordinate agreements between A.I.D. and implementing organizations. Adherence to these guidelines and regulations is constantly monitored by A.I.D. to insure full compliance.

(3) Natural Family Planning

In 1981, Section 104(b) of the Foreign Assistance Act was amended to ensure that information and services relating to natural family planning (NFP) methods be included among the population activities supported by A.I.D. A.I.D. missions have been informed of this legislative amendment and of A.I.D.'s intention to see that natural family planning methods, defined to include all those methods which rely on periodic abstinence, are integrated into all relevant forms of population assistance, including research, training, service delivery and information programs, wherever this is appropriate to the culture and desires of the recipient population and its government.

Although natural family planning itself is not a new concept, it has received increased attention and interest in the last decade. A.I.D. missions should continue to explore ways of encouraging the inclusion of natural family planning approaches within the programs of public and private family planning agencies working in the country. A.I.D. policy governing the funding of natural family planning activities is based on the same principles of voluntarism and informed choice which govern activities related to other methods of family planning. A.I.D. gives preference in its funding to programs which provide a wide range of choices in family planning methods (excluding abortion) and strongly encourages such programs to include information

[1] Policy Determination (PD) 3 *(formerly PD-70)* summarized below is attached as an Annex.

and/or services related to methods of natural family planning. All A.I.D. supported population programs must demonstrate that they are free of coercion regarding not only the practice of family planning, but also the choice of a particular family planning method.

(4) The Relationship Between Population and General Development

Recognition of the reciprocal links between fertility and other aspects of development led Congress to amend the Foreign Assistance Act to include Section 104(d). This section states that:

> (1) Assistance under this chapter shall be administered so as to give particular attention to the interrelationship between (a) population growth, and (b) development and overall improvement in living standards in developing countries, and to the impact of all programs, projects, and activities on population growth.

Implementation of 104(d) requires A.I.D. to maximize the impact of scarce development resources, not only by avoiding support to development programs that appear to work at cross-purposes, but also by building upon what is known about the links between social and economic progress and fertility decline. A.I.D. has interpreted 104(d) as a mandate to work for improvements in the socioeconomic setting within which voluntary family planning services are provided, (an important development goal in its own right) in order to support parents' growing interest in smaller families as well as their ability to utilize modern, effective contraceptives to achieve their desired family size. In implementing this mandate, A.I.D. does not seek to tie assistance to fertility reductions, but rather to coordinate development activities and the availability of family planning services so that they are mutually reinforcing.

(5) Contraceptives

It is A.I.D.'s general practice to provide to other countries only those contraceptives approved by the Food and Drug Administration for use in the U.S.

III. Factors Affecting Policy Implementation

Constraints to the achievement of population assistance policy objectives include:

- weak or inconsistent government policies;
- regulations which inhibit efficient distribution of contraceptives;
- inadequate infrastructures for service delivery; and
- social and economic conditions, e.g., poor health, low educational levels, and low income levels, especially for women, which militate against the acceptance or effective use of modern family planning methods.

There are a variety of government policies and socioeconomic changes which often tend to encourage (or at least not discourage) high fertility; for example, the breakdown of traditional practices which have served to ensure child spacing; protective labor legislation making it more difficult for women to work; the lack of regulations prohibiting child labor; the settlement of nomadic people; and the trend away from prolonged breastfeeding (one of the most important traditional means of postponing the next pregnancy) to intermittent breastfeeding and early weaning. There are also a variety of socioeconomic changes which are associated with higher fertility in their early stages, although over the long term they are associated with smaller families (increased female education, improved health and increased family income, for example).

Most LDCs, often with U.S. or other donor assistance, are currently investing heavily in development activities in a number of sectors; most LDCs also have stated policies to reduce population growth. However, often there is little attention to integrating or coordinating these development programs and policies so as to maximize their combined impact. For instance, in some countries, family planning services are virtually unavailable outside the major cities; at the same time, governments are investing in family income generation and education programs in rural areas—programs that are likely to foster couples' interest in limiting family size and thereby increase the demand for modern family planning services. In many areas, family planning services have not been integrated with existing maternal/child health programs, although the former is a critical factor in improving health status in most LDCs.

Where the constraints to acceptance or effective use of modern contraception are rooted in the lack of improvement in basic living conditions and economic opportunities, A.I.D. is careful to coordinate its development activities in other sectors with its support for family planning pro-

grams so that the two are mutually reinforcing. A.I.D. also works with LDC countries to help them analyze and strengthen their policies, which may in some cases include modification of regulations that inhibit contraceptive distribution, and in others focus on improved maternal and child health or education opportunities for females. Where infrastructures are weak or inadequate, A.I.D. supports institutional development activities or works with the private sector which often has more efficient channels for delivery of services than the government. The major priority emphases of the Agency—an expanded role for government-to-government discussions on country policies, the private sector, institutional development, and technology transfer—are particularly relevant to overcoming major constraints to successful implementation of U.S. and LDC population policy objectives.

A. Host Country Policies

A.I.D.'s experience has been that family planning programs are most successful where governments support strong service delivery systems, are committed to curbing excessive population growth through provision of voluntary family planning services, and where this commitment is translated into a clear population policy, backed by policies stressing improved education, health and employment opportunities, especially for women. In countries where continued high population growth rates appear to be eroding economic development, A.I.D. includes this factor in its policy discussions with the government. While the U.S. does not and will not make development assistance conditional on the host government adopting a particular population policy, A.I.D. will continue to seek and respond to opportunities for policy-level discussions on voluntary family planning. Indeed, many of the family planning program "successes" in Asia and Latin America involved not only substantial bilateral support for expansion of quality family planning services, but also a continuing official dialogue on the policy and institutional reforms needed to improve the quality and coverage of the programs. A.I.D.'s application of Section 104(d) of the FAA is an important element in ongoing discussions on population and development policies. In addition, A.I.D. will continue to sponsor the development and use of a variety of tools for analyzing and demonstrating the impact of rapid population growth on economic progress, making these programs available to interested LDC governments as they examine the full range of their development objectives, programs and problems.

B. Private Sector

In most countries, the distribution of contraceptives began through the private sector: private physicians prescribed contraceptives for their patients; some methods of family planning were available over the counter; and private voluntary organizations offered services, most often in urban areas. The private sector has acted as an important "supply side" force, responding to demands for services and also demonstrating to the government how efficient contraceptive distribution systems could be implemented. After governments begin to provide services, there remains a mix (which varies by country) of public and private sector delivery systems. In a number of countries, the government relies on the private sector to provide all or a large proportion of the services available.

Over the past several years, A.I.D. support to private voluntary organizations has amounted to roughly one-third of the population assistance program. This support is channeled for the most part through large U.S. based or international intermediaries that implement programs in LDCs through or in collaboration with local organizations.

Family planning service delivery, whether private or public, has typically involved clinic-based physician-oriented services. Although effective, such programs are costly and often biased toward urban consumers. In an effort to reach the rural population, and the poor in particular, modified programs have been developed to meet the needs and circumstances of isolated areas. Increasing the number of distribution points and types of contraceptive methods offered is critical to expanding the accessibility of services. In an attempt to increase services and stimulate greater private sector involvement in the delivery of family planning A.I.D. is placing greater emphasis on community based distribution involving paraprofessional and volunteer personnel. Additionally, in many developing countries, A.I.D. supports commercial retail sales (CRS) programs under which family planning is delivered through the commercial sector. A.I.D. will stress the need for family planning delivery systems to become less dependent on external resources, by systematically encouraging

greater local fundraising, voluntarism and community participation, fee-for-services, and improved management efficiencies in all programs. The Agency will also support efforts by U.S. private firms involved in the manufacture and distribution of contraceptives to promote similar development in LDCs. To the extent practicable, the methods, research, and experiences of such firms should be adapted and utilized in developing countries.

C. Institutional Development

Strengthening and fostering the direct involvement of local institutions in the development process will continue to be actively pursued under the A.I.D. population assistance program. Both public and private institutions are involved in the delivery of family planning services in LDCs. The magnitude of effort needed to make services available to all individuals who want them, and the inadequacy of infrastructures to deliver such services in the majority of countries, point to the importance of strengthening a variety of types of local institutions which are or could be effective service providers.

Appropriate institutions range from local women's groups, to private family planning associations, to Ministries of Health. In many countries it is important to have family planning services included as part of government maternal and child health (MCH) services, due to the real as well as perceived links between MCH and the spacing or limiting of births. Increased effort is also being directed to the involvement of local community organizations in the delivery of services as well as in the dissemination of information and education about both the concept of family planning and contraceptive methods. The mobilization of community resources (labor, materials, money, leadership) as a contribution to government-financed or private sector projects is an important means of encouraging community interest in a service, as well as fostering initiative and building local management capabilities.

The population assistance program seeks not only to involve local institutions in service delivery, but also to build or strengthen the capacity of local demographic and social science research institutions, government units responsibile for policy analysis and development, training institutions, and systems through which information, education, and communications about family planning reach potential clients.

The effectiveness of local organizations depends on such things as sound allocation and use of resources; quality of leadership; clarity of articulated goals and programs; and flexibility in implementation of programs. Improving organizational effectiveness may require changes in structure and function, in management systems, or in people's knowledge and skills. For this reason, greater attention must be given to building management and skills-training capacities into local organizations.

While it is generally understood that public policies affect the success of development efforts, less well understood are the ways in which government policies may handicap the effectiveness of local institutions. For instance, government policies may regulate the import and/or distribution of contraceptive supplies, fix prices at levels that militate against cost recovery, or define, in a limiting way, the role and functions of a private organization.

D. Technology Transfer

One of the strengths of the U.S. population assistance program has been the transfer of U.S. scientific and technological know-how to LDCs implementing family planning programs. The U.S. has led the way in developing, testing and disseminating the most widely used contraceptives and family planning delivery systems. A.I.D. is increasing the amount of its support for the development of promising new contraceptive methods and for research on the safety and effectiveness of contraceptives tested under actual LDC conditions. In addition to the transfer of technology directly applicable to the delivery of contraceptives, A.I.D. has sponsored the development and dissemination of a variety of technologies for analyzing and demonstrating the impact of rapid population growth on economic progress, making these tools available to LDC governments as they examine their policy and program goals. Demand from LDCs for technologies developed by the U.S. continues to be high. Our ability to transfer technology appropriate to various country needs has given the U.S. a longstanding leadership role in this field.

IV. Conclusion

Population Assistance will continue to be an essential element of U.S. development assistance. The content and direction of the U.S. program is guided by a number of factors:

- the commitment to helping LDCs achieve self-sustaining economic growth;

- the belief that individuals and couples should be able to decide freely the size of their families;

- the conviction that sustained economic development and the achievement of a decent life for all LDC citizens can only occur when population growth no longer outpaces economic progress;

- the evidence that voluntary family planning programs are needed and wanted by citizens of the developing world;

- the belief that it is in line with U.S. strategic as well as humanitarian interests to help LDC governments achieve national economic goals, and to support the efforts of their citizens for a better life for themselves and their children; and

- the growing evidence that the U.S. has unique strengths in this area of international development assistance.

Strengthening and fostering the direct involvement of local institutions in the development process will continue to be actively pursued under the A.I.D. population assistance program. A.I.D. will capitalize on the flexibility and innovativeness of the private sector in the search for new and better ways to make safe, effective and acceptable contraceptives widely available. There will be increased attention to the needs and interests of the consumer of the services, so that the services will meet, to the fullest extent possible, the cultural preferences of both current and potential users. Finally, A.I.D. will stress in its programming the integration of family planning services with health and other development activities.

V. Annex

PD-3 (September 1982) *(formerly PD-70 June 14, 1977)*

A.I.D. Policy Guidelines on Voluntary Sterilization

I. Overview

The *World Population Plan of Action* of the World Population Conference of 1974 observed that; "All couples and individuals have the basic right to decide freely and responsibly the number and spacing of their children, and to have the information, education and means to do so...."

The Foreign Assistance Act (FAA) of 1961 (as amended) reflects additional considerations:

(1) the process of economic and social development which is in turn affected by the pace, magnitude and direction of population growth; and,

(2) in many LDCs high rates of population growth limit attainment of broader development goals, contribute to economic hardship and hazardous health conditions, and deny opportunities for improved quality of life for many parents and their children.

In carrying out a comprehensive population assistance program *authorized by the FAA*, A.I.D. has responded to the growing number of LDC requests for assistance and has helped to make the various methods of family planning permitted by our legislation available on a broader scale to the rural and urban population for use on a strictly voluntary basis.

More recently, LDC governments and non-government organizations have requested assistance to extend the availability of voluntary sterilization (VS) services.* Such requests are partially in response to the preparatory work conducted by various organizations which have received A.I.D. support, including the Association for Voluntary Sterilization (AVS), the Pathfinder Fund, the International Fertility Research Program (IFRP), and the Johns Hopkins University Program for International Education in Gynecology and Obstetrics (PIEGO) as part of its broad program of advanced training in obstetrics and gynecology. These organizations have contributed to signifi-

*VS service programs include those activities which are primarily intended to provide voluntary male and female sterilizations to persons requesting this type of contraceptive procedure. For purposes of this discussion, however, VS training programs are included, since training generally requires that trainees conduct supervised procedures on patients who have voluntarily presented themselves at a service/training facility for sterilization.

cant advances in the development of new surgical techniques which make sterilization safer, simpler and less expensive as an outpatient procedure. They have developed specialized equipment and given LDC medical personnel specialized training in the practice of obstetrics and gynecology, including endocrinology, identification of cancerous conditions, maternal care, and the management of infertility and fertility, including sterilization procedures.

In providing support for sterilization services, A.I.D. must reaffirm its long-standing and complete commitment to the basic principle of voluntary acceptance of family planning methods and determine basic conditions and safeguards within which A.I.D. support for sterilization activities can be provided. These conditions and safeguards are needed because of the special nature of sterilization as a highly personal, permanent surgical procedure and to ensure that the needs and rights of individuals are scrupulously protected.

The official positions of national governments are mixed. While voluntary sterilization has become a basic part of comprehensive family planning services in many countries, in some there is only unofficial approval for action by non-government agencies while in other countries there is opposition to the method. A.I.D. staff and A.I.D.-funded grantees and contractors must be fully aware of national sensitivities and must receive AID/W and mission approval before making any commitments on commencing support for sterilization activities in any context.

II. General Guidelines

A.I.D. acknowledges that each host country is free to determine its own policies and practices concerning the provision of sterilization services. However, A.I.D. support for VS program activities can be provided only if they comply with these guidelines in every respect.

A. Informed Consent: A.I.D. assistance to VS service programs shall be contingent on satisfactory determination by the USAID (bilateral programs) and/or A.I.D.-funded grantees or contractors that surgical sterilization procedures, supported in whole or in part by A.I.D. funds, are performed only after the individual has voluntarily presented himself or herself at the treatment facility and given his or her informed consent to the sterilization procedure.

Informed consent means the voluntary, knowing assent from the individual after he or she has been advised of the surgical procedures to be followed, the attendant discomforts and possible risks, the benefits to be expected, the availability of alternative methods of family planning, the purpose of the operation and its irreversibility, and his or her option to withdraw consent anytime prior to the operation. An individual's consent is considered voluntary if it is based upon the exercise of free choice and is not obtained by any special inducements or any element of force, fraud, deceit, duress or other forms of coercion or misrepresentation.

Further, the recipient of A.I.D. funds used all or in part for performance of VS procedures must be required to document the patient's informed consent by (a) a written consent document in a language the patient understands and speaks, which explains the basic elements of informed consent, as set out above, and which is signed by the individual and by the attending physician or by the authorized assistant of the attending physician or (b) when a patient is unable to read adequately a written certification by the attending physician or by the authorized assistant of the attending physician that the basic elements of informed consent were orally presented to the patient, and that the patient thereafter consented to the performance of the operation. The receipt of the oral explanation shall be acknowledged by the patient's mark on the certification and by the signature or mark of a witness who shall be of the same sex and speak the same language as the patient.

Copies of these informed consent forms and certification documents for each VS procedure must be retained by the operating medical facility, or by the host government, for a period of three years after performance of the sterilization procedure.

USAID Missions should note their responsibility to monitor A.I.D.-assisted VS programs-whether such programs are funded bilaterally or by A.I.D.-funded grantees or contractors—to ensure continuing adherence to the principle of informed consent. In order to carry out this monitoring function effectively, all proposed programs—either bilaterally funded or funded by A.I.D.-supported intermediaries—shall be approved by the mission and AID/W prior to any commitment of funds or promise to commit funds for VS activities. In carrying out this responsibility, USAID staff should be thoroughly familiar with local circumstances and government administrative patterns and be able to communicate effectively with host country representatives.

B. Ready Access to Other Methods: Where VS services are made available, other means of family planning should also be readily available at a common location, thus enabling a choice on the part of the acceptor.

C. Incentive Payments: No A.I.D. funds can be used to pay potential acceptors of sterilization to induce their acceptance of VS. Further, the fee or patient cost structure applied to VS and other contraceptive services shall be established in such a way that no financial incentive is created for sterilization over another method.

D. Quality of VS Services: Medical personnel who operate on sterilization patients must be well-trained and qualified in accordance with local medical standards. Equipment provided will be the best available and suitable to the field situations in which it will be used.

E. Sterilization and Health Services: To the fullest possible extent, VS programs—whether bilaterally funded or conducted by A.I.D.-funded private organizations—shall be conducted as an integral part of the total health care services of the recipient country and shall be performed with respect to the overall health and well-being of prospective acceptors. In addition, opportunities for extending health care to participants in VS programs should be exploited to the fullest. Consideration must also be given to the impact that expanded VS services might have on existing general health services of the recipient country with regard to the employment of physicians and related medical personnel and the use of buildings or facilities.

F. Country Policies: In the absence of a stated affirmative policy or explicit acceptance of A.I.D. support for VS activities, USAIDs should take appropriate precautions through consultation with host country officials in order to minimize the prospect of misunderstandings concerning potential VS activities. In monitoring the consistency of A.I.D.-supported VS programs with local policy and practices, USAIDs and A.I.D.-funded donor agencies shall also take particular note of program activities among cultural, ethnic, religious or political minorities to ensure that the principles of informed consent discussed under "A" above are being observed and that undue emphasis is not given to such minority groups.

Addendum to PD-3 *(formerly Addendum to PD-70, 2/9/81)*
Additional A.I.D Program Guidance for Voluntary Sterilization (VS) Activities

1. **INTRODUCTION:** The previously provided Policy Determination No. 3 (PD-3), remains in effect. However, in light of several years experience, additional clarification of a number of points relating to the application of PD-3 and specific interpretation of its provisions appears to be needed.

2. **APPLICABILITY OF PD-3:** PD-3 states "A.I.D. support for VS program activities can be provided only if they comply with these guidelines in every respect". This means that the provisions of PD-3 must be applied if A.I.D. funds are used for whole or partial direct support of the performance of VS activities. However, as also noted in PD-3, "A.I.D. acknowledges that each host country is free to determine its own policies and practices concerning the provision of sterilization services". The provisions of PD-3 do not apply if A.I.D. provides support for population and family planning programs within a country and provision of VS services is not called for in the support agreement, i.e., VS activities may be a part of the host country's program, but A.I.D. funds are not used to support such services. For example, if A.I.D. support for VS program activities is geographically confined to particular parts of a country, PD-3 applies only to those areas with VS program activities supported by A.I.D. PD-3 does not apply if activities and projects are only peripherally related to provision of VS services, for example, A.I.D. support for construction of multipurpose buildings or broad-based training in reproductive health which includes VS techniques. Finally, in A.I.D.-supported population and family planning programs in host countries which use A.I.D. funds for activities other than VS and support VS activities with their own or other non-A.I.D. funds, PD-3 does not apply.

3. **INFORMED CONSENT:** The recipient of A.I.D support used fully or in part for performance of VS procedures must obtain and document voluntary informed consent as part of the conduct of any VS procedure. A.I.D. does not require any specific format for this procedure. However, the elements of the procedure described in PD-3 (i.e., an explanation of the nature of the procedure, the attendant risks and benefits, availability of alternative methods of

family planning, that the procedure is irreversible, and that the patient may withdraw consent) all must be part of the process of obtaining informed consent.

4. **METHODS OF PAYMENT:** All acceptor and/or provider payments in cash or kind beyond VS service costs as well as fees charged for VS and other contraceptive services shall be established in such a way that no financial incentive is created for sterilization over another contraceptive method.

(A) Payment of Acceptors: It should be noted that guidance differs for payments which may be made to acceptors of VS as contrasted to payment to providers of VS (guidance applicable to providers of VS services is described in para 4.B. below). As stated in PD-3, para C, "no A.I.D. funds can be used to pay potential acceptors of sterilization to induce their acceptance of VS". Further, A.I.D. support generally cannot be provided to VS services which include incentive payments paid to potential acceptors. For example, a VS program supported by A.I.D. cannot be supplemented with acceptor incentives to induce acceptance of sterilization services. Determination of what constitutes an incentive must be made locally based on thorough knowledge of social and economic circumstances of potential acceptors. In general, recompense to acceptors for legitimate, extra expenses related to VS program services such as transportation, food during confinement, medicines, surgically related garments and dressings and the value of lost work are not considered incentive payments and are eligible for A.I.D. support. It should be emphasized that these payments must be of a reasonable nature and aimed at making VS services equally available at the same cost as other contraceptive services. For example, payment for lost work must correspond to a reasonable estimate of the value of lost labor over a reasonable duration of convalescence.

(B) Payment of Providers of Services: In light of experience, it seems desirable to modify the previous A.I.D. program guidance relating to reimbursement for VS services as defined in AIDTO Circular 393 (10/27/77), page 6, section 3, "operating service costs", para. 4. The suggested prohibition of reimbursement to providers of VS services on a per-case basis has not proven practical in that payment per case or procedure is the time-honored method of paying for surgical procedures both in developed and less developed countries. Reimbursement of physicians, paramedical and other service personnel on a per-case basis can be an acceptable procedure. Compensation to providers for items such as anesthesia, personnel costs, pre and post-operative care, transportation, surgical and administrative supplies, etc., on a per-case basis is also generally acceptable. These payments to providers must be reasonable relative to other medical and contraceptive services provided so that no financial incentive is created for the providers to carry out VS procedures compared to provision of other methods of family planning. As in the case of payments to acceptors, this is a judgment which will have to be made on a country and program specific basis. However, in both cases, AID/Washington will provide assistance and guidance in making such determinations, and decisions relating to application of PD-3 should be submitted to AID/Washington for review. Even though payment on a per-case basis is often customary, A.I.D. Missions are advised to encourage patterns of service delivery and methods of payment which do not unduly emphasize VS procedures compared to other methods of fertility control. For example, if physicians who carry out the surgery are paid on a per-case basis and they have no role in the selection or counseling of patients, these service providers cannot induce additional patients to accept sterilizations over other contraceptive methods. Payments of physicians on a per-session rather than a per-case basis may also serve the same function. Since payments on a per-case basis do raise questions, often of a complex nature, beyond those raised by other types of compensation, where a mission can persuade a government to use such other frameworks for payment, whether immediately or phased-in, it should do so.

(C) Payment of Referral Agents: In some countries fieldworkers are employed to inform and refer potential acceptors of contraceptive methods including VS. When extra expenses are incurred in informing and referring VS acceptors, a per-case payment of these costs is acceptable. Again, as is the case with payments to providers and/or acceptors, a country or program specific determination that the payment is for legitimate extra expenses or activities associated with VS referral must be made. The aim is to make all available contraceptive methods available at the same cost to the acceptor.

II.G (TM 1:34)
11/9/84

A.I.D. Policy Paper

DOMESTIC WATER AND SANITATION

U.S. Agency for International Development
Washington, D.C. 20523

May 1982

II.G (TM 1:34)
11/9/84

A.I.D. Policy Paper

Domestic Water and Sanitation

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

May, 1982

Water Supply and Sanitation Policy Paper

Table of Contents

		Page
	Summary	1
I.	Introduction	2
II.	Rationale for A.I.D. Support of Water and Sanitation Programs	3
III.	Current Situation in Developing Countries and the Role of International Donors	4
	A. The U.S. Commitment to Supporting Water and Sanitation Programs in Developing Countries	5
	B. A.I.D. and Other International Donors	5
	C. A.I.D.'s Role in Water Supply and Sanitation in Developing Countries	5
	D. The Linkages Between Domestic Water Supply, Sanitation, and Health	6
IV.	Guidance for the Development of the Drinking Water and Sanitation Programs in Developing Countries: Major Issues	8
	A. Technical Issues	8
	B. Social and Cultural Issues	10
	C. Issues of Implementation and Administration	12
V.	Water in the Context of General Economic Development	14

Summary

The combination of unsafe drinking water and inadequate sanitation facilities constitutes one of the major causes of death and disability among the poor in developing countries. Safe, convenient water supply and adequate sanitation is a fundamental component of broad-based economic growth strategies. Lowering mortality and morbidity from water and sanitation-related diseases is a goal in itself; it can also lead to increased productivity and decreased absenteeism among members of the labor force and can reduce the time and energy burden on the household, leading to more time for crop cultivation, child care, and income-generating activities, as well as more regular school attendance.

The availability of a minimum of 20-40 liters of relatively safe water per person per day is essential to achieve sustained health improvements in developing countries. Where this minimum is not readily available and where inadequate domestic water and sanitation creates significant health problems, A.I.D. will consider funding projects for improvements in water and sanitation. The following criteria will guide A.I.D.'s investment in the area:

1. **Evidence of need and effective demand**: *The need for improved water and sanitation is clearly indicated by high prevalance of disease caused by (a) insufficient water, (b) consumption of highly contaminated water, and/or (c) inadequate or inappropriate sanitation systems; and consumers are willing to (a) support recurrent costs through some combination of fees, contributions, and local or national budget allocations, and (b) cover some portion of the investment costs to improve traditional systems or build new ones. Where consumers are unable to make such a commitment, but the absence of basic water and sanitation systems poses a public health hazard for the community at large, the government must demonstrate a commitment to shoulder a substantial portion of the investment costs, as well as those recurrent costs which the community cannot cover in the short-run while local arrangements for financing are being developed. A.I.D. will not fund projects where there is inadequate assurance that the community can and will support operation and maintenance costs of the system within a reasonable time frame.*

2. **Institutional responsibility and capacity**. *The local or national institutions responsible for national domestic water supply and sanitation policy must have the responsibility, personnel, and budgetary resources to ensure the construction, expansion and continued operation and maintenance of the improved water and sanitation systems. At a minimum, there must be evidence that the institution can be strengthened to the point where it can assume such responsibility with only* **modest** *outside support.*

3. **Infrastructure**: *Roads and other aspects of transportation and communications must be sufficiently developed to permit routine contact with local communities for the purposes of supervision, technical assistance, maintenance, and the delivery of fuel and spare parts. Alternatively, the technology adopted in the improved water and sanitation systems must be such that the system can be maintained by the community without outside assistance or supervision.*

Where these conditions are met, A.I.D. will consider funding water and sanitation programs to improve health in rural areas as well as market towns, secondary cities, squatter settlements, and urban centers. Development Assistance funding for these programs is available from Section 104, the Health and Population Account and when part of rural development activities, from Section 103, the Agriculture, Rural Development and Nutrition Account; in addition, Economic Support Funds and the Housing Guarantee Program can support domestic water and sanitation projects, principally in urban areas.

As noted above, A.I.D. will not support water supply and sanitation programs whose operation and maintenance costs cannot be financed over the long-term by some combination of consumers, the local community, and the regional and central government. Where possible, consumers themselves should bear primary responsibility for covering all costs, since it is under these conditions that the systems are most likely to remain in operation over the long-term. A.I.D. will give particular attention to identifying and promoting opportunities for private sector involvement in the construction, operation, and maintenance of water and sanitation systems and in the manufacture of related equipment.

Among the factors that will guide the design of A.I.D.-supported domestic water and sanitation projects designed to improve health are the following:

— a minimum of 20-40 liters of relatively safe water per capita per day;
— improvements in water quality (as opposed to quantity) where improvements can be introduced at reasonable cost without compromising the reliability of the system;
— selection of a technology that can be maintained and operated easily and is acceptable within the local culture;

— measures to promote water conservation and reuse;
— project design and implementation that responds to the needs of the community and, wherever feasible, encourages or requires active community involvement in all phases of the project;
— sustained educational efforts to instruct users in proper water use and hygiene;
— a demonstrated means of financing and ensuring operations and maintenance of the project over the long-term;
— training of community level workers and of personnel at the regional and national level in the maintenance, operation and repair of water supply and sanitation systems;
— technical assistance or training, as required, to improve the administration of water supply and sanitation systems.

In addition, A.I.D. encourages attention to other factors which may have implications for domestic water water supply and sanitation, including: the strength of existing institutions that govern the allocation of water resources; opportunities to incorporate water supply and sanitation activities into primary health care, agriculture (irrigation) and other programs; and the implications of rapid urbanization for existing water supply.

I. Introduction

This paper is the first of a series designed to give more explicit guidance on major health issues, and draws on A.I.D.'s experience with domestic water and sanitation programs.[1] The paper provides suggested guidelines on how and under what conditions scarce U.S. development funds may be used cost effectively to improve health conditions through selective investments in domestic water supply and sanitation programs.

Improvements in water supply and sanitation have important ramifications in areas other than health, including education, employment, nutrition, agriculture, industry, housing, and the environment. This paper, however, concentrates primarily on the health rationale for investments in domestic water supply and sanitation, and brings together A.I.D.'s practical experience, that of other international donors, and the findings of numerous research studies.

[1] U.S. Agency for International Development, "Community Water Supply in Developing Countries, Lessons from Experience" (Draft), 1982.

This paper is concerned with both water supply for "domestic use"[2] and sanitation in developing countries. The discussion of sanitation deals principally with the disposal of human excreta, domestic waste water, and other household waste materials. This paper addresses water supply and sanitation policy issues pertinent to urban and periurban populations as well as to rural communities.[3] This paper does not address issues arising from large-scale irrigation projects or from the use of water for primarily agricultural puposes. Nor does it deal with recent conservation or watershed management efforts which A.I.D. also finances.

A.I.D.'s policy on domestic water supply and sanitation can be summarized as follows:

The availability of a minimum of 20-40 liters of relatively safe water per person per day is essential to achieve sustained health improvements in developing countries. Where this minimum quantity is not readily accessible and where there are significant health problems associated with inadequate water and sanitation, water supply and sanitation programs deserve attention.

However, domestic water supply and sanitation programs require considerable initial investment and are difficult (financially and logistically) to maintain. To ensure that domestic water and sanitation systems will be maintained over the long run, A.I.D. believes that projects sponsored by the Agency must address certain critical issues, among them:

— coverage of recurrent costs through fees, taxes or other means;
— proper education of users of the system;
— adequate operation and maintenance;
— encouragement of the involvement of private enterprise;
— adequate national or regional governmental capability for policy formulation and oversight.

[2] As used here, this term encompasses water used for drinking; for hygiene (handwashing, bathing, cleaning the home, washing kitchenware and eating utensils, food preparation, and frequently for washing clothes as well); for watering poultry and livestock, in small numbers, near the dwelling; and, in minor amounts, for irrigation in small household gardens.

[3] U.S. development assistance has long supported some rural and village water supply programs. In recent years, through the Housing Guaranty Program, through urban development projects, and through Economic Support Fund programs, A.I.D. has given increasing attention to water and sanitation programs that serve the poor in rapidly growing urban centers of the developing world as well. (See Table I for trends in A.I.D. funding of water and sanitation programs.) The project criteria developed in this paper are intended as guidance for ESF and HG programs as well as for DA projects.

When these and other policy issues are satisfactorily addressed, domestic water supply and sanitation programs rank high within A.I.D.'s health sector priorities.

II. Rationale for A.I.D. Support of Water and Sanitation Programs

An important goal of U.S. development assistance—indeed, perhaps the most important goal—is to help developing countries bring about the conditions under which their citizens can look forward to full lives, sharing in the benefits of a sturdy and growing econony. As President Reagan noted recently, "In its ultimate form, development is human fulfillment—an ability of all men and women to realize freely their full potential." The challenge for development assistance agencies and LDC governments alike is to identify the most critical obstacles to guaranteeing individual freedom and initiative, and to design and implement programs that overcome these obstacles with as few negative side effects for the individuals and communities involved as possible.

Very clearly, in countries where a life of chronic, energy-sapping illness and death at an early age is likely for most people, learning potential and the options for exercising individual initiative are extremely circumscribed. A.I.D.'s health policy paper, approved in 1980, highlighted the problems which continued poor health in LDCs poses for the achievement of important personal and national aspirations. This paper investigates and provides guidance on one of the most important vehicles for improving health and living conditions in LDCs: safe water and adequate sanitation.

The combination of unsafe drinking water and inadequate sanitation facilities constitutes one of the major causes of death and disability among the poor in developing countries. The World Health Organization estimates that more than 25,000 people (most of them children) **die each day** from water and hygiene-related diseases.[4] Less than one-half of the people in developing countries have reasonable access to reliable sources of safe drinking water and a satisfactory means of excreta disposal. Most of those who lack reasonable access to these sources live in rural areas.

A.I.D.'s efforts to increase access[5] to safe water supply, adequate waste disposal and sanitation in developing countries reflect U.S. interest in furthering economic growth by helping countries meet the basic needs of their populations.

Safe,[6] convenient water supply and adequate sanitation is a fundamental component of a broad based economic growth strategy.[7] Waterborne and sanitation-related diseases, particularly diarrheal disease and parasitic infections, are principal causes of morbidity and mortality among infants and young children in Less Developed Countries (LDCs). Lowering mortality and morbidity from water and sanitation-related diseases is, of course, a goal in itself. It can also lead to increased productivity and decreased absenteeism among members of the labor force, and is therefore an important factor in promoting economic growth.[8]

To satisfy basic needs, water must be not only safe, but also available in quantities sufficient for personal hygiene and a healthful environment.[9] Sufficient safe water is particularly necessary for the control of certain diarrheal diseases and skin and eye infections. Trachoma, for example—the leading cause of preventable blindness in the developing world—is in large measure a result of

[4] WHO Rapid Assessment Report, 1980 (United Nations, Report of the Secretary General, **International Drinking Water Supply and Sanitation Decade: Present Situation and Prospects**, No. A/3567, July, 1980).

[5] According to World Health Organization (WHO) definitions, "reasonable access" in urban areas denotes a public fountain or tap not more than 200 meters from a house; in rural areas "reasonable access" implies that members of a household do not have to spend a "disproportionate part of the day" obtaining water for the family ("World Health Statistical Report," World Health Organization, Vol. 29, No. 10, 1976). Access is a somewhat subjective term, varying according to the perceptions of a given society and with topography (e.g., reasonable access may be defined in relation to available alternative water sources only, or the energy and time required to haul water over a distance considered close when the terrain is flat).

[6] In this context, "safe" is a term of art, often used interchangeably with "potable," "clean," etc. to mean water of sufficient quality that it can be used, untreated, without major risk of contracting serious disease. "Safe" does not imply quantifiable standard, see pp. 8-9.

[7] "Foreign Assistance Act of 1961, Amended." U.S. Agency for International Development, "Basic Human Needs Discussion Paper," 1977.

[8] Evidence of the indirect links between improved water supply and overall economic growth is found in Saunders, Robert J. and Jeremy J. Warford, **Village Water Supply**, Baltimore: John Hopkins University Press (for the World Bank), 1976; Feacham, Richard et. al., **Water, Health, and Development**, 1978; White, Gilbert F., et. al., **Drawers of Water**, University of Chicago Press, 1972; and Feacham, Richard, et. al. (eds.), **Water, Wastes and Health in Hot Climates**, Chichester: John Willen & Sons, 1977.

[9] It is generally agreed that 20-40 liters per capita per day is the minimum required to assure adequate supplies for consumption, sanitation, and hygiene.

poor hygiene, as is epidemic typhus, spread by human body lice.[10]

There has been considerable debate over the trade-off between water quantity and quality in improving health conditions. The issue appears to turn on the prevalence and mode of transmission of diarrheal and other diseases. Where these are almost entirely water-borne, or water-based, improving water quality is likely to be the most effective way to reduce disease incidence. Where diarrheal diseases are primarily "water-washed", as opposed to "water-borne", priority should be given to promoting the availability and use of water in greater quantity, and to improved domestic hygiene.[11]

Improved access to convenient, reliable sources of safe water also has an impact on health through reducing the time and energy burden on the household. This benefit is of particular significance to women and children, who bear the principal responsibility for seeking, drawing, and carrying water in the developing world. These responsibilities are particularly burdensome for pregnant and lactating women, who are already somewhat more vulnerable to disease and poor health.

Time saved as a result of more convenient sources of water has been used in subsistence agriculture, in child care, in leisure, and in income-generating activities—all of which can contribute both to improved health and to increased income.[12] Numerous studies have documented the importance which beneficiaries of water projects attach to these improvements in living conditions.[13]

Indirect benefits of improved domestic water supply and sanitation may be even more important than the direct benefits listed above. For instance, some have suggested that the rate at which girls drop out of school is directly linked to the burden of domestic responsibilities they bear[14]; carrying water competes directly with school attendance since it can take anywhere from one-half hour daily in urban areas to 4-6 hours in difficult terrain, during dry seasons, or when numerous trips and substantial waiting time are required. Getting girls into school and making sure they stay in school is important not only for them but also for their families. There is mounting evidence that mother's education is directly related to family size (educated mothers have fewer children) and to child health: mortality among children whose mothers completed more than three years of primary school tends to be significantly lower than for children born to women with less schooling, *regardless of income*.[15]

III. Current Situation in Developing Countries and the Role of International Donors

In recent years there has been relatively little improvement in the proportion of people in LDCs who have access to adequate supplies of safe water and basic sanitation, in large part because continued rapid population growth has outpaced the expansion of basic health-related services. Even a vigorous and well coordinated effort by LDCs and developed countries is unlikely to result in safe water and adequate sanitation for all the world's population by 1990, the goal of the International Drinking Water Supply and Sanitation Decade. The UN estimates that the cost of achieving universal access to adequate

[10] Feacham, 1977 and 1978, **op. cit.**

[11] Feacham, et. al., 1978, **op. cit.**, p. 217. Thus both water quantity and water quality are important to health, and should be addressed in project design. The minimal quantity needed to promote health is at least 20-40 liters per capita per day. Additional quantities are desirable; however, as quantity exceeds about 100 liters per capita per day marginal health benefits decline. The most important quality parameter is microbiological purity. This is best assured by selection of nonpolluted, protected sources, and, if necessary water treatment (purification). Given the scarcity of resources in most developing countries, investments in additional improvements in quality and quantity should be weighed against providing these minimal services to a larger population.

[12] For an excellent discussion of some of the difficulties involved in quantifying the health and economic benefits of improvements in water supply and sanitation, see White, Gilbert F., **et. al.**, 1972, **op. cit.**

[13] Time saved in rural Thai villages where water was provided in or near the home made possible economically productive activities—such as crafts and small vegetable gardens. Villagers cited increased craft activities and more gardening and farming as the most beneficial consequences of the piped water systems. (Dworkin, D. and B.L.K. Pillsbury, "The Potable Water Project in Rural Thailand," A.I.D. Project Evaluation Report No. 3, Washington, D.C. 1980.) Findings such as these have been cited in numerous recent studies. See, for instance, White, **et. al.**, 1972, **op. cit.**

[14] Russel, Annemarie, "Report on the Situation of Women in the Target Village of the UNICEF Domestic Water Supply Project in Bahr El Ghazal Province, Sudan," Khartoum: UNICEF, 1979.

[15] Cochran, Susan, **The Effects of Education on Health**, Washington, D.C. IBRD Working Paper 405, 1980.

water and sanitation will be $300 billion over the decade. This estimate probably falls short of actual requirements, because the total cost of providing water to all rural areas, where the bulk of LDC populations live, is very high. But the estimated $300 billion far exceeds the resources that are likely to be available over the decade for drinking water and sanitation programs.

A. The U.S. Commitment to Supporting Water and Sanitation Programs in Developing Countries

The United States has voiced strong support for water supply and sanitation programs in developing countries in numerous international fora in recent years. The U.S. has supported resolutions endorsing the provision of safe water supplies and hygienic means of waste disposal at the U.N. Conference on Human Settlements (Habitat) in 1976; at the U.N. Water Conference in 1977, which proposed that the U.N. establish the 1981-1990 International Drinking Water and Sanitation Decade; at the International Conference on Primary Health Care (Alma Ata) in 1978; at the U.N. World Health Assembly; and, most recently, at the convocation of the U.N. General Assembly inaugurating the International Drinking Water and Sanitation Decade.

B. A.I.D. and Other International Donors

A.I.D. is one of the leading international donors providing financial support and technical assistance for water supply and sanitation programs in developing countries. (See Table I). Compared with the aggregate contribution of other donors, however, the level of A.I.D. financing for such activities is small. The World Bank (including IDA), by far the largest donor in developing countries, lent nearly $900 million for water supply and sanitation programs in 1979, primarily in urban areas. UNICEF devotes one-quarter of its budget ($53 million in 1979) to water supply and sanitation activities. Other bilateral, multilateral, and private voluntary donors in this area include the Inter-American Development Bank, UNDP ($698 million in 1979), the Asian Development Bank, the various Arab development banks, and the bilateral agencies of the OECD countries. While there is an impressive number of organizations involved in development assistance in this sector, it should be noted that at least 75 percent of the roughly $10 billion expended annually on improving domestic water supply and sanitation, comes from the LDCs (both governments and consumers) themselves.

TABLE I
AID FUNDING, WATER SUPPLY AND SANITATION (1978-82)
($000)

	FY 1978		FY 1979		FY 1980		FY 1981		FY 1982*	
	DA[1]	ESF[2]	DA	ESF	DA	ESF	DA	ESF	DA	ESF
Asia	3,684		3,500		16,104		9,400		3,033	
LAC	330		8,425		18,961		220		150	
NE	3,844	166,500	8,469	192,100	2,190	139,500	5,000	237,900	1,450	163,000
Africa	6,557		3,060		8,330		11,980		7,597	
S&T/H	545		66		2,652		2,650		2,450	
HG	45,000		55,000		70,500		42,000		46,000	
TOTALS, DA/ESF	59,960	166,500	78,529	192,100	118,737	139,500	71,250	237,900	60,680	163,000
Annual Totals	226,460		270,620		258,237		309,150		217,180	

[1] Development Assistance Funds.
[2] Economic Support Funds.
* 82 = Estimated

C. A.I.D.'s Role in Water Supply and Sanitation in Developing Countries

Many of the water supply and sanitation programs supported by major donors other than A.I.D. have traditionally been urban-oriented and have generally employed relatively sophisticated levels of technology. However, the majority of LDC populations lives in rural areas and in villages and market towns, and it is in these

areas that access to safe water and sanitation is most limited.[16] Another residential grouping that has largely been bypassed by traditional water and sanitation systems is the recent immigrants living in the slums, squatter settlements and fringe areas of burgeoning LDC cities. Their poverty, their illegal or squatter status, and their lack of familiarity with urban life all tend to deny them the basic services more likely to be available to other urban residents. The neediest groups in developing countries include not only rural households but also those in cities and, in particular, in high density urban slums, and it is A.I.D.'s policy to assist in providing water supply and sanitation to both.

The cost-effectiveness of alternative tehcnologies in various settings therefore becomes of paramount concern in A.I.D.'s investment decisions. For instance, providing domestic water and sanitation to people who live in extremely isolated regions or in widely dispersed households is likely to be more costly on a per capita basis than providing the same technology and services to settlements that are somewhat more densely populated and more readily accessible. But less costly technology and related design factors can narrow considerably if not close this gap. In certain regions the minimum community size for provision of improved water supply and sanitation at a reasonable cost will be 2,000-10,000, whereas in others, as a result of less costly technologies and other factors, it may be as low as 500.[17] Providing improved sanitation in rural areas does not necessarily involve a large capital investment in construction; sanitation in urban areas, on the other hand, tends to be more costly on a per capita basis, because relatively sophisticated technology is frequently required.[18]

In the selection of technologies for water supply and sanitation programs, planners should also pay attention to "software" components. These might include training, technical assistance, the development of host country institutions, hygiene education, the promotion of community participation, the support of complementary nutrition and health activities, and the development of national and regional water and sanitation policies and plans. A.I.D. does not and should not support water supply and sanitation programs where these essential software elements have not been adequately considered in the design of the project.

In general, A.I.D.'s increasingly scarce and limited levels of funding in many countries are not likely to be sufficient to support the capital investment costs of major urban water supply and sanitation programs.[19] The Agency will finance "software" components of programs in urban and urban fringe areas. This policy is based on several considerations, not the least of which is expense. More substantial resources for major capital investments in water supply and sanitation tend to be available from other donors and lending institutions such as the World Bank; these funds are less often available for the technical assistance elements of such projects. Furthermore, in line with growing U.S. concern for assuring the long-term viability of LDC institutions, A.I.D. is placing strong and increasing emphasis on the "software" and technical assistance components mentioned above.

D. The Linkages Between Domestic Water Supply, Sanitation, and Health

What priority should water supply and sanitation programs have in A.I.D.'s overall health objectives? There is a strong temptation to compare health improvements that result from water and sanitation programs with those from other health activities, especially interventions such as immunizations or oral rehydration that appear to achieve comparable health objectives at lower per capita cost.

Although improvements in water supply and sanitation are generally linked to improvements in life expectancy and decreases in mortality and morbidity,[20] water and sanitation programs tend to be relatively costly per capita compared with other health interventions.[21] While per capita costs of establishing and operating water and

[16] It may be extremely costly to provide these services for the poorest, most widely dispersed groups (who are least able to pay for them), but A.I.D. is committed to the search for low-cost technologies that lower the cost of serving the poorest populations in LDCs (see pp. 21-24 below).

[17] Saunders and Warford, *op. cit.* Total cost depends on the quality and quantity of the water available, the type of "hardware" selected, the related training, administrative, and other costs, and much more.

[18] "Water Supply and Waste Disposal," Poverty and Basic Needs Series, The World Bank, Washington, D. C., 1980.

[19] Housing Guaranty and Economic Support Fund Programs which operate primarily in urban areas are exceptions.

[20] Barnum, Howard, *et. al.*, *A Resource Allocation Model for Child Survival*, Cambridge, Ma: Oelgeschläger, Gunn & Hain, 1980. According to this analysis of health improvements in five barrios in Colombia, at least 25% of the drop in mortality was directly attributed to improved water and sanitation programs.

[21] See, for instance, Grosse, Robert N., "Interrelation Between Health and Population: Observations Derived from Field Experience," *Social Science and Medicine*, Vol. 14C, No. 2, pp. 99-120, 1980.

sanitation systems are important considerations, and in many cases will be the most important factor determining investment strategies in health, other factors should also be considered. For instance, water and sanitation systems, depending on the type of system, water source, storage and treatment (if any), may not require heavy involvement of highly skilled manpower. In settings where the absence of such skilled personnel is a major constraint, water and sanitation projects can be competitive alternatives to other health programs designed to combat diarrheal and other water-related diseases.[22]

In addition, in any assessment of water and sanitation benefits, effects other than health must be taken into account.[23] Thus while an analysis of the relative cost-effectiveness of water programs in improving health might discourage investments in domestic water supply and sanitation programs in favor of simpler or "more direct" health interventions (immunizations, etc.), a cost-benefit analysis (of *all* benefits, not only health) might argue strongly in favor of investments in water projects.

The Agency's past experience has resulted in a fairly thorough appreciation of what is needed to keep water supply and sanitation systems functioning in the developing countries in which A.I.D. typically works. Unfortunately, there is much less certainty about the precise characteristics of water and sanitation systems that have the greatest impact on improving health. Will more convenient, reliable, and safe water supplies necessarily improve health in all communities, or must an area have achieved a certain level of socioeconomic development (whether measured in terms of educational level, level of agricultural or industrial production, or family income) before health improvements result?[24] What types of health improvements can be expected in given settings and what is the best means of bringing about the behavioral changes necessary to translate improved water and sanitation into improved health?

While A.I.D. continues to support economic and social research on these important questions, it has developed some general guidelines, listed below, for its support of improved domestic water supply and sanitation programs. More specifically, A.I.D. will consider funding projects for improvements in domestic water supply and sanitation where:

1. A clear need exists, as indicated by high prevalence of disease caused by (a) insufficient water, (b) consumption of highly contaminated water, and/or (c) inadequate or inappropriate sanitation systems; and demand for services is indicated by a willingness on the part of users to (a) support recurrent costs through some combination of fees, taxes or labor contributions, and (b) cover some portion of the investment costs to improve traditional systems or build new ones; or

2. The absence of basic water and sanitation services poses a public health hazard for the community at large and the national government demonstrates a commitment to shoulder a substantial portion of investment costs where demand is insufficient to generate the revenue necessary to cover these costs[25]; and

3. The local or national institution responsible for water and sanitation programs has the personnel and budgetary resources to assist in the construction, operation, and maintenance of the improved systems, or, with modest outside support, can be strengthened to the point where it has that capacity; and

4. Infrastructure (both roads and other means of communication) is developed enough to permit routine contacts for supervision, technical assistance, maintenance, and the delivery of fuel or spare parts; or where the technology adopted is such that the system can be sustained by the community itself.

[22] Barnum, *op. cit.* p. 4.

[23] See, for instance, the studies cited in footnote 11. See also Hollister, Arthur C., Jr., et. al., "Influence of Water Availability on Shigella Prevalence in Children of Farm Labor Families," *American Journal of Public Health*, 45 (3):354-362, 1955; Moore Helen, et. al., "Diarrheal Disease Studies in Costa Rica. IV. The Influence of Sanitation Upon the Prevalence of Intestinal Infection and Diarrheal Disease." *American Journal of Epidemiology, 82* (2): 162-184, 1965; Schliessman, D. J., et. al., "Relation of Environmental Factors to be Occurrence of Enteric Diseases in Areas of Eastern Kentucky," *Public Health Monograph No. 54* (Issued concurrently in Public Health Reports, 73 (11).), Washington, 1958.

Section 611(b) of the Foreign Assistance Act requires "...a computation of benefits and costs made insofar as practical in accordance with the procedures set forth in the Principles and Standards for Planning Water and Related Land Resources, dated October 25, 1973, with respect to such computations."

[24] Shuval, Hillel, *et. al.*, "The Effect of Water Supply and Sanitation Investments on Health Status: A Threshold-Saturation Theory," in press, 1981.

[25] In situations where the public need is compelling, host government subsidization of recurrent costs may be necessary on an interim basis, with the expectation that consumers will eventually assume these costs.

There are numerous complementary programs, in the areas of education, nutrition, primary health care, housing, irrigation, cottage industries, and rural development with which domestic water supply and sanitation programs can be combined to improve the impact of the program; such integrated approaches should be adopted wherever technically and financially feasible. For instance, where improved water supply and sanitation systems have been introduced in a community to improve health conditions, especially among young children, high priority should be given to constructing latrines and providing adequate water supplies in the local schools, and to including hygiene in the curriculum. In some settings, the school environments are so unhealthy that parents are reluctant to allow their children to attend. Furthermore, having appropriate sanitation facilities in the schools is a powerful way of reinforcing the hygiene lessons being taught in the classroom. Where provision of more convenient water in greater quantity is designed to lessen diarrheal disease, simultaneous introduction of oral rehydration (teaching women to mix solutions hygienically) can enhance the health impact of the new water supply, thus further diminishing mortality.

Among the benefits generally thought to flow from investments in water are: (1) improved health, (2) more cash income, (3) increased food production or diversification of crops, (4) more employment, and (5) more leisure.[26] The extent to which any one of these benefits is realized or sustained varies considerably from setting to setting.[27] In subsequent sections of this paper, the factors that tend to lead to sustained health improvements and ancilliary benefits are discussed in greater detail. Except in unusual circumstances, A.I.D. programs will be expected to adhere to the guidance contained below.

IV. Guidance for the Development of the Drinking Water and Sanitation Programs in Developing Countries: Major Issues

The issues in water supply and sanitation programs in developing countries can be divided into three categories: technical issues; social and cultural issues; and issues concerning the implementation and administration of programs.

[26] Carruthers, I.D., "Impact and Economics of Community Water Supply: A Study of Rural Water Investments in Kenya" (Kent, England: Agrarian Development Studies Report No. 6), 1973, p. 30.

[27] Warner, Dennis, "Social and Economic Preconditions for Water and Sanitation Programs," Washington, D.C.: U.S.A.I.D., 1981.

A. Technical Issues

1. Convenience, Reliability, Quantity, and Quality

These four characteristics are key to the success of water supply programs; the first two apply to sanitation programs as well. Safe water supplies and sanitary means of excreta disposal must be both convenient (as perceived by the consumer) and reliable (in good working order throughout the year). Water should be available in at least some minimum quantity, which will vary among regions and even within countries, but should fall within the range of 20-40 liters per capita per day for the domestic uses defined above if health improvements are to be sustained.[28] This range may be too high for certain arid zones, where limited availability of water may dictate more modest objectives.

The importance of water quality must be weighed not only against the diseases prevalent in the region but also against other factors such as cost, quantity, and reliability (e.g., the ability of a system to operate continuously, during reasonable periods every day, throughout the year).[29]

Water quantity: Domestic water should be available in adequate quantity to satisfy minimal requirements for drinking, cooking, and food preparation as the highest priority. Ten liters per capita per day is the minimum estimated for these requirements. Second in priority is sufficient water for bathing, personal hygiene, and washing utensils, for which 10-15 liters per capita per day is the minimum. Third, if feasible, domestic water should be available for washing clothes, and for watering small garden plots and/or small numbers of livestock or poultry.[30]

Water quality: Water treatment should be introduced where needed to improve water quality, especially for drinking, cooking, and food

[28] White et. al., *op. cit.* (See also page 18).

[29] The WHO's International Drinking Water Standards, are currently being reformulated. See also: Chamberlain, Charles E., et. al., *Wholesome and Palatable Drinking Water: A Background Paper on Water Quality Aspects of Water Supply*, Washington, D.C., 1979; Wolman, Abel, et. al., "A Panel Report to U.S. Agency for International Development on Sanitary Services During 1980-1990," Washington, D.C.: U.S.A.I.D., 1979.

This issue was thoroughly reviewed by A.I.D. during 1979 by an external panel of experts. Guidelines on water quality are based on the findings in their report, which is available from A.I.D.'s Office of Health. (Chamberlin, et. al., *op. cit.*)

[30] Donaldson, David, "Sanitation and Health: An Overview," in *The Impact of Interventions in Water Supply and Sanitation in Developing Countries*, U.S.A.I.D., April 1981.

preparation. Water treatment to improve the quality of water for bathing, personal hygiene, clothes washing, or garden plots should only be introduced where treatment does not prejudice the reliability of the water supply and where water quality can be improved at a reasonable cost. Simple household treatment may be sufficient to assure adequate quality for domestic use. Education (particularly for mothers and school-age children) can help ensure maintenance of the water's quality during its storage and transportation from point of collection to point of use (see pp. 11-13 below).

Where these minimum standards of quantity and quality cannot be assured, investments in water supply are not likely to achieve completely their desired health impact.

2. **Site Selection and Source Development**

In selecting the site and the appropriate method of developing and providing the water for domestic uses, attention should be given to potential future demands on the system, which should be designed with a view of possible future expansion if population growth or other conditions require it. These considerations lead to several guidelines:

— **Water and sanitation surveys** should be conducted to aid project designers and the community in selecting the most appropriate water sources among available alternatives and to identify feasible, efficient and appropriate methods of waste disposal.

— **Social and cultural factors** should be taken into account in site selection and source development (e.g., location of communal washing areas; identification of cultural norms pertaining to the tasks of fetching water, cleaning, etc.; and consideration of water laws and current patterns of ownership, allocation and access to water). Where feasible the beneficiaries themselves should be actively consulted and involved in the development of the project activity.

— In most cases, *groundwater should be the first possible source of water considered*, since it is often the least costly and most reliable source that is relatively free of bacteria and does not normally require treatment. However, where surface water can be easily treated, and where sufficient quantities are available year round, surface water may be the least-costly and most reliable source for systems that require large quantities of water. Gravity-fed systems that require no pumping are less costly and less susceptible to mechanical failure than alternative methods.

— When surface water is used, its variable quality requires monitoring throughout the year. It should be treated when necessary to meet minimum standards of safety for purposes of drinking, cooking, and food preparation.

3. **Selection of a Suitable Technology**

Experience in many developing countries has shown that the selection and adaptation of technologies suitable to the local setting is crucial in finding a balance among desirable characteristics of water and sanitation systems: convenience, reliability, costs and, in water systems, quantity and quality. There is some evidence that utilizing LDC private sector enterprise for the manufacture and installation of water and sanitation systems is not only cost-effective, but also stimulates the private sector and promotes employment.

There are now a large number of alternatives to Western style water and sanitation systems, including pit latrines and water-sealed latrines (pour-flush commodes).[31] Selection of a suitable technology should take into consideration local preferences as well as social and cultural factors, the repair and maintenance support systems, availability of labor and management, appropriate institutional structures, the level of investment and recurrent cost implied, and the willingness and ability of beneficiaries to cover the expected costs. Although the selection process is not an easy one, the factors discussed in this section should serve as a guide.

The local manufacture of parts and equipment can significantly ease the operation and repair of the system, and often with substantial cost savings. A simple well screen that would cost $10-30 per foot to manufacture in the United States may cost only $2-3 per foot in many developing countries, because of lower production costs. A hand

[31] In many arid regions, traditional societies developed water supply and excreta disposal systems which were designed to fit within the constraints imposed by the environment. For example, in the Near East, huge cisterns were built to store rain water for the dry season. Dry toilets built within the homes provided an ecologically sound means of human waste disposal. Excreta deposited in an isolated chamber was readily available as a soil additive or fuel supplement. Planners should consider modifying time-tested traditional approaches such as these, rather than automatically replacing them with modern methods that may waste resources already in short supply. New technologies, such as pumps and self-closing valves that curtail water waste, should also be considered. See Winblad, Uno and Wen Kilama, *Sanitation Without Water*, Stockholm: SIDA, 1980; Kalbermatten, John M, et. al., *Appropriate Technology for Water Supply and Sanitation, Technical and Economic Options*, Washington: World Bank, 1980.

pump costing $300 to produce in the United States may be manufactured for $40-$60 in a country like Indonesia. In estimating potential cost savings through local manufacture of parts and equipment, however, it is necessary to assure that locally manufactured equipment is of sufficient reliability and durability, and is as easy to install properly and maintain as the more expensive foreign equipment, or else the cost differential may involve no savings at all.

A.I.D. has been active in the development and testing of technologies suitable for local manufacture (e.g., improved handpumps and well screens) and has also sponsored comparative reviews of other locally producible equipment and machinery (e.g., non-sewered excreta disposal devices, desalinization devices, small diameter pipe, and well-drilling equipment). The Agency's guidelines for the promotion of appropriate technologies for water and sanitation projects include the following:

— A.I.D. supported water supply and sanitation programs should encourage LDCs to use efficient technologies that can be maintained and operated easily and are acceptable within the local culture.[32]

— A.I.D. should investigate the potential of private firms in LDCs to develop and operate efficient water and sanitation systems.

— A.I.D. should stimulate local manufacture and field testing of simple equipment. In specific instances (where local capacity is not adequate or where a small market is involved), manufacture on a regional level may be preferable.

— Instead of introducing a new system, A.I.D. should support the improvement of traditional systems, where local preferences or cost considerations indicate system upgrading is the most desirable approach.

— A.I.D. recognizes that success of water and sanitation programs depends in large measure on the ability and commitment of people to use, operate, and maintain the system properly. Thus, A.I.D. should also support programs to train maintenance and other personnel and to educate current and potential users of the services.

— A.I.D. should promote standardization of water and sanitation equipment and parts, even while seeking technologies in which hardware can be produced efficiently on a small scale. A.I.D.'s efforts to eliminate wastage and maintenance failure currently caused by a proliferation of mechanical designs and specifications will necessitate closer coordination among donors and local private investors, and may on occasion require a procurement waiver.

4. Water Conservation and Reuse

In most LDCs, potable water is neither cheap nor abundant, and with continued rapid population growth, water shortages may affect significant proportions of LDC populations. Certain areas of the world (e.g., the Sahel) have already experienced grave water crises. Water conservation is playing an increasingly important role in development planning, not only because water is recognized as a scarce resource but also because wastage of water contributes to health problems: pools of water that collect around taps present health hazards, and saturation of the soil with waste water (such as has been observed in rural Egypt) can contaminate the aquifer.[33] Water metering in urban areas, safe restricted flow measures, increasing block rates,[34] reduction of leakage by proper installation and regular repair and maintenance, and reuse of waste water for agricultural and industrial purposes are among the means that can contribute to water conservation.

B. Social and Cultural Issues

Water and sanitation programs are most likely to succeed when they respond to the needs of the community. Those needs — and how they are perceived by the community — will differ greatly depending on the country, whether the setting is rural or urban, the current availability and adequacy of water and sanitation, and other factors. A thorough understanding of social, cultural and institutional factors and relationships is therefore a basis for developing and implementing effective water and sanitation programs.

1. Community Participation

Recent project impact evaluations and other project reviews of A.I.D.'s experience have

[32] The level of technology that is appropriate in a given situation should not be underestimated. The evaluation of A.I.D.'s potable water project in rural Thailand demonstrated that the best technology was not necessarily that which appeared to be the most capital saving technology. Villages perceived piped water systems with household connections as preferable to traditional sources of hand-pumps. They were therefore willing to finance and maintain the piped systems, while few of the handpumps have remained in operation. Dworkin, D. and B. L. K. Pillsbury, 1980, *op. cit.*

[33] Varisco, Daniel and Max Kroeschel, "Rural Sanitation in the Arab Republic of Egypt," Washington, D.C.: Metametrics (for U.S.A.I.D.), 1981.

Pools of waste water may promote mosquito breeding (especially of *Culex fatigans* and *Aedes egypti*, vectors of filariasis and yellow fever) and may create soil conditions favorable to transmission of geohelminthic diseases, e.g., hookworm and ascariasis.

[34] Increasing block rates refers to the pricing structure where the first units of water are provided at low prices, with cost per unit increasing with the volume of water consumed.

documented the importance of community participation to effective water supply and sanitation programs in developing countries.[35] Local residents must have a strong interest in keeping the system functioning. They must use the system, and be able to support the bulk of the costs of operating and maintaining the system,[36] whether in the form of cash, labor, or in-kind contributions. It is their contribution that can help ensure commitment to maintaining the system over the long-term.[37]

Participation of the community is for these reasons often crucial in rural areas, small communities and low-income urban areas served by communal facilities such as standpipes. A.I.D.-funded programs intended for such areas should adhere to the following guidelines. These guidelines may need to be modified or relaxed in the case of higher income urban residential or commercial areas served by building-to-building connections where a high degree of community participation is not practical. However, even in such situations some indication of community interest is desirable.

—A.I.D. should require a request by community leaders or by a representative community group, or some other formal evidence of community support, and the community should be involved in the program from the outset. Communities where support is lacking will be bypassed unless a compelling public health need exists.

— Wherever possible, the community must be fully aware of the costs and benefits of alternative systems, and should help select the site, level of service, and technology employed. Communities must understand and agree to water rates and other fees at the outset. They must be consistent with the beneficiaries' ability to pay.

— The project should where feasible include a plan to train community workers in the construction, operation, and maintenance of systems. Women as well as men should be trained. (See p. 13.)

— Wherever possible, the project will use the existing indigenous organizations to assure community participation and to institutionalize maintenance, management and administration of the system.

Social analysis, especially at the initial stage of project design, is essential to determine whether or not these conditions have been or can be met.

2. User Education

The provision of basic sanitation and a reliable supply of safe, convenient water is not sufficient to guarantee improved health. A variety of social and cultural attitudes affect the pattern of usage of water and sanitation facilities: people must use facilities and use them properly to discourage environmental contamination (particularly with fecal material) and disease transmission. In some areas, for instance, children are not encouraged to use the latrines, which are dark and distant from the home, because children's feces are considered harmless. In other areas, men and women prefer not to share the same latrines, which tends to limit use of household latrines to female members of the family. As a recent study noted: "Decisions about drinking water are often based on sensory perception — color, taste or smell — rather than technical purity."[38]

Water supply and sanitation interventions can be most effective in improving health when they are coordinated with other primary health care activities, especially health and hygiene education, and maternal and child health services. Examples of user education which seem obvious but which are often overlooked include: advice on the protection of stored household water from microbial contamination and mosquito breeding; promotion of handwashing (particularly by food handlers); promotion of hygienic food preparation, including the proper use of water for cleaning utensils; promotion of breastfeeding, especially during the first six months of life; promotion of safe excreta disposal by all family members; and instruction on preparing water for use in oral rehydration therapy, infant formula, where used, and weaning foods.

Consumers must be encouraged to transport water in clean containers, and store it under sanitary conditions. They must know how to wash their hands and bathe properly to break the fecal-oral cycle of many diarrheal diseases.

---

[35] **Observations of Rural Water Supply and Sanitation Programs in Eight Developing Countries.** IBRD, Report No. PUN 42, 1978; Self, George, "Social Analysis of Rural Potable Water Programs," A.I.D., 1979. **UNICEF/WHO Joint Study on Water Supply and Sanitation Components of Primary Health Care,** JC 22/UNICEF-WHO/79.3.

[36] Larger and more complex systems will require full-time staff and supervision. Even when systems can be operated and maintained by the users, access to the expertise of a central water authority will occasionally be necessary.

[37] **Social and Behavioral Aspects of Project Work in Water Supply and Waste Disposal,** IBRD, Transportation, Water and Telecommunications Department Public Utilities Notes, 1980.

[38] Elmendorf, M. L., and R. B. Iseley. "The Role of Women as Participants and Beneficiaries in Water Supply and Sanitation Programs," Washington: Mimeographed draft, 1981, p. 4.

Hygiene education can be provided in a variety of ways: by community-based, primary health care workers or other health personnel; by "promoters" working with a water agency through primary schools; or by extension workers in other sectors. Evidence from evaluations of development projects suggests that sporadic information and education campaigns do not result in real behavioral changes. Therefore hygiene education associated with water and sanitation programs must be incorporated in continuous education program efforts.

— Effective hygiene education is almost always a necessary complement to the provision of safe water supplies and adequate sanitation in A.I.D.-sponsored programs.

— Whenever possible, proper hygiene should be taught in primary schools, and water and latrines should be provided in schools and their use encouraged so that children may begin to practice the normative hygiene behavior they are taught.

— Mothers should be a main target of hygiene education programs, since they are primarily responsible for the health and training of their children; and women will be included among those employed to carry out the promotional and hygiene education activities associated with AID-supported programs.

C. Issues of Implementation and Administration

1. Costs and Financing of Water Supply and Sanitation Systems

The long-term financing of water supply and sanitation systems is a matter of critical concern for developing countries and donor agencies. Per capita cost of water systems vary according to the country, characteristics and distance of the water source, and kind of technology used (e.g., communal standpipes or household connections).[39] Most estimates of long-term operation and maintenance costs ignore indirect costs, including such factors as the cost of running regional and national offices and training middle management personnel, and therefore seriously underestimate the costs of water systems.

Initial investment costs for water systems have been estimated to range from approximately $25 per capita for household connections in both urban and rural areas. The annual cost of installing and maintaining an adequate sanitation system also varies enormously, from about $20 per household per year (capital and recurrent costs) for single pour-flush toilets, to $400 per household per year for sewerage systems.[40]

Where water and sanitation systems are provided through household connections, consumers must be charged fees which at least cover operating expenses, and preferably the full cost, possibly through loan arrangements. Where services are provided as public goods and no consumer can be excluded, as in the case of water standpipes or public sanitation services, their costs must be recovered through some other mechanisms such as increasing the price of water for house connections and raising the per unit cost of water as the volume used rises (increasing block rates). Other means of financing include the use of community funds or assessment of consumers based on ability or willingness to pay criteria.[41]

Whether in urban or rural settings, water and sanitation tariffs must be structured so that users can afford them. Charges for initial hook-ups and policies that compel all new users to purchase a tank or other equipment at a uniform price may effectively exclude poor households from the system. Such devices as a loan fund, long-term credit arrangements, or charges pegged to income can help ensure more broad-based participation in the system. Where charges do not cover the costs of at least maintaining the system, and where the difference cannot be guaranteed through general tax revenues, A.I.D. will not, in general, support a major investment in domestic water supply.

While most people in developing countries may be prepared to pay a significant portion of their income for improved water supply, in many areas they are less persuaded or even unaware of

[39] The World Bank has recommended that (1) "minimum" water service be available to all and (2) the charge not exceed 5-6 percent of the income of the poorest household to be served. Unfortunately, the high costs of reaching isolated groups may make total coverage of populations in developing countries an "impractical and perhaps unattainable objective. See The World Bank "Water Supply and Waste Disposal." *op. cit.*

[40] Kalbermatten, John M., et. al., *op. cit.* Precise figures for recurrent costs of alternative water systems are unavailable, and estimates vary widely. The World Bank, "Water Supply and Waste Disposal," *op cit.*

In some unusual settings, such as Bangladesh (which has an alluvial delta, high water table, and high population density), the cost of shallow wells with handpumps may be as low as $3 per capita (F. Eugene McJunkin, personal communication).

[41] Building on established community financing mechanisms is a useful starting point for developing financial schemes. In some instances leasing standposts or similar public sources of water to private entrepreneurs can improve operation and maintenance and simultaneously ensure the system's financial viability. However, problems encountered in the use of private vendors have included price fixing, failure to maintain water quality, and the use of inefficient technologies.

the need for improved sanitation facilities, especially when they do not understand or believe the importance of these improvements for health. Thus an education program to highlight the benefits of improved sanitation may have to be coupled with initial subsidization of sewerage systems or, in urban areas at any rate, sewerage charges may have to be subsidized by water users who have water piped to their household.

— The economic analysis of all water supply and sanitation projects will explicitly demonstrate a feasible means of financing the program over the long-term.

— A.I.D. will not support water supply and sanitation programs whose operation and maintenance costs cannot be paid by the users through fees, taxes and/or contributed labor.

— Where possible, each user household should bear primary responsibility for covering all costs, and certainly recurrent costs, except in areas with extremely poor households where some level and combination of cross subsidy and/or allocation of general tax revenues may be required. A.I.D. encourages adoption of methods, such as cross subsidies, which do not exclude the poorest members of the community.

2. Operation and Maintenance

Too frequently the success of a water and sanitation project has been measured in terms of the total number of wells, handpumps, or latrines constructed, with little attention to actual operation, maintenance, or usage. Long-term success of these systems depends on the availability of supplies, parts, equipment, and the trained people needed to monitor, maintain, and repair the systems.

— In general, A.I.D. will give preference to water supply and sanitation systems that are appropriate to the setting, inexpensive, and simple to install, operate, and maintain.

— In rural and village water and sanitation systems, revenues for operation and maintenance should be generated and controlled by the local community, which has a vested interest in maintaining the system, so that they are readily available when breakdowns occur.

— A.I.D.-supported programs for water and sanitation systems should include training for regional and national level personnel in the operation, maintenance and repair of water supply and sanitation systems, and for community members when community participation is a major feature of a program. Special emphasis will be placed on training women, since they are the major users of the systems. Emphasis will be placed on short-term, in-service training of village-level personnel.

3. Management and Logistics: The Administration of Water Supply and Sanitation Programs

Effective institutional support for water supply and sanitation programs is essential. However, in many LDCs, the administration of water supply and sanitation programs is divided among numerous ministries and coordination among them is often deficient. In some LDC settings, there may be no clearly demonstrated capacity anywhere in the public sector to initiate and support water and sanitation programs.

The participation of the private sector in both the construction and operation of water and sanitation systems can increase the efficiency of such efforts, especially where water and sanitation services are provided directly to households willing to pay for services. However, where the services are not provided directly to households but are "public goods" in the form of standpipes or other communal facilities, special private sector incentives or public sector involvement may be necessary to ensure broad access to water.[42]

Given the fact that utilities such as water supply tend to be natural monopolies, some public sector oversight is required to set service standards and tariff structures, to endorse operation and maintenance procedures and schedules, and billing and collection activities, and, most important, to plan for efficient and equitable water use. Relatively small, individual communities can generally take direct responsibility for management of water systems, but larger jurisdictions normally require a local or national water agency (either public or private), and where private firms are involved, public oversight is necessary.

— A thorough analysis of existing and potential institutions, including private sector entities, should be part of any project analysis for water supply and sanitation projects.

— A.I.D.-supported water supply and sanitation programs should include technical assistance and/or training to improve the efficiency and effectiveness of program administration by government institutions and private firms.

— An established, national or regional level unit responsible for domestic water supply and

[42] For example, where the private sector is encouraged to provide public goods (for example, sanitation), incentives such as higher water fees could be allowed by the water authority to cover costs of sanitation services.

sanitation programs is a prerequisite for substantial A.I.D. assistance for domestic water supply programs. The public water authority can be governmental or parastatal, but must be responsible for assessing long term water and sanitation needs, planning for effective utilization of national local water resources, assessing and monitoring environmental hazards, rate setting, the establishment of standards, and, where applicable, oversight of private sector activities in water and sanitation. In terms of implementation of the other aspects of water supply and sanitation systems, the governmental agency and/or private firms must have responsibility for at least the following:

— administering national/local water and sanitation systems;

— establishing technical requirements for water supply and sanitation;

— ensuring operation and maintenance of the system, including procurement and distribution of equipment and supplies;

— assessing manpower needs, and providing appropriate training for operations and maintenance.

4. Role of the Private Sector

A.I.D. endorses the role of private enterprise in water supply and sanitation activities, particularly with respect to operations and management. Where private entrepreneurs are interested, franchises can be auctioned by the public sector for building and/or operating urban water systems. The public water and sanitation authority would then set rates based on acceptable rate of return criteria and ensure that where necessary public goods (standposts and, where relevant, sanitation systems) are financed through some combination of innovative community financing, common central government revenues, or cross-subsidies. Opportunities for private businesses to operate and maintain water supply systems and waste disposal (including cartage) exist, and A.I.D. should fully explore the feasibility of expanding and improving these activities. However A.I.D. recognizes that, given the high cost and modest returns as well as the uncertainty and risk associated with such investments in LDCs, the private sector is generally reluctant to finance establishment of water and sanitation systems.

5. Program Evaluation and Applied Research

Careful evaluation of water supply and sanitation programs is needed to ascertain which types of water supply and sanitation systems work best under particular field conditions. To date, A.I.D.-supported applied research has stressed the development of technical and engineering aspects of water supply and sanitation programs. In the future, A.I.D. will give much more attention to social, economic, and administrative considerations, and will evaluate regularly the water and sanitation programs it supports. Programs that involve major innovations — either a new technology or a new combination of interventions — will have a built-in evaluation component. A.I.D. will also continue to support applied research studies.

V. Water in the Context of General Economic Development

Development programs do not operate in a vacuum, and there are, of course, a variety of other factors and considerations that have a bearing on the nature and extent of A.I.D. support for water and sanitation programs. More specifically, the need and demand for improved water supply and sanitation services can both affect and be affected by changes in other development sectors. Four such intersectoral linkages are highlighted below to illustrate the contextual issues that surround water and sanitation programs in developing countries.

A. Water, Sanitation and Natural Resources

The exploitation of natural resources may unintentionally diminish the availability and quality of water for domestic use. For instance, dam and irrigation projects may divert water supplies that would otherwise be available for domestic use.[43]

Domestic water supplies may be contaminated by municipal sewage, agricultural chemicals, or industrial wastes. The availability and quality of water can also be compromised by such development activities as irrigation, pesticide spraying, and vector-borne disease control programs.

The reverse is also true: water supply and sanitation practices can have a detrimental effect on the natural environment. The increased use of water that generally follows the provision of more convenient water sources can lead to the discharge of large volumes of potentially contaminated, untreated waste water which may create health and environmental problems. Environmentally sound and cost-effective wastewater and excreta disposal procedures must be a part of A.I.D.-supported water supply programs.

[43] The environmental assessment required by the Agency for all such projects under the provisions of 22 CFR 26, "A.I.D. Environmental Procedures", should address this issue directly.

B. Water, Sanitation, and Primary Health Care

Sound primary health care programs must incorporate a mix of activities, since neither improved water supply nor any other single health-promoting activity can by itself fully meet the health objectives of LDCs in any reasonable time frame. Although for many poorer countries water and sanitation programs may not be included in the initial primary health care services provided (because of cost, logistics, and other factors), improvements over time in water supply and sanitation are a necessary part of a comprehensive primary health care program.[44]

Some aspects of water supply and sanitation can be incorporated readily into primary health care programs. Village health workers can be taught to recognize diseases that are caused by inadequate or poor water and sanitation and can learn to provide hygiene education as part of their preventive health activities. Community-level personnel can be trained to carry out simplified sanitary surveys and to provide encouragement and advice to communities for the construction of water supply and simple excreta disposal systems.

C. Water Supply, Sanitation, and Agriculture

Rural development activities can have both beneficial and detrimental effects on water supply and sanitation in developing countries. Programs to increase agricultural production and increase farm family income can enable rural families to pay for improved water and sanitation systems, and irrigation activities themselves may make greater quantitites of water available for domestic use.

Irrigation programs can also have a directly detrimental effect on the quality of water available for domestic use: in many countries, large-scale irrigation programs have resulted in chemical contamination of domestic water supplies and in the spread of communicable disease. Careful local and regional planning which gives particular attention to possible environmental degradation is therefore essential.

D. Water Supply, Sanitation, and Urban Development

Rapid urbanization, a result of natural population increase and of rural- to urban-migration, has strained the already limited capacity of existing water supply and sanitation and other public service systems. In addition to the health sector programs cited earlier, A.I.D. funds water supply and sanitation programs in urban areas through its shelter sector program.[45] Sites and services programs provide utilities, including domestic water and sanitation; the construction of core housing generally includes water and sanitation facilities; slum upgrading projects often include improved water supplies, excreta disposal, and sewage treatment; and home improvement loans offered to property owners are frequently used to finance better domestic water supply and sanitation systems. Through its shelter program, A.I.D. can help developing countries devise innovative and effective responses to the massive water supply and sanitation needs of third world cities.

Among the topics currently being addressed in A.I.D.'s research and development program in urban development that bear on water supply and sanitation are: improving the financial and managerial capacity of local government to provide essential services (including water supply and sanitation) efficiently and equitably; demonstrating the feasibility and economic viability of safe disposal, recycling, and production of useful byproducts from the wastes generated in secondary cities; and field testing a strategy to help cities increase efficiency in the consumption of important scarce resources (e.g., land, water, and energy).

E. Future Strategy Considerations

A number of strategy questions emerge for priority consideration by A.I.D. For instance, the development of local financing systems for domestic water and sanitation programs is clearly an extremely important area for attention of economists and other development planners. Under what conditions is a user's fee preferable to a local tax to assuring continued operation of a common water system? Under what conditions should the government be prepared to contribute to the ongoing costs of water and sanitation programs, and what sort of government support is most effective? How reliable are government supported programs? Answers to these questions are critical to the maintenance and expansion of basic water systems in the developing world over the next several years.

Other topics on the Agency's strategy agenda include questions of program integration (e.g., under what conditions should water and sanitation activities accompany or precede other development interventions); community participation (e.g., what are the most practical ways of

[44] Primary Health Care: Report of the International Conference on Primary Health Care, Alma Ata, USSR, 6-12 September, 1978, Geneva: World Health Organization, 1978.

[45] "Urbanization and the Urban Poor," U.S. Agency for International Development, Policy Determination 67, Supplement, Handbook 1, 1976.

assuring meaningful community involvement in water programs); and suitable technology (e.g., what practical information is available to guide program planners in the selection among and adaptation of alternative small-scale technologies in the water and sanitation field). Work on these strategy questions will continue, as will efforts to collect and disseminate information that will allow the Agency to do a better job of targetting its water and sanitation programs to the most appropriate groups. Underlying all this effort and continuing attention is the recognition that water is not only a basic requirement of life but also contributes to overall economic growth and development. It is for both these reasons that A.I.D. has supported and will continue to support the efforts of LDCs to assure basic water and sanitation services for their populations.

II.H (TM 1:34)
11/9/84

A.I.D. Policy Paper

BASIC EDUCATION AND TECHNICAL TRAINING

U.S. Agency for International Development
Washington, D.C. 20523
December 1982

II.H (TM 1:34)
11/9/84

A.I.D. Policy Paper

Basic Education and Technical Training

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

December 1982

TABLE OF CONTENTS

Page

Executive Summary 1

I. Introduction 1

II. Education and Economic Development 2

III. LDC Education Problems in the 1980s 2

IV. A.I.D. Policy 4

1. Internal efficiency of basic education systems . 4

2. External efficiency of vocational education and technical training programs 5

3. Local initiative and diversification of education and training opportunities 5

A. A.I.D.'s Policy for Basic Education for Children 6-14 7

B. A.I.D.'s Policy for Vocational Education and Technical Training 8

V. Implementation Issues and Constraints 11

A. Policy Constraints 11

B. Organization and Management Constraints 11

C. Technology Constraints 11

D. Resource Constraints 12

Conclusion 12

EXECUTIVE SUMMARY

The development of human resources (or "human capital") is vital to the growth of overall productivity and the efficient use of physical capital. While the accumulation of physical capital resources is essential to economic growth, it is the people who shape and energize a nation's development.

There is broad agreement among development agencies—multilateral, bilateral, and private—that assisting countries to establish more efficient systems of education, to moderate their recurrent cost and administrative burdens, and to relate them more effectively to employment opportunities and trained manpower needs are essential components of an effective development strategy. Efforts to raise the levels of basic education and to relate technical training systems more effectively to productive employment are essential to the Agency's development strategies focused on: the fuller application of science and technology in development programs; reliance on market mechanisms and the private sector to stimulate economic development; strengthening of institutions which are key to the development process; and reinforcement of the efforts of local leaders to address their own development problems and to improve the administration and management of local resources.

Accordingly, increasing the efficiency and improving the distribution of basic education and skills training—that is, schooling for children 6-14, vocational education and functional skills training for adolescents and self-employed adults, and technical skills training for wage employment—are among the priorities of A.I.D.'s assistance programs.

While A.I.D. policy is to focus first on problems of resource utilization and internal efficiency, this focus is expected to lead over time to improved access and more broadly based distribution of educational opportunities. Most of the children who do not enroll, or whose education experience is truncated by grade repetition, examination failure and dropout, are poor, rural or female. Those who are poor, rural *and* female have the least opportunity in essentially all cases. Thus, access is closely related to system efficiency and relevance, requiring measures to increase the numbers and percentages of children who, once enrolled, successfully complete at least the first cycle of basic schooling.

In assisting LDC efforts to improve education and training systems, A.I.D. will focus its attention on increasing (1) the efficiency with which education resources are used, (2) the quantitative and qualitative outputs of education and training investments, and (3) the effectiveness of the education and training systems in supporting economic and social development objectives. To the maximum extent possible, A.I.D. will seek to ensure that communities are directly involved in the establishment and maintenance of schools and that employers are directly involved in the implementation of technical training programs.

I. Introduction

The development of human resources (or "human capital") is vital to the growth of overall productivity and the efficient use of physical capital. While the accumulation of physical capital resources is essential to economic growth, it is the people who shape and energize a nation's development. Nations which have failed to understand this fact, or have ignored it, have seen even the most ambitious economic development efforts frustrated by inefficient public and private administration, low utilization of physical productive capacities, high rates of population growth, internal and external migration, and other social and economic problems.

Human resources development* is a long-term process and is integral to all aspects of national development. While improvements are required at all levels of national education and training systems, the most basic task for all developing countries is the establishment of schooling systems for children and skills training opportunities for adolescents and adults. Sustained economic and social development requires a concerted effort to:

- increase the numbers and percentages of children successfully completing the first levels of schooling;
- ensure that most adolescents and adults have skills to participate fully in modernizing institutions and productive activities; and

*Narrowly defined, the education sector tends to be equated with the formal school system for children. The broader definition used in this paper includes both formal schooling and basic vocational and technical skills training for adolescents and adults. Higher education and manpower development represent a further broadening of human resources development activities, and a separate policy paper devoted to this topic is scheduled for 1983. Initial guidance on the Agency's policies in the area of participant training (one, but not the only, means of assisting high level manpower development) was provided in 82 State 24382 and will be further elaborated in the forthcoming policy paper.

• establish instructional systems which are both effective and cost-efficient.

There is broad agreement** among development agencies—multilateral, bilateral and private—that assisting countries to establish more efficient systems of education, to moderate their recurrent cost and administrative burdens, and to relate them more effectively to employment opportunities and trained manpower needs are essential components to an effective development strategy.

Accordingly, increasing the efficiency and improving the distribution of basic education and skills training—that is, schooling for children 6-14, vocational education and functional skills training for adolescents and self-employed adults, and technical skills training for wage employment—are among the priorities of A.I.D.'s assistance programs.

II. Education and Economic Development

Basic education and related skills training are strongly correlated with agricultural productivity, rural and urban development, lower fertility, and increased health and nutritional status. Education expands awareness, informs decision-making in all aspects of peoples' lives, and facilitates the transmission of new knowledge, attitudes, and behavior.

Basic education and skills training programs increase peoples' chances for more remunerative *employment* as well as their productivity, whether wage-employed or self-employed. In those settings where most adolescents and young adults do not have a basic education, the employer pays the price through reduced efficiency, increased supervision or increased on-the-job training costs. Alternatively, the employer must pay a premium to compete for the few educated workers who are available. In short, a skilled workforce is essential for the development of the private sector in developing countries.

Agricultural productivity improves as farmers acquire basic education and become both willing and able to adapt their traditional methods of farming to new technologies, to obtain and use information from extension systems, to use inputs efficiently, and to supplement farm income with other employment.

With education, particularly for females, *health, sanitation* and *nutrition* practices improve, infant mortality declines and adults are less susceptible to debilitating disease. Parents and children learn modern methods of hygiene and food preparation, people learn to use health services effectively, and family incomes rise.

Birth rates tend to fall as education levels rise: marriage is deferred, women have increased opportunity for employment, couples are better able to make effective use of family planning, people gain confidence in their ability to control their lives, and, with improved health practices, the need for additional births in anticipation of a certain number of child deaths is obviated.

III. LDC Education Problems in the 1980s

In the last twenty years, primary school enrollment in developing countries has tripled, from less than 100 million in 1960 to 236 million in 1975 and over 300 million today. While a number of the LDCs have made substantial progress toward full enrollment, most developing countries continue to fall well short of achieving their basic education objectives.

• Approximately 600 million adults in LDCs cannot read or do simple calculations;

• Education opportunities are poorly distributed, with children in the rural areas, the urban poor, and females having the least opportunities to learn;

• Due to high rates of dropout and grade repetition, less than half the children complete the four years necessary to obtain and retain basic skills;

• The quality of education is poor, with schools typically lacking essential equipment, materials, and trained teachers;

• Because the school-age population is growing, some countries may have more children not enrolled in school in 1985 than they had a decade earlier, even though enrollment *ratios* may be higher.

In addition, the education and training systems of most countries, including those with relatively high enrollments, continue to have a number of general problems: lack of fit between skills required by employers (and in adult life in general) and those being taught in schools; substantial recurrent costs, combined with inefficient use of scarce financial, physical, and human resources for education and training; and social, economic and political factors which impede efforts to ex-

**See for example, the *World Development Report, 1980* and the associated World Bank staff working papers as well as the report on *Accelerated Development in Sub-Saharan Africa*, IBRD, 1981.

pand access in rural areas and for girls. Resolution of these problems is often complicated by adherence to relatively standardized institutional models and pedogogic approaches and highly centralized administrative and funding arrangements.

It is becoming increasingly difficult for developing countries to keep up—financially, logistically, and otherwise—with the growing demands on their education and training systems. Unless considerable progress can be made in improving the efficiency of primary and secondary schooling, vocational education and technical training, the goals of enabling most people to obtain at least a basic education and of meeting labor market demands for trained manpower will remain unattainable for many LDCs. Thus, a priority task is to ensure that available resources are fully mobilized and efficiently employed.

There is mounting evidence, both econometric analysis and case studies, that it is possible to overcome the technical and financial obstacles to enrollment of most children in the basic education grades within the next decade or so for most of the countries currently being assisted by A.I.D.

Available evidence suggests that full enrollment (i.e., sufficient capacity to provide 6 years of education for all children) can be achieved with an investment of 3 percent of GNP or less, with the percentage of GNP declining over time as the initial capital costs are amortized and as per capita income increases. Most countries currently invest in the range of 2.0 to 2.5 percent of GNP on education for the 6-14 age group. A number of the poorest countries cannot achieve anything approaching full enrollment within the next decade without a major investment of political, administrative and financial resources. Even so, most countries already commit sufficient resources to enable *most* children to obtain a basic education, were the resources optimally allocated and efficiently utilized. Thus, whether countries can significantly expand the number of children receiving a basic education lies less in any absolute resource constraint than in the ability (and willingness) of countries to experiment with diverse approaches and to make the changes in education policy necessary to use available resources more efficiently and effectively.

A related priority task for most LDCs is to improve the relevance of the education and training systems, both to the personal characteristics of the learners and to the needs of the local economies. Quantitative expansion of education and training opportunities is not sufficient to ensure effective learning or skill acquisition. The appropriateness and effectiveness of education and training approaches, the availability of instructional materials and qualified teachers, and the relevance of the curriculum to the personal background and motivation of learners, have an important impact on how much learning actually occurs. Thus, efficiency and relevance are two sides of the same coin—if little learning occurs or if the learning is not effectively related to employment and other desired functions, it is largely irrelevant how many individuals have the opportunity; and if the system is inefficient or ineffective in reaching potential students, it is of little relevance that the curriculum and pedogogy are appropriate.

While a number of countries face a substantial problem of inadequate opportunities for initial enrollment, particularly for girls and in rural areas, most countries have increasingly serious problems of differential patterns of success for those who do enroll. Most of the children who do not enroll, or whose education experience is truncated by grade repetition, examination failure and dropout, are poor, rural or female. Those who are poor, rural *and* female have the least opportunity in essentially all cases. Thus, access is closely related to system efficiency and relevance, requiring measures to increase the numbers and percentages of children who, once enrolled, successfully complete at least the first cycle of basic schooling. While A.I.D. policy is to focus first on problems of resource utilization and internal efficiency, this focus is expected to lead over time to improved access and more broadly based distribution of educational opportunities.

For the basic schooling systems, cost-effectiveness, efficiency, and relevance depend on factors such as:

- participation of parents and community leaders in the establishment, maintenance, and governance of local schools;
- diversification of educational approaches, enabling adaptation to local needs (particularly, innovative use of community resources, competitive supply of education inputs, policies encouraging non-government schools, and appropriate choices of instructional technologies);
- administrative and financing practices which encourage decentralized decision-making, community participation, and local management of resources;

• the adequacy of technical and logistic support services for schools of all kinds and in all areas (particularly measures to improve the distribution of qualified teachers and instructional materials); and

• the coverage of the systems (generally, as the systems expand to reach those not previously enrolled, the marginal costs tend to increase unless innovations are introduced to fit the schooling to the characteristics of the new groups of learners).

For vocational education and technical training programs, cost-effectiveness, efficiency, and relevance depend on factors such as:

• the level of basic education which trainees bring to subsequent vocational and technical training programs;

• the job-specificity of the training programs;

• the consistency of training programs with labor market demands;

• economic incentives in the labor market which reflect the real economic value of the training;

• cooperation among training institutions, employers and public agencies supporting training;

• the degree to which employers retain responsibility for in-service and on-the-job training which is specific to the job, firm or technology (and, the degree to which employers can obtain pedagogic and other technical support for their training programs from supporting institutions); and

• the flexibility of training programs to respond to changing needs and to the specialized skills training required for specific employment sectors.

IV. A.I.D. Policy

In assisting LDC efforts to improve education and training systems, A.I.D. will focus its attention on increasing (1) the efficiency with which education resources are used, (2) the quantitative and qualitative outputs of education and training investments, and (3) the effectiveness of the education and training systems in supporting economic and social development objectives. To the maximum extent possible, A.I.D. will seek to ensure that communities are directly involved in the establishment and maintenance of schools and that employers are directly involved in the implementation of technical training programs. The general considerations that affect all A.I.D. supported education and training activities are discussed below, after which specific guidance on A.I.D.'s basic education, vocational education, and technical training policies is provided.

1. *Internal efficiency of basic education systems.* Increasing the output of *current* education investments should receive highest priority in A.I.D.'s program strategies directed at improvements in the basic education and vocational training systems. It is becoming increasingly clear that current levels of education investment could go much further toward achieving education objectives were it not for built-in inefficiencies. A major part of LDC investment in education is wasted as a result of academic failure, grade repetition, and student dropout. Hence, in efforts to expand basic education, A.I.D. will give first priority to improvements in retention, promotion, and other efficiency measures at each level rather than to increasing initial enrollment figures.

In many cases the poor quality and capacity of the schools themselves (lack of sanitation; crowding; poor acoustics and ventilation; lack of basic materials, equipment, and furniture) make effective instruction impossible. Some students withdraw (or do not enroll), and some parents make similar decisions for their young children, judging (often correctly) that the available schooling is not worth the cost and may even be harmful. The involvement of parents and community organizations in activities supporting local schools is one of the most effective means of ensuring that the schools are relevant and acceptable to the community.

Many children enter school with stunted growth (physical and cognitive) due to poor nutrition and other conditions in the home. Thus, many of the factors associated with poor school performance must be addressed by programs external to the schooling system—programs which improve family income, the availability of food and basic health services, and the physical environment in the home. In addition, two education-related activities may be key to the preparation of children for success in school:

First, the children of mothers with at least primary education are generally better nurtured (both physically and cognitively) and are much more likely to enroll and complete primary school. Thus, among the many reasons for emphasizing education for girls is that this contributes to better health and nurturing for their children and stronger parental support for education.

Second, there has been some success (mainly in the more developed countries) with early childhood interventions designed to enrich the learning environment for children from relatively disadvantaged homes. The more expensive and managerially complex programs are not feasible in most developing countries, particularly those which have inadequate resources for basic schooling. However, there is promising experimentation in a number of LDCs with programs of relatively short duration, concentrating on mothers and others responsible for child care within the home and, typically, combined with adult nonformal education, MCH and other primary health care, and community development activities involving women. While direct support for preschool education programs will be limited (see p. 8), it may be appropriate in certain country settings to support LDC research on preschool cognitive development and experimentation with cost-effective ways to improve the home learning environment.

Support for national efforts to increase initial enrollment should be contingent on an assessment of the adequacy of the extant system (quality, relevance, instructional effectiveness, etc.). The first priority for technical assistance should be resolution of the factors which limit the possibility of children, once enrolled, successfully completing the primary cycle. While the first priority for increasing enrollment rates is ensuring that available resources are used effectively, in many cases it may not be possible to improve completion rates without mobilizing additional resources. Expansion that results in the replication of an inadequate, ineffective, or inefficient education system is not, in fact, likely to result in expanded output—that is, more children successfully completing 4-6 years of schooling.

2. *External efficiency of vocational education and technical training programs.* It is important to develop realistic estimates of the demand for skilled labor and to avoid overestimating the level of skills required for entry into various fields of employment or for the performance of specific jobs.

Family circumstances and the aspirations which parents have for their children must be taken into account in the provision of basic schooling. In providing training for adolescents and adults, greater attention must be paid to the personal backgrounds and motivations of individual trainees. Training programs must take into account such factors as migration patterns (internal and external), labor market incentives and disincentives, distortions in the labor market (e.g. low participation rates of women), and the complementarities between skills training programs and other education programs—particularly basic education programs designed to improve literacy and numeracy levels.

Particular attention must be paid to the roles of employers in providing in-service and on-the-job training. Such training is the essential means of relating the vocational skills developed in pre-service training to the more specific skills requirements of individual jobs. **The critical problem facing vocational education and technical training programs is how to relate these programs effectively and efficiently to the rapidly changing skill needs of the LDC labor market.**

3. *Local initiative and diversification of education and training opportunities.* A diversity of education and training approaches enhances choice and provides the flexibility to respond to parental preferences and local circumstances. Policies encouraging local administration and the participation of parents and community leaders in education decisions facilitate the fuller mobilization and more effective use of a wider variety of education and training resources.

The administrative and financial responsibility for establishing and maintaining schools and technical skills training programs may be accepted by almost any institution, organization, or level of government—or combination thereof. There are practical examples of an extraordinarily wide range of educational approaches, forms of sponsorship, and systems of administration and finance. Directly or indirectly, most countries provide public support to education at least through the elementary level, though schools may be administered by local governments, community organizations or private sponsors. In some cases individuals run schools for profit; in other cases, private trusts, endowments and other not-for-profit entities offer schooling; in still others, employers or cooperatives may support local schools; and finally, private voluntary and religious organizations provide education for up to 20-30 percent of all children. The range of alternatives, and the potential for private initiative and sponsorship, increases at the higher levels of education and for most types of skills training. In a number of countries, most of the secondary and post-secondary education and skills training is private.

In general, the willingness of communities and of parents to provide at least partial support for the establishment and maintenance of schools is quite high. The commitment of

community resources provides an important market test of the relevance of the education and training to the perceived needs of the community and helps to establish the community organization and institutions which are necessary to sustain education or technical training systems. Further, the community organization and resource mobilization needed to establish and maintain the educational systems are often a stimulus to and institutional base for community initiatives to meet other local needs.

Typically, communities contribute to the costs of building the school—often through self-help efforts and donations in kind, such as materials and land. Less frequently, communities provide partial payment for the teachers. Direct expenditures by parents for books, school uniforms, meals and school fees are often substantial, even where the schools are publicly funded and nominally free.

Typically, central ministries contribute to the costs of schooling through capital grants or partial reimbursement of school building costs; subsidized provision of key instructional inputs such as teacher salaries or instructional materials; partial or full reimbursement of per capita instruction costs (in effect, various forms of voucher systems); and provision of technical and administrative services such as examinations administration, student data collection, curriculum and materials development, research, and pre-service and in-service teacher training. In those cases where governmental support is provided to private or quasi-private schools, it is critical that government regulation and oversight not impair the creativity or limit the expansion of such schools. At the same time, merely subsidizing education for the children of economic elites serves no educational purpose. Support for private schools must serve the objectives of mobilizing additional resources, encouraging diversity and expanding enrollment capacity.

The private sector can be involved in the provision of education inputs even where most of the schools are public. Stimulating additional sources for key inputs can contribute both to the objectives of diversification and qualitative improvement, and to cost reductions. For example, a wide range of basic classroom materials is needed—from furniture to writing paper to laboratory equipment. These inputs, essential for effective instruction, are often unavailable in rural schools or exceptionally expensive. Encouragement of private producers and distributors for text materials and other instructional inputs may contribute both to qualitative improvements in the rural schools and to cost savings in all schools. Similarly, for technical education and skills training, it is in the interest of the employer to ensure that the equipment used for training purposes is representative of that used in the workplace. There are many examples of cooperative training programs with employers providing equipment and other support for training in publicly administered institutions.

A major bottleneck, even in countries with capital resources, is the lack of public sector capacity for the physical construction of schools—either due to problems in the way public funds are budgeted and dispersed or to the lack of the technical and administrative capacity to implement the construction. In a number of countries, most schools are built by private contractors and in some countries a significant number of schools are privately built and owned, but leased for public education. Many other examples exist of public-private partnership. A.I.D. policy is to encourage exploration of such alternative arrangements through technical assistance and policy dialogue with both public and private education organizations.

There are both advantages and disadvantages to any of these means of supporting basic education and technical training. On the one hand, there is a substantial public interest in ensuring that basic education opportunities are available to most children, that scarce resources are allocated and used efficiently, and that the systems succeed in providing education and skills training relevant to development goals. On the other hand, in most developing countries there is little possibility of fully funding the education and training systems from general public revenues and there are many persuasive arguments for encouraging a diversity of approaches and sponsors.

A.I.D. will seek opportunities to work with key public and private sector educators, education institutions, and administrative systems required to improve education policy, provide technical support to local schools, and ensure efficient implementation of large-scale programs of basic and vocational education and technical training.

A.I.D. will encourage those systems which facilitate local governmental or private administration of schools, vocational and technical training programs and which mobilize at least part of the resources at the community level. A.I.D. will also support experimental efforts to assess the strengths and limitations of different modes of education sponsorship in particular LDC settings.

A. A.I.D.'s Policy for Basic Education for Children 6-14

Literacy and numeracy are almost universally regarded as prerequisites for the acquisition of additional technical skills and information and for productive employment either in the wage economy or in self-employment. In many parts of the developing world, adult literacy is the exception; this is almost universally the case for female literacy. *For literacy to become the norm rather than the exception is a slow process, and one that cannot be achieved without increases in the number of children successfully completing basic schooling.*

Where less than half the school-age population is able to complete 4-6 years of schooling (the minimum experts estimate is required to gain and retain literacy), little improvement in adult literacy rates is possible. Indeed, where the school-age population is growing rapidly, continued inadequacy of the basic education system may result in a rise in the number of adult illiterates. While the goal of A.I.D.'s education policy is increasing the availability of basic formal education and educational training opportunities in LDCs, A.I.D.'s education assistance must necessarily be directed first at improving the efficiency of *existing* education systems—both formal and nonformal—as a whole. An essential element of A.I.D.'s education program is strengthening the capacities of LDCs to:

- identify inadequacies in existing education systems;
- test technical and strategic options for overcoming inadequacies; and
- implement cost-efficient new programs.

The central questions for both A.I.D. and the host country include the following:

- what enrollment targets are financially, physically, and administratively feasible within a reasonable period of time (say, the next decade)? With what assumptions? If full enrollment is not considered feasible in the foreseeable future, what targets are realistic?
- Under what assumptions would faster progress or more complete coverage be feasible? What changes in educational policy or administrative practices appear necessary to permit more efficient use of education resources and to encourage greater diversification, localization and use of alternative pedagogies or instructional technologies? What is necessary to test these assumptions and projections?

A.I.D. must be extremely sensitive to the inherent political problems involved in establishing curriculum goals and objectives. However, A.I.D. assistance for education should be considered only where such questions are being raised and tested. Support for system expansion should be contingent on an assessment of the adequacy of the extant system and should be accompanied by measures to resolve problems of the extant system. A.I.D. must be concerned that:

a) expansion does not result simply in the replication of qualitatively inadequate, pedagogically ineffective or inefficient education;

b) the expansion does not result in a qualitative decline or a decrease in internal efficiency—spreading already inadequate resources more thinly, reducing output standards, and overextending the administrative and support systems;

c) the innovations or reforms be verified as politically acceptable, as well as technically and administratively feasible for existing schools, before being experimentally applied to new areas.

Basic guidelines for assistance to basic education programs are:

- *A.I.D. will concentrate educational assistance in countries which encourage private as well as public schools.* Such mixed systems are more efficient in the use of resources and more effective in encouraging parental and community participation in all aspects of schooling.
- Localized schooling systems are an essential part of local institutional development strategies. *A.I.D. will encourage decentralized management, local participation, and diversified sponsorship of schools wherever possible.*
- The highest marginal returns on education investments, at least in the short term, are likely to result from improvements in the quality and efficiency of the existing system rather than from system expansion at the existing level of efficiency. Hence, in efforts to expand basic education, *A.I.D. will give priority to improvements in the retention, promotion, and efficiency measures at each stage of schooling rather than to increasing initial enrollment figures.*
- A.I.D. will encourage the expansion of basic education systems. However, efforts to improve access and reduce wastage of education resources are needed to obtain a proportionate increase in the numbers successfully completing basic formal schooling. *A.I.D. will not support programs which promise only marginal improvements or which contribute mainly to maintenance of a qualitatively inadequate, inefficient, or ineffective education system. A.I.D. will*

not support programs which do not increase opportunities for girls, poor and rural children. A.I.D. assistance will be directed at:

- major improvements in education administration and management of resources;
- significant increase in the number of students completing the existing system;
- substantial improvement in access for girls, the rural poor, and children of urban and peri-urban slums; and
- significant improvements in technical and material support for local education initiatives.
- Inefficiencies at the secondary and higher levels waste education resources, reduce the motivation of children to complete the primary cycle, and hence limit the potential for improving the efficiency of the basic education system. Therefore, A.I.D. will provide technical assistance to help LDCs examine the efficiency of the education system as a whole *where such assistance is important for the improvement of the basic education system.*
- Similarly, in those countries which have established sufficient primary school capacity to enroll most children, A.I.D. may consider technical support for preschool programs where these are necessary to reduce cognitive, affective and physical deficiencies which contribute to poor school performance, grade repetition and dropout. However, *A.I.D. will not support development of preschool education in those countries which have not established such basic schooling capacity.*
- Because of the proportion of national budgets committed to the education sector and the importance of education for a wide range of development objectives, *A.I.D. will encourage the policy discussions and reform initiatives of other donors prepared to assist the basic education system, even in those countries where A.I.D. itself has not assigned a high priority to funding education programs.*

B. A.I.D.'s Policy for Vocational Education and Technical Training

Though most countries have made substantial improvements over the past two decades in their training capacities, they continue to face major difficulties in relating the supply of skilled workers to employment and productivity objectives. This task is central to sustained economic development. In several countries, the number of trained people is substantially in excess of effective demand (i.e., the capacity of the economy to employ) leading either to very high rates of out-migration or to inefficient employment practices and high rates of underemployment. All countries, including those with a surplus in absolute numbers, have three general problems:

- shortages in specific skill areas or imbalance in the mix of skills available;
- a need to supplement the pre-service training with training for specific jobs; and
- a need to plan for the future supply of skilled workers, taking account of changing technologies.

In addition, the majority of workers in most countries are self-employed, employed mainly in household and farm production, or otherwise outside the modern wage economy. Effective development strategies must encourage the expansion and diversification of opportunities for out-of-school adolescents and self-employed adults to develop basic functional skills and to obtain access to the technologies and information they need to be economically productive and to participate fully in the choices affecting their family and their personal welfare. This group is strategically important in LDC efforts to improve production practices, encourage the adaptation and use of new technologies, foster participation in new organizations and institutions, and encourage modification in a number of attitudes (e.g., risk-taking) and behavior (e.g., health practices).

For the modern sector wage economy, shortages of mid-level technicians and skilled workers constrain new investments, full utilization of available capital, and effective delivery of services. Expanded opportunities and effective wage incentives are needed to retain trained workers and to induce new workers to enter training.

Over the years, A.I.D. has supported a diverse set of projects in the area of vocational education and training. A.I.D.'s experience suggests that effective training projects related to wage employment must be developed in response to specific needs in specific contexts and must involve prospective employers as directly as possible. Similarly, training related to community needs, local project staffing, and informal sector self-employment should be organized as locally as possible and should involve representative community organizations as directly as possible.

Among the goals of A.I.D.-sponsored vocational and technical training projects are:

- To increase the productivity of the individual leading to increased income.
- To increase the productivity of the enterprises using the trained employee.

• To increase employment opportunities resulting from more diversified productive capacity based on a broader skill base.

• To improve the productive performance of public sector agencies.

• To strengthen technical and administrative capacities of local development organizations through training of local staff and extension workers.

Each of these training purposes suggests somewhat different approaches to training and has different budgetary and management implications for A.I.D.

The nature of demand for skilled labor varies substantially by enterprise size, among other factors. For example, there is substantial evidence suggesting that shortages of skilled labor for *large-scale modern sector industries* is often due to ineffective incentives for employment and other factors affecting the efficient utilization of available skilled workers (e.g., appropriate choices of technology). Generally, those large employers who are willing to pay the price are able to meet their demand for skilled labor, though they may need to provide on-the-job and other training for specific positions and technical roles. *For these industries, A.I.D. will emphasize in-service training, with a strong and direct role for employers in implementing their own training programs.*

Efforts to stimulate indigenous *small and medium scale enterprise development* (SMEs) will necessarily stimulate demand for skilled labor. This, in turn, will require technical training for new labor market entrants as well as a substantial amount of retraining and skill-upgrading for the existing labor force. Most of those needing retraining or skills upgrading will be drawn from the self-employed and under-employed rather than from those employed in the larger enterprises. Management training for the SMEs, including training aimed at helping managers utilize the existing supply of skilled labor more efficiently, will also be required. *For the SMEs, A.I.D. will encourage both in-service training for the existing workforce and pre-service training for new workers and workers needing retraining for new occupational areas.*

The *informal sector* appears to face a very different training problem—namely, an oversupply of unskilled and semi-skilled labor who have acquired their skills informally (e.g., through apprenticeships and on-the-job training). In these markets, the skills which are most needed include basic functional skills such as literacy and numeracy, and basic business and entrepreneurial skills such as simple bookkeeping, management of small credit loans, and merchandising. *For the informal sector, nonformal approaches will be encouraged, with as direct a role as possible for community organizations, local PVOs, and producers associations.* In this regard, a number of PVOs have developed useful approaches to vocational and non-formal training for small scale enterprise, for the informal sector, and for women. These organizations may be able to play a helpful collaborative role in addressing various training needs in these areas.

Futher development of vocational education and technical training capacities in LDCs will require explicit attention to three critical issues:

• how best to support training for employment in the informal sector and in small and medium scale enterprises;

• how best to strengthen local (i.e. in-country) technical training capacities; and

• how to involve employers in implementation of vocational and technical training programs.

A key policy concern is the cost of long-term technical training. Specialized training in formal training facilities is extremely expensive and difficult to relate effectively and efficiently to rapidly changing skill needs in the labor market. To moderate costs and to improve the fit between training and employment, it is desirable to limit specialized technical training to the skills required for specific jobs; to leave the development of more generalized vocational skills to pre-service vocational education systems; and to defer specialization to a relatively late stage of the training cycle (generally, the stage at which probable employment has been determined).

The direct involvement of employers in the planning and implementation of training programs is essential both to ensure that the costs of training are shared proportionately by the employers who will benefit and to ensure that the judgment of employers concerning future needs for trained workers are taken into account in planning the training programs.

Employers (including local development institutions) may be assisted to become more directly involved in meeting their own technical training needs through attention to the following factors:

• *The amount of influence over curriculum content and training priorities which any employer can expect to have will depend directly on the willingness and ability of the employer to contribute to the costs of training and to make other com-*

mitments to the trainees. Where the employer contributes directly and substantially to the costs, either financially or in kind (e.g. provision of facilities or experienced technicians as instructors), or where the employer is able to make an employment commitment to the trainees, the employer should influence the curriculum content and training approach directly. Because of the costs involved and the need to ensure that their own employees benefit, such direct contributions or commitments to trainees are in most cases only possible for the larger firms.

• *A substantial amount of training is in generic skills which are not firm-specific.* This is true of the skills needed in most labor-intensive industries (e.g., construction, agriculture), most fabricating and processing industries (e.g., textiles, metal-working), some service industries (e.g., transportation, printing), and for large segments of commercial enterprises (e.g., bookkeeping, secretarial). While the design and implementation of effective training programs in these skills areas require a realistic training setting, practical hands-on experience, and the cooperation of at least some employers, the sponsorship and advisory functions are normally provided either by some body representing the industry as a whole or by a quasi-public training organization which is mandated to work closely with employers rather than by individual employers acting on their own. Where training is not provided directly by employers, A.I.D. should ensure that such intermediate organizations as industry associations, Chambers of Commerce, trade associations or other employee membership-type organizations are involved as fully as possible both in advisory and sponsorship functions.

• Even when the employer is in a financial position to sponsor training, and when the training is short-term and directly related to specific jobs or employment-related skills, *most employers do not have the technical capacities to develop and implement their own training programs.* For this reason, A.I.D. is encouraging the "service agency" approach to technical training. This approach enables an intermediate institution to provide technical support and training expertise to sponsors of training programs, but the "service agency" institution does not itself initiate training or determine the pritorities for training. In this way, A.I.D. can help local public institutions, PVOs, and employers themselves to establish the capacity for training while letting the demand for training be controlled by the marketplace.

In short, A.I.D. encourages the maximum possible involvement of employers in the identification of training needs, the specification of training objectives, and the support (financial, material, technical) of the actual training initiatives. While public institutions will continue to have an important role in supporting employment-oriented training, it is clear that training programs cannot be effectively related to employment and productivity objectives or efficiently implemented without a strong role for employers, groups representing sectors of productive employment, community organizations, or local PVOs familiar with the realities of the local labor market.

Basic guidelines for support to vocational and technical training programs are:

• *For adolescents and adults, A.I.D. will concentrate on vocational education and skills training related to employment (including self-employment) and improving economic productivity in key development sectors.*

• *The skills and information provided in vocational education and technical training projects should be directly related to specific social or economic program objectives.* To the maximum extent possible, *participants themselves and potential employers should be involved in the identification of training needs and specification of training objectives.*

• *Vocational training programs should be responsive to the skill needs of specific groups of learners.* To the maximum extent possible, the content, implementing organization, instructional technology, and pedagogic presentation of the training material should be fitted to the needs and personal characteristics (e.g. time, location, educational background) of the learners. To maintain flexibility, it is *important to avoid relying exclusively on any one medium or organization as the main vehicle for supporting or implementing skills training programs.*

• In all vocational and technical skills training programs, there should be particular attention to the inclusion of adolescent and adult women. *Training programs which do not provide opportunities for women to participate will not be encouraged.*

• In assistance to LDC vocational and technical training programs, preference will be given to *supporting initiatives of community organizations (including groups of employers) themselves for specific vocational and technical training.*

V. Implementation Issues and Constraints

Four types of constraints inhibit the strengthening of the education and technical training systems of LDCs: policy constraints, organization and management constraints, technology constraints, and resource constraints.

A. Policy Constraints

A.I.D. will give priority to strengthening the local capacity to make and implement policy decisions.

A.I.D.'s education policy focuses on the need for systemic reform, that is, strategies which address the problems of the education system as a whole. For that reason, *A.I.D. assistance should be part of a larger reform effort involving a combination of initiatives by other donors and by the country itself.* An important element of U.S. policy dialogue with the host government will be encouragement of the full range of educational approaches, forms of sponsorship, and systems of administration and finance [see pp. 5-6]. If appropriate, the dialogue should also include the question of the return to private sponsorship of schools which have been nationalized.

A.I.D. is prepared to assist countries which request help in strengthening their capacities to undertake policy-relevant education assessment, analysis, and research. Toward that end, A.I.D. will give priority to education researchers, policy analysts, administrators, and key technicians in general participant training programs.

B. Organization and Management Constraints

Management and logistic constraints affect all levels of LDC education and technical training systems, and constitute one of the most critical impediments to strengthening the capacity and quality of these systems. A.I.D. will encourage efforts to diversify the means of financing and administering local education and training systems. There are many examples of countries which are successfully combining a strong public commitment to education and skills training with an equally strong preference for private and local administration of the actual schools and training programs. To cite just one example, Chile provides full public funding for most students through the secondary level. However, it relies upon an education voucher system to encourage private schools (subvencionados) to accommodate most of the additional enrollment and is planning to hand over administration of the public schools to the municipalities by 1983. While the Ministry of Education will retain the power to make and enforce policy, the actual administration of funds and operation of schools will be handled locally.

The U.S. has a great deal to offer LDCs in technical assistance to overcome some of the major management problems facing administrators of LDC education and technical training programs. Among the areas where the U.S. experience may be particularly relevant are: decentralized administration and financing of local school systems; production and distribution systems for educational materials, with extensive use of private sector suppliers; and extensive participation by employers in the sponsorship and implementation of skills training programs. A.I.D. will therefore give attention to supporting such programs as:

- experimental ("operations") research programs to improve management at all levels, but particularly at the local level;
- technical assistance to improve logistic and personnel management; and
- policy dialogue and technical assistance to help resolve questions of the appropriate level of decentralization and sponsorship of education and technical training programs.

C. Technology Constraints

A.I.D. will continue to support R&D efforts, particularly in the use of radio and other media (e.g., rural satellites, video- and audio-recorders) which contribute to cost-effective extension of education and training services. While the upgrading of education and technical training technology is often seen as an end in itself, A.I.D. will concentrate its efforts on fitting the most cost-effective technology to particular learning objectives and the needs of particular sub-populations. The technology must be feasible for application in the typical school or training setting. Local education institutions must be able to afford, must have access to, and must have the technical and administrative capacity to make effective use of the technologies.

The technology needs of LDC education and training systems include logistic systems for the production and distribution of essential pedagogic materials as well as media technology and other means of providing supplementary instructional materials. In many rural schools, the most critical technological improvement may well be the supply of blackboards, basic text materials and writing paper to village classrooms. As for vocational education and technical training, there is a need both for more cost-effective instructional

technologies and for more practical experience with the production technologies actually used in the workplace. The technologies used in the training programs must be realistic in terms of the conditions likely to exist in the prospective employment sector. Additional means of providing technical support for employer-sponsored in-service and on-the-job training and of providing technical information and skills upgrading for individuals self-employed or employed in small enterprises must be encouraged.

A.I.D. support for efforts to improve basic education and technical training technology must reflect specific learning objectives and the needs of specific target populations, and therefore must be highly country-specific in development and field application.

D. Resource constraints

Resource constraints include issues of resource mobilization, the efficient use of available resources, and the availability and reliability of external resources. Among the most critical, albeit intangible, resources are local leadership and administrative structures which facilitate full participation in local decision-making and resource mobilization.

Education reform and improvements in the effectiveness and efficiency of training systems involve a long-term process. For most countries, the financial resources likely to be available from A.I.D. will not be sufficient to overcome the financial constraint to expansion of education and technical training capacities. Indeed, most education assistance programs are expected to be relatively small. Only a few developing countries, in which there is both a major need for education expansion or improvements in technical training and a policy context in which substantial education resources can be used effectively, will have education sector assistance programs as large as $5 million annually. [Reference is only to assistance directed at improvements in basic education and technical training capacities; most countries will continue to have substantial additional Education and Human Resources programs for participant training, labor and PVO activities, as well as project-related manpower training in other sectors.]

For most countries, A.I.D. will seek to assist countries to make more effective use of their own education and technical training resources through technical assistance directed at policy choices, organization and management, logistic capacities, and training technology. A.I.D. will also stress close cooperation with other donors and will look to the international lending institutions to assist with any large-scale capital finance that may be required.

In selected cases it may be desirable to include a limited amount of capital assistance to resolve physical capacity bottlenecks to basic education and vocational training system reforms. In all cases, A.I.D.'s capital assistance for education and technical training programs must be carefully related to the goal of more efficient resource utilization, strengthened capacities for policy reform, and qualitative improvements in the schooling system.

Conclusion

There is growing recognition that education and technical training are not ends in themselves, but rather important means of achieving social and economic goals; they shape both national policies and individual, personal aspirations. There is consensus among donors and development assistance recipients alike that in a world of rapid change, a combination of basic education and specific, job-related skills training is a prerequisite to enable men and women both to adapt to change and to contribute to it.

A.I.D. support for LDC efforts to raise the levels of basic education and to relate technical training systems more effectively to productive employment is an essential part of the Agency's development strategies. These strategies are focused on: the fuller application of science and technology in development programs; reliance on market mechanisms and the private sector to stimulate economic development; strengthening of institutions which are key to the development process; and reinforcement of the efforts of local leaders to address their own development problems and to improve the administration and management of local resources.

A.I.D.'s policies for agriculture and rural development programs stress the importance of institutional strengthening and the development of basic infrastructure. Local schools and training systems are among the most important local institutions: in addition to the education which they provide, they can also have a powerful effect on community organization and local administrative systems. Generally, parents are willing to make substantial sacrifices to establish schooling opportunities in their community; the ability of local administrative systems to assist private efforts to establish and maintain schools is among the most important and tangible evidence of effective community organization for local development efforts.

The ability of people to participate effectively in development is substantially increased as they acquire basic skills, ranging from basic literacy and numeracy through vocational and technical skills required for employment. Until a substantial majority of children have the opportunity for basic schooling, the labor force (which they eventually become as adolescents and adults) will not have the skills and resources to take its part in national development programs. Employers will be forced to cope with a largely unskilled and inadequately productive workforce, and individuals will tend to rely more on traditional leaders and government officials than on themselves for most important decisions. Neither market mechanisms, nor democratic processes, nor informed personal choice can flourish in such a context.

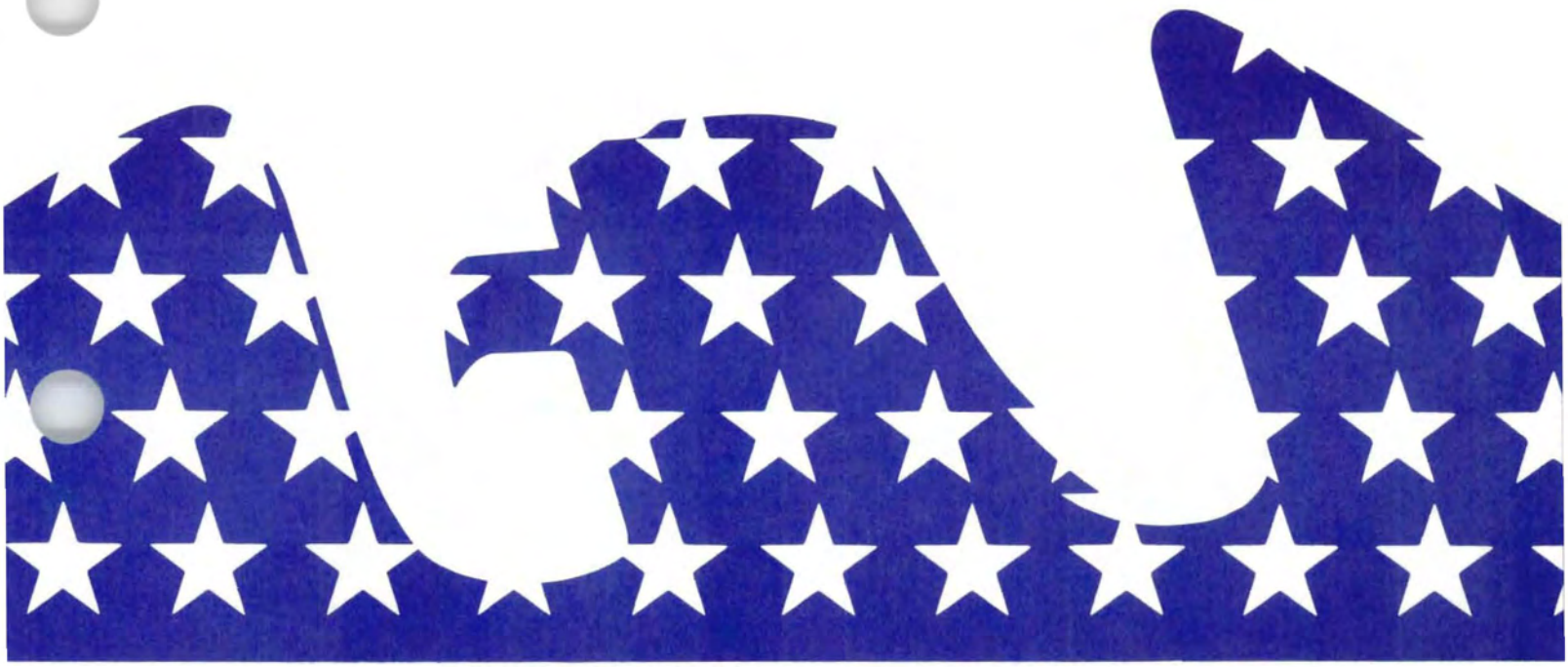
Finally, among the most pragmatic reasons for U.S. support for efforts to improve education and training systems in LDCs is the dominance of these systems in local administration and financial allocations. Education and training systems are one of the largest sectors of public investment; indeed, in many countries, they are *the* largest sector. The organization of financing, administrative, data collection and logistic distribution systems, and the locus of decision-making on education and training matters play a powerful role in shaping the relationships between central and local governments, and between the private and public sectors. In short, A.I.D. views opportunities to support efforts to reorient and restructure LDC education and training systems as an essential component of efforts to strengthen the role of local institutions, relieve the budgetary burden on central governments, and improve the public policy climate in which new development initiatives of all kinds can be considered.

II.F (TM 1:40)
8-20-87

A.I.D. Policy Paper

HEALTH ASSISTANCE

(REVISED)



Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

December 1986

A.I.D. Policy Paper

Health Assistance

(REVISED)

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

December 1986

TABLE OF CONTENTS

Page

I. **Introduction** 1

II. **Background** 1

A. **Health Problems & Prospects in Developing Countries** 1
B. **A.I.D. Response to Health Problems** 2

1. Evolution of the Child Survival Approach 2
2. Child Survival as the Focus of Primary Health Care—Mid-1980's 2

III. **A.I.D. Policy Objectives** 3

A. **Overall Health Goal** 3

B. **Specific Health Sector Objectives** 3

1. Reduction of Infant & Early Childhood Mortality & Morbidity 3
2. Reduction of Maternal Mortality & Morbidity 3
3. Child Survival Interventions as the Basis for Health Care Services 3
4. Sustainability of Child Survival Gains 4
5. Development of New Technologies & Improved Delivery Mechanisms 4

IV. **A.I.D. Health Program Assistance Activities** 4

A. **Child Survival** 4

1. Selected Child Survival Interventions 4
2. Other Child Survival Interventions 4
3. The Delivery of Child Survival Services 5
   a. Private Sector Involvement 5
   b. Sustainability of Services 5
4. The Selected Country Approach for Child Survival Programs 5

B. **Beyond Child Survival** 5

1. Primary Health Care 6
2. Water & Sanitation 6
3. Vector Control 6
4. Health Financing 6
5. Research 6

V. **Funding** 7

VI. **Donor Collaboration** 7

VII. **Evaluation** 7

A.I.D. HEALTH POLICY PAPER

I. Introduction

The goal of A.I.D.'s health assistance program is to improve health status in A.I.D.-assisted countries as reflected in increased life expectancy. Most health problems in developing countries stem from poor environmental conditions; lack of health care and knowledge; malnutrition; infectious diseases (including diarrheal diseases, respiratory illnesses, measles, tetanus and tuberculosis); and parasitic diseases. Hundreds of millions of adults suffer from chronic illness, but children are the most vulnerable group. Half of all deaths in developing countries occur in the age group of five and under. The most direct way to increase life expectancy and general health status in developing countries is by addressing the health problems of children and their mothers. Thus, within A.I.D.'s health assistance program priority will be given to support for child survival and improved maternal and child health.

Child health will be approached primarily through selected child survival interventions—immunizations, diarrheal disease control and specifically oral rehydration therapy (ORT), improved nutrition and adequate birth spacing. These interventions will also provide the basis for building up more comprehensive primary health care systems over time. Priority will be placed on immunizations and diarrheal disease control/ORT, but the choice of which interventions to support will be made on the basis of country-specific conditions.

A.I.D. recognizes that other health interventions in addition to the four listed above can make important contributions to child survival; and that other health problems in developing countries not specific to children or their mothers also need to be addressed. Therefore, other health activities, including primary health care, water and sanitation projects, and vector-borne disease treatment and control, will also be supported where there is a need to meet pressing country-specific health problems. Health financing concerns should be addressed in all health projects. However, in some countries improving the financing of health care may be the main A.I.D. activity. Where health programs beyond the four direct child survival interventions are proposed for A.I.D. support, an additional burden of proof will be required to demonstrate their appropriateness.

Because substantial resources will be required to reach developing country goals in health, A.I.D.'s policy emphasizes investment in interventions known to be cost-effective. Such interventions are essentially preventive in nature, reducing potential future expenditures by averting diseases and conditions which are very costly to treat. Because of the high cost of curative care, A.I.D. will not generally support curative activities except to deal with common conditions for which prevention is either difficult or even more costly than treatment. Given current technologies, examples are diarrheal disease, acute respiratory infection (ARI), malaria, and certain water-borne diseases. Major investments in the construction of physical infrastructure, the operation of which will increase host country recurrent cost burdens, will not be supported.

II. Background

A. Health Problems and Prospects in Developing Countries

Life expectancy at birth in many A.I.D.-assisted countries is below 50 years. In those countries infant mortality is in excess of 100 per 1000 live births. In addition, many children and adults suffer from chronic, debilitating diseases. Chronic illness leads not only to early mortality, but also to reduced working time and low productivity. The pattern of mortality in developing countries means that as many as half of all deaths occur among children under five years of age. Some fifteen million children die annually in developing countries due to the cumulative effect of repeated disease episodes exacerbated and catalyzed by malnutrition. Low birth weight renders infants vulnerable from the very beginning of life.

Infant and child mortality are the tragic results of complex interactions between poverty and disease. A variety of development efforts can contribute to reductions in infant and young child deaths, disease and disability. These include: increased income for poor people stemming from general agricultural and economic growth; reduction in hunger as reflected by the percentage of the population receiving adequate levels of nutrient and caloric intake and by reduction in the percentage of children under age five suffering from chronic and acute undernutrition; increased literacy and basic education levels, especially among women; improved health services; and increased use of voluntary family planning services.

Global goals for improvement in income and education levels, reduction in hunger, disease and early death, and increased access to voluntary family planning services are established in the Agency's Strategic Plan. Efforts to increase overall economic development will improve the chances for child survival and general health status in the long term. At the same time, selected cost-effective technologies, specifically aimed at infants and children, can have a direct impact on mortality and morbidity at comparatively low cost in a relatively short time frame.

Immunization against childhood diseases, including maternal immunization with tetanus toxiod, and management of diarrhea with oral rehydration therapy (ORT) can significantly reduce infant and child mortality and form the basis for an effective primary health care program. Children saved from death due to measles or diarrheal dehydration may succumb, however, to the next disease episode especially if nutritional status is low. Concurrent efforts to reduce malnutrition through a focused nutrition package including breastfeeding, feeding during and after diarrheal episodes, good weaning practices, growth monitoring and supplementary feeding programs where appropriate can help prevent this "replacement mortality" effect.

Adequate birth spacing also has a significant impact upon chances for child survival. In developing countries, a child born within two years of a sibling's birth is twice as likely to die as a child born after an interval of more than two years. An older child also has a greater chance of dying if a sibling is born within two years after that child's birth. Lower parity and births that are well spaced and are not at the extremes of the mother's reproductive life protect maternal health and help to ensure an adequate birth weight. (Low birth weight is a major determinant of infant mortality.) Improved maternal health as a result of better nutrition also affects child survival through breastfeeding and the mother's ability to provide better child care.

Other diseases that are major contributors to high infant and child mortality include vector borne diseases (especially malaria), acute respiratory disease, and infectious and parasitic diseases caused primarily by poor environmental conditions. Diagnosis and treatment of these conditions can be important and cost-effective in areas where these diseases contribute heavily to child mortality. Prevention of these diseases requires other kinds of interventions, including vector control, improved housing, and provision of safe water and sanitation.

B. A.I.D. Response to Health Problems

1. Evolution of the Child Survival Approach

The Agency's policy to emphasize child survival interventions in its health assistance program has evolved from A.I.D. and other donor experience in the health sector. Past experience with comprehensive primary health care programs did not provide evidence of improved coverage hoped for, or of improvements in morbidity and mortality rates, particularly in children. The current policy also has been influenced by the availability and acceptability of technologies which have a dramatic effect on child survival.

In the mid-70s, A.I.D. began to emphasize a primary health care (PHC) approach. The U.S. Government participated in the Alma Ata Conference and was a signatory to the Alma Ata Declaration supporting primary health care. The 1980 A.I.D. policy and program emphasized strengthening PHC systems through training, health education, planning and evaluation, pharmaceutical supply, administrative and logistic support, and operational and applied research. Support for water and sanitation programs, disease control, and improved planning and management also was continued.

The PHC concept was further refined in A.I.D.'s 1982 Health Policy Paper which emphasized the importance of determining the relative efficiency of alternative health intervention packages and improved management and administration of these programs. Another focus was the promotion of economically viable health programs, emphasizing improved resource allocation, efficiencies, and self-financing. Finally, increased emphasis was given to biomedical research. Raising the health status of children and their mothers was a primary objective of A.I.D.'s 1982 health policy, although the approach to health care programs was more comprehensive.

2. Child Survival as the Focus of Primary Health Care—Mid-1980's

A.I.D. has funded activities aimed at child survival for many years through general health service and PHC projects. During the past few years, increased national (including Congressional) and international interest has focused on provision of selected child survival interventions as cost-effective and direct means of improving health and preventing mortality in developing countries. A.I.D. has

agreed to assist in the achievement of international child survival targets. These include the development of sustained developing country capacity to provide immunizations to children under five years of age, and ensuring access to ORT by all children in A.I.D.-assisted countries.

A.I.D.'s child survival approach is consistent with, but more selectively focused than, the more general PHC approach previously advocated. Initial emphasis on selected child survival interventions will provide the basis for more comprehensive PHC services as other selected health interventions are added gradually. A.I.D. will support not only accelerated delivery of child survival services, but also, and more importantly, investment in institutional development efforts which will ensure sustainability of child survival services within each country.

In addition to the continued emphasis on providing primary care, current policy emphasizes the importance of the secondary and tertiary levels of the health system, particularly the financing and resource management aspects of the health care system as a whole, and their effect on child survival. These aspects were not fully addressed in the previous PHC-oriented policies. Finally, whereas most PHC projects were concentrated in rural areas, current policy also encourages direct attention to urban health problems.

III. A.I.D. Policy Objectives

A. Overall Health Goal

A.I.D.'s goal in the health sector is to increase life expectancy in less developed countries. Since infant and child deaths are half of the deaths occurring in these countries, A.I.D. will focus on reduction of infant and child mortality and morbidity as the main intermediate objective toward the ultimate health goal.

B. Specific Health Sector Objectives

A.I.D.'s primary specific objectives in the health sector are to help developing countries:

- Reduce infant and early child mortality and morbidity;
- Reduce maternal mortality and morbidity;
- Use child survival interventions as the basis for building a more comprehensive health care system over time;
- Ensure that gains made in improving child survival and health are sustained; and
- Develop new, basic, effective technologies and improved systems for delivery of child survival services.

1. Reduction of Infant and Early Childhood Mortality and Morbidity*

This objective will be achieved primarily through:

- **Increasing immunization coverage.** A.I.D. will collaborate in an international effort to develop sustained capacity to provide immunizations to the world's children, with specific coverage goals defined at the country level;
- **Reducing diarrheal disease mortality** by increased use of ORT and proper feeding during and after diarrheal episodes. A.I.D. has joined other donors and developing countries in a worldwide effort to ensure worldwide access to ORT by those who need it;
- **Improving nutrition in young children** through adequate breastfeeding and improved weaning practices, growth monitoring, and targeted supplementary feeding (using PL 480 Title II resources and programs when available); and
- **Improving birth spacing and maternal health** in order to decrease the occurrence of low birth weight infants and increase the survival prospects of children.

2. Reduction of Maternal Mortality and Morbidity

A.I.D. will promote birth spacing, child bearing during the safest part of the woman's reproductive life, pre-natal and post-natal care, safe delivery practices and adequate maternal nutrition in order to reduce maternal mortality and morbidity which affects both mothers and their children.

3. Child Survival Interventions as the Basis for Health Care Services

Provision of selective child survival interventions is not an end in itself. Child survival interventions are an effective and focused way to lay the foundation for a more comprehensive health care system with gradual addition of other interventions over time. Incremental strengthening of essential management systems, including improved training and supervision, logistics and information systems

*The Agency Strategy on Child Survival and additional A.I.D. strategies on Immunization, Control of Diarrheal Disease/ORT, Nutrition for Child Survival and Birth Spacing for Child Survival provide guidance on program strategy and project design.

are also important elements of a strong health care system.

4. Sustainability of Child Survival Gains

Achievement and maintenance of child survival gains will require:

- Promotion of revised national policies which will foster improved health financing through resource mobilization, resource allocation, containment of escalating recurrent costs, and the re-organization of the health services delivery system;
- Increased private sector involvement; and
- Improved coordination among donor agencies.

5. Development of New Technologies and Improved Delivery Mechanisms

A.I.D. will continue to support biomedical research where there are favorable prospects for early application of new technologies to developing country health problems, particularly those of infants and children. A.I.D. also will continue its leadership in applied/operations research to address weaknesses in health technology delivery systems and to improve efficiency. In addition, A.I.D. will continue to address the programmatic obstacles to the effective use of child survival technologies.

IV. A.I.D. Health Program Assistance Activities

A. Child Survival

Priority for A.I.D. health assistance will be given to service delivery and research on selected child survival interventions. Other health interventions described in this paper may be supported, but an additional burden of proof will be required to demonstrate why these programs are proposed rather than, or in addition to, the priority child survival interventions.

1. Selected Child Survival Interventions

In order to achieve A.I.D. child survival objectives, priority will be placed on four interventions which form the basis of the Agency Child Survival Strategy: immunization, diarrheal disease control emphasizing ORT, a focused nutrition package and birth spacing.*

Emphasis will be given to immunization and diarrheal disease control/ORT. Birth spacing and nutrition activities may be carried out simultaneously, or added as immunization and ORT coverage levels improve. In many countries, family planning and nutrition programs are already established and should not be delayed while immunization and ORT coverage levels are raised. As the delivery system is strengthened for each intervention in turn, additional services can be added.

2. Other Child Survival Interventions

A number of diseases not yet preventable by vaccination contribute to high infant and child mortality. Malaria and acute respiratory infections (ARI) are major causes of death and disability. In tropical Africa alone, it is estimated that at least one million infants and children die annually from malaria. New cases of malaria may reach upwards of 300 million worldwide per year, of which at least 100 million are infants and children. The social and economic impacts of this disease have made malaria treatment and control a priority health activity in most countries in tropical Africa, Central America, and a large part of Asia.

Between 1.5 and 3.5 million children die annually from ARI. Bacterial pneumonias, which account for the majority of deaths in the developing world due to respiratory infection, remain the most treatable. With emerging vaccine technologies, they may also become preventable.

Thus, malaria treatment and control, and diagnosis and treatment of acute respiratory infections are essential to achieving child survival goals in many countries. In countries or regions where such interventions contribute significantly to reduction of infant and child mortality they may be supported. Focused research to develop vaccines for malaria and ARI will be emphasized. A.I.D. also may help countries to improve malaria programs to make more cost-effective use of resources.

Maternal health is important to child survival. Thus, in addition to birth spacing activities, other maternal services such as maternal nutrition and prenatal services may be supported where they can increase the prospects of child survival and reduce maternal mortality.

It also may be necessary to take into account diseases such as AIDS which may adversely affect current or future gains in child survival. The transmission of AIDS heterosexually and transmission from infected mothers through

*Family planning services, which are usually funded from the Population account, are considered part of the Agency's child survival effort.

the placenta means that increasing numbers of infants will contract the disease. Other diseases which contribute significantly to infant and child mortality may exist or emerge in different geographic settings. Where appropriate cost-effective interventions are identified to address these problems, they also may be supported.

Environmental conditions such as poor water and sanitation can affect child health and mortality. Although not considered direct child survival interventions, certain activities to improve water supply and sanitation can be important complements to priority child survival programs and may be supported when justified on these grounds.

3. The Delivery of Child Survival Services

a. Private Sector Involvement

In countries with high infant and child mortality, the coverage rates for immunization and ORT are often low; and the government infrastructures are lacking or very weak. The use of PVOs and other private sector mechanisms to deliver services, as well as the strengthening of the government service delivery capability, are important to building and sustaining child survival services. Where government infrastructures are weak, PL 480 Title II PVO programs can assist with logistics systems, distribution, and contacts with communities and families.

In the context of child survival, private sector mechanisms include private physicians and other practitioners; private pharmacists and traders, who traditionally dispense pharmaceuticals; private health insurance organizations; and private manufacturers, as well as indigenous and U.S.-based PVOs. A.I.D. has had considerable experience in involving the private sector in family planning and health service delivery and, in particular, in the use of social marketing and modern communication techniques in health and family planning. Private sector approaches, social marketing and use of modern communication techniques should be included in child survival programs where appropriate.

b. Sustainability of Services

Strengthening child survival services will require efforts to improve the sustainability of the delivery systems. These efforts will focus primarily on improved allocation of resources, cost containment and organizational reforms in the health sector to ensure sustained levels of recurrent financing for child survival services. Improvements in essential management systems required to implement the child survival service delivery such as improved information systems, training, supervision, drug/vaccine procurement and logistics systems are also necessary.

4. The Selected Country Approach for Child Survival Programs

In order to achieve maximum impact on child mortality and morbidity within budgetary constraints, A.I.D. will give priority in allocation of its resources to selected countries. A.I.D. will support major child survival programs in a number of countries selected on the basis of the:

- Total number of infant and child deaths;
- Infant mortality rates;
- Mobilization and absorptive capacity;
- Government commitment to child survival;
- Availability of funds from various accounts;
- Opportunities for effective donor collaboration; and
- Expectation that A.I.D. will continue to maintain a major program over at least the next five years.

A number of constraints adversely affect the implementation of effective health and child survival programs. Even when external funding is available, a country's capacity to absorb additional resources may be limited. Outdated policies and legal frameworks often inhibit the introduction and delivery of services. Inadequate planning and information systems, lack of infrastructure and insufficient trained personnel also constrain the ability of countries to effectively program available donor assistance and local funds. The existence of such constraints will be taken into account in the selection of countries for major child survival programs.

B. Beyond Child Survival

Among A.I.D.-assisted countries, infant and child mortality rates, disease patterns, environmental conditions, economic growth levels, and government policies differ widely. The Agency's priority will be on child survival because infant and child mortality and morbidity are high in the majority of developing countries and in pockets of the populations of all countries. Countries which have not been selected for major child survival programs, but which have health programs, will also be expected to give priority to child survival interventions, although levels of assistance in most cases will be lower.

Other health interventions can be supported in both selected child survival countries and other countries. However, an additional burden of proof will be required where such programs are proposed to explain why they should be funded.

Activities supported by A.I.D. which may affect child survival but are beyond the four primary interventions include assistance for primary health care, water and sanitation, vector control, health financing, and biomedical and operations research. These health activities will continue to be a part of the A.I.D. health assistance program where warranted on the basis of one or more of the conditions described below.

For example, other health activities may reinforce the impact of the primary child survival interventions on infant and child mortality, or address problems which go beyond child survival. Where government commitment to child survival or ability to implement child survival activities is insufficient, but other health programs can be implemented successfully, A.I.D. may support these other health programs to the extent that U.S. support will further policy reform in the health sector. A.I.D. also may support health activities that are necessary components of other A.I.D. development projects, for example, malaria control in irrigation project areas. Where lack of potable water and sanitation measures are thwarting child survival gains, A.I.D. may help correct those environmental conditions.

In other countries, A.I.D. support for child survival may not be required because low levels of infant mortality have already been achieved. Many, particularly some in the Caribbean, Central America and East Asia, are characterized by moderate income levels and established health systems, but the systems are not cost-effective. In such countries, A.I.D. may want to support health financing initiatives to ensure the maintenance of child survival gains and the financial stability of the health care system.

In both high and low infant mortality countries there may be a level above which effective utilization of child survival interventions such as ORT and immunization will not rise in the absence of changes in other conditions. Specifically, increasing coverage of immunization, ORT or other child survival services from 60% or 70% to 80% or above may not be feasible in the absence of improvements in environmental, social or economic conditions.

Although priority will be given to specific child survival interventions, the complex interactions between the effectiveness of child survival interventions and other factors should not be forgotten.

Health interventions which go beyond the scope of child survival activities are described below:

1. **Primary Health Care**

A.I.D.-supported PHC projects should emphasize child survival. During evaluation and/or redesign of existing projects special attention should be given to increasing the child survival focus of these projects. PHC services should be strengthened and expanded to meet clearly defined country-specific health needs through policy dialogue, management improvement and manpower development support. However, the services should focus initially on phased, selective interventions directed at improving child survival with additional services added incrementally.

2. **Water and Sanitation**

Urban water and sanitation projects will be funded mainly from the Economic Support Fund (ESF) account. Low cost per capita community water and sanitation projects will continue to be supported through PVO activities. Other community water projects will be considered for funding from the Health account on a case-by-case basis. The projects must be justified as cost-effective; have been shown to have an impact on child survival in the proposed setting; and be proposed in conjunction with other child survival interventions.

3. **Vector Control**

Vector-borne diseases affect over half of the world's population and cause an extraordinary amount of illness and deaths throughout the developing world. Yet programs of vector control incur heavy recurrent costs. In areas where such diseases cause major health problems for children, or where child survival activities may not be feasible in the absence of such support, A.I.D. support for vector control projects may be considered. However, A.I.D. will focus its future activities in this area on biotechnological approaches to prevention of major vector-borne diseases like malaria, onchocerciasis, schistosomiasis, and guinea worm infection.

4. **Health Financing**

An appropriate health financing system is critical to the ability of a society to sustain

targeted reductions in morbidity and mortality among infants and children. The heavy burden of recurrent costs associated with health care must be considered in all A.I.D.-assisted health projects. Thus, health financing activities will be supported as part of child survival programs and in order to establish a sound financial basis for a health care system as a whole. Special attention to health systems finance in middle income countries will be a major part of A.I.D. assistance outside of child survival.*

Host country inability to cover recurrent costs of preventive health care may result from excessive government spending on personal, curative care and excessive utilization of secondary and tertiary care facilities. Health financing activities should address development of private services, fees-for-service, efficient resource allocation and utilization; equitable distribution of resources, cost containment, and the overall organization of the health system. Excessive reliance on donor funding for costs of primary and preventive health services must be avoided.

A.I.D. should use policy dialogue, design and implementation of health projects, and special health financing initiatives as mechanisms for supporting the development of sustainable health care systems. In all countries, projects should address the question of cost-effectiveness. This frequently means relating cost savings and the mobilization of new resources to activities, like child survival, which are most cost-effective in improving health status.

5. **Research**

A.I.D. will continue to invest in basic and applied research to develop new technologies for child survival and to improve the delivery and effectiveness of existing technologies. Continued priority will be on improvements in diarrheal disease control and immunization. Research activities will include development of a malaria vaccine; improvements in measles, pertussis and other vaccines; more cost-effective systems for service delivery; better evaluation techniques; and improved techniques for diagnosing diseases with severe impact on child survival. A.I.D. also will support basic research on the next generation of child survival needs, such as new vaccines, low birthweight, acute respiratory infections, the role of micronutrients in child health, and maternal nutrition. Finally, the Agency is giving special attention to research on improved approaches to financing health care, including operations research and pilot activities to involve the private sector in the delivery of critical health services.

*Agency Health Financing Guidelines providing detailed guidance in this area have been issued separately.

V. Funding

Funding for A.I.D. child survival programs and for other health activities will come from the DA Health Account, the Child Survival Fund (for child survival activities only), the ARDN account (for nutrition activities not funded from the Health Account), the Population Account (for family planning activities), ESF, Sahel Funds and local currency generations from PL 480 and ESF. PL 480 Title II food resources also will be increasingly used to achieve child survival objectives.

VI. Donor Collaboration

Achievement of internationally agreed targets for child survival through immunization, ORT, and other critical health interventions will require careful donor coordination. A number of multilateral and bilateral donors are contributing to this effort, but maximum impact will only be achieved through collaboration at both international and country levels. In areas where the U.S. has a comparative advantage, such as communications and social marketing, and biomedical and operations research, A.I.D. should take a leadership role.

VII. Evaluation

A.I.D. must satisfy several different requirements for information and data through the monitoring and evaluation of its child survival and other health programs. Data are needed for: 1) reporting to Congress on progress in meeting targets for immunization; 2) reporting on progress in achieving designated ORT and immunization coverage targets; 3) reporting on the implementation of the Agency's child survival activities and health programs as required for all A.I.D. projects; 4) evaluation of the impact and cost of selected child survival projects; and 5) operations research to improve the delivery, acceptance and effectiveness of child survival interventions. A standardized system for collecting information on projects has been developed, and the capacity for monitoring and evaluation should be incorporated into all project plans. A.I.D. will collaborate with

WHO, UNICEF and other donors in monitoring progress toward meeting international goals for immunization and ORT.

Evaluation of health projects which are not directly aimed at child survival will be especially important, since these projects will have been approved on an exceptional basis and future projects will be competing with child survival activities for scarce health funds.

A.I.D. Policy Papers and Policy Determinations

The following reports have been issued in a series. These documents with an identification code (e.g. PN-AAM-323) may be ordered in microfiche or paper copy. Please direct inquiries regarding orders to:

A.I.D. Document and Information
Handling Facility
7222 47th Street
Suite 100
Chevy Chase, MD 20815

Title—Policy Paper	Date	'Fiche #
Domestic Water and Sanitation	May 1982	PN-AAM-323
Food and Agricultural Development	May 1982	PN-AAM-322
Nutrition	May 1982	PN-AAM-321
Recurrent Costs	May 1982	PN-AAM-319
Population Assistance	September 1982	PN-AAM-320
Private and Voluntary Organizations	September 1982	PN-AAM-318
Women in Development	October 1982	PN-AAL-777
Pricing, Subsidies, and Related Policies in Food and Agriculture	November 1982	PN-AAN-373
Approaches to the Policy Dialogue	December 1982	PN-AAM-431
Basic Education and Technical Training	December 1982	PN-AAM-190
Health Assistance	December 1982	PN-AAL-817
Institutional Development	March 1983	PN-AAN-108
Co-Financing	May 1983	PM-AAN-457
Local Organizations in Development	March 1984	PN-AAQ-157
Energy	July 1984	PN-AAQ-160
Urban Development Policy	October 1984	PN-AAQ-158
Shelter	February 1985	PN-AAQ-162
Private Enterprise Development (Revised)	March 1985	PN-AAQ-163
International Disaster Assistance	May 1985	PN-AAQ-164
Cooperative Development	April 1985	PN-AAQ-165
Trade Development	July 1986	PN-AAV-461
Health Assistance (Revised)	December 1986	PN-AAV-462

Title—Policy Determination	Date	'Fiche #
PD #1—Narcotics	August 5, 1982	PN-AAM-443
PD #2—Mixed Credits	September 29, 1982	PN-AAM-444
PD #3—Voluntary Sterilization	September 1982	PN-AAM-445
PD #4—Title XII	October 5, 1982	PN-AAM-446
PD #5—Programming PL 480 Local Currency Generations	February 22, 1983	PN-AAM-591
PD #6—Environmental and Natural Resources Aspects of Development Assistance	April 26, 1983	PN-AAN-375
PD #7—Forestry Policy and Programs	May 16, 1983	PN-AAN-376
PD #8—Participant Training	July 13, 1983	PN-AAP-273
PD #9—Loan Terms Under PL 480 Title I	September 27, 1983	PN-AAN-753
PD #10—Development Communications	February 17, 1984	PN-AAP-616
PD #11—Using PL 480 Title II Food Aid for Emergency or Refugee Relief	July 26, 1984	PN-AAQ-159
PD #12—Human Rights	September 26, 1984	PN-AAQ-161
PD #13—Land Tenure	May 9, 1986	PN-AAQ-166
PD #14—Implementing A.I.D. Privatization Objectives	June 16, 1986	PN-AAQ-167
PD #15—Assistance to Support Agricultural Export Development	September 13, 1986	PN-AAV-460

POLICY DETERMINATION

Agency for International Development

PD-8 CORRECTED COPY July 13, 1983

PARTICIPANT TRAINING

PARTICIPANT TRAINING

I. Introduction and Background

For more than three decades, AID has emphasized the training of developing country scientists, technicians, administrators and managers as well as the improvement of specialized training capacities in developing countries. Such training is an essential component of AID's development strategies in all sectors, complementing other forms of assistance and continuing commodities or technical assistance have been expended.

"Participant training", as used here, refers to AID-sponsored training of selected individuals in the U.S. or in other (third) countries. The more generic term "development training" includes both external participant training and training in local institutions. Where training is and "input" to a project in the logframe sense, the term "project-related training" applies.

Participant training is a major, but not the only, means of assisting the development of high-level skills and institutional leadership. Other methods include:

technical or capital assistance for the development of local training capacities, ranging from specialized short course training to universities and technical institutes;

technical assistance to help countries establish local scholarship programs and their own administrative and funding mechanisms for external training;

technical assistance to strengthen institutional capacities for assessing manpower demand and to improve personnel policies and management practices affecting the utilization of trained personnel; and

encouragement of professional organizations, informal networks, technical publications and information systems to keep trained personnel current with developments in their field and to facilitate career advancement and mobility.

PD - 8
July 13, 1983
(TM 1:49)

Purposes of Participant Training

AID policy encourages participant training for three purposes:

(1) staff development for AID-assisted projects;

(2) strengthening of key development institutions; and

(3) establishment of local training capacities.

Project-related Training: AID will support short-term and long-term training as needed to ensure the effective implementation and institutionization of AID-supported projects. The types and levels of training as well as the number of trainees to be supported should be as determined by project design, provided that:

a) the project is otherwise consistent with AID policy, CDSS and sector strategy papers;

b) all costs of training are considered in assessing the cost-effectiveness of the project; and

c) the training is coordinated and integrated with other essential project inputs.

Where trainees are expected to replace or to function as counterparts to technical assistance personnel (whether sponsored by AID or other donors), project design must ensure that training is phased appropriately and coordinated with the schedule for arrival and departure of such technical assistance personnel.

Institutional Strengthening: AID will support training as needed to strengthen key private and public institutions (see Institution Development Policy Paper). The institutional priorities for training are determined by CDSS and sector strategy analyses. Training may be provided under a general participant training program, under a training program focused on a specific sector or as a component of a project supporting a specific institution or set of institutions.

A broad range of training may be justified for specific institutions, provided that the training contributes to specific strengthening objectives for those institutions (e.g., improved management, research and development capacity, logistic delivery). Those programs which are general or sectoral should focus more selectively on the types and levels of training most widely needed in key sectors. Institutional needs may be identified by:

a) institutional profiles identifying key technical or managerial constraints to institutional functions;

b) assessments of manpower supply, demand and utilization;

c) assessments of the existing local training capacities.

Training of Trainers: AID will support training as needed in response to the above purposes, AID Policy does not encourage:

general participant training which is not linked to specific development objectives identified in CDSS and sector strategy documents. Policy on training priorities is flexible, recognizing that needs will differ greatly among countries and over time. However, the intention is to discourage the use of participant training programs as general scholarship funds.

training of teaching faculty in technical fields or disciplines not judged by CDSS or sector strategy to be of developmental priority. The range of fields in which training for teaching faculty may be justified will be substantially broader than the project portfolio of the country program. However, advanced training for teaching faculty should be concentrated on fields which strengthen local training capacities of development importance.

training which could otherwise be accomplished cost-effectively in local institutions. Where training capacity exists in a local university or technical institute, there will be a presumption that the training should be accomplished locally. Further, where there is a substantial need for training in any field in which local capacity is not judged to be adequate, the presumption is that the first priority for external training should be the development or strengthening of local training capacity through faculty training and other means.

General Policy Guidance

The appropriate balance to be struck among the three purposes for participant training must be determined in the development of the CDSS. The country program as a whole, of which participant training is but one part, is expected to support private as well as public sector activities and institutions as well as such macro objectives as policy dialogue, reinforcement of market-oriented development and the expose of key leaders to U.S. institutions and practices. It is AID policy to measure the consistency of the participant training programs with these objectives in terms of their strategic

relationship to the approved CDSS, rather then by counting the number of private sector individuals or acknowledged leaders included in the training programs.

AID policy is to use participant training to address specific human resources constraints to development, e.g., leadership for key institutions, teaching faculty in priority development fields, key project staff. Long-term external training is not in most cases a cost-effective response to general shortages of high-level manpower or the need for on-going staff development and in-service training. Therefore, AID policy is to discourage the use of participant training programs as general scholarship funds and to encourage the provision of participant training to meet specific needs as identified in CDSS analyses, sector assessments, institutional profiles and project design exercises.

Fields of study will be determined primarily by mission assessments of needs as reflected in CDSS and project documentation. Project Papers in all sectors should identify human resources requirements and implications as specifically as possible, whether or not the purpose of the project is human resources development. Where training is required to ensure the availability of key staff or counterpart personnel, the project paper should specify how the training will be provided and should include the costs of training in economic analysis of the project, whether provided as project-related training or under an identified general participant training program.

* All participant training programs are expected to provide opportunities for women. AID affirms that all training programs are expected to give attention to means of ensuring substantial participation of women. Where relatively few women are expected to participate, there must be indications of initiatives being taken to increase the number of women in participant training programs. Indicators will include the following information:

1. number of men and women included in participant training program;

2. constraints to women's participation;

3. opportunities for enhancing women's participation;

4. strategies to overcome these constraints or make use of these opportunities; and

5. benchmarks to measure progress in implementing these strategies.

Due to the rapidly rising costs of training, all participant training programs are expected to be supported by thorough needs assessments and economic analysis. Particular attention should be given to cost-effectiveness issues, including: alternative modalities for training and personnel development; incentives affecting the recruitment and retention of trained personnel; and, provisions for recurrent salary costs. *

* Revised

All feasible steps should be taken to ensure that AID-sponsored trainees return to work (1) in their home countries and (2) in positions where their training is utilized effectively. The timely return of trainees and their continued employment in fields relevant to development (not necessarily specific institutions or institutional roles) will be major criteria for evaluations of training programs.

Where patterns of unsatisfactory return rates or subsequent employment are identified, particular attention should be given to whether the needs assessment and trainee selection processes are appropriate and to whether project design and institutional assessments have adequately considered the professional incentives and support systems needed to attract, retain and utilize key staff effectively.

Specific Policy Guidance

Participant training supported under functional accounts other than Section 105 (EHR) is expected to increase, through both training components of projects and sector-specific staff development projects. Where the training relates mainly or exclusively to development in a specific sector, the project should be funded from the respective sector account.

The purpose of the general participant training programs is institution development not otherwise supported by current sector projects. All AID-assisted countries are expected to have access to a general participant training program either as part of the bilateral country program or under a regional or sub-regional program.

External training funded under the Section 105 account should be limited to general participant training programs and to training as needed for EHR project implementation. Where institutionalization of a technical capacity (e.g., research, training, analytic or planning capacity) is a primary purpose of the project, it may be appropriate to train more than the minimum number of specialists to establish a "critical mass" and ensure a self-sustaining team. Where projects include training for personnel additional to those expected to be employed directly in the assisted project or more than one candidate for a position, the project paper should specify the purpose for the additional training and should include the social and economic impact of this training in the economic and social analysis of the project.

Training in the U.S. should be limited to fields in which training is not available locally, for which U.S. training is cost-effective, or which support other strategic considerations such as the exposure of key leaders to U.S. institutions and practices. AID has no implicit preference for one form of training over another, but it does expect that the option of training more cost-effectively in local or third-country institutions be explored before relatively expensive training in U.S. institutions is recommended.

Long-term academic training in U.S. institutions should be concentrated on graduate training. Most long-term training for non-teaching managers and technicians should be at the Master's level. Ph.D. training should be limited to teaching faculty, researchers and scientists, and key administrators of programs or institutions which employ scientists and researchers. In some specialized technical fields a baccalaureate, associate degree or certificate program may be appropriate. However, non-specialized undergraduate training in U.S. institutions is not encouraged and should be supported only as a limited and interim response for countries which have not yet developed local training capacity at this level.

With a few exceptions, AID support for academic training in U.S. institutions will be limited to three calendar years. Where it is anticipated that individuals may need training for periods longer than three years, for example to provide time for language preparation, alternatives should be considered (e.g., providing language training and preliminary coursework in the home country or a third country, non-thesis master's training, or completion of thesis/dissertation work in the home country). Where no alternatives appear feasible or cost-effective, exceptions should be justified in the original PIO/P and may be approved on a case-by-case basis. The main basis for exception is to provide a fourth year for completion and defense of a Ph.D. dissertation. However, where training in the U.S. for longer than three years is justified, a return trip to the home country should be provided in the third year.

Continuation training involving more than one consectutive degree should be anticipated in the original PIO/P. The main justification for such training is where the first degree is incidental to enrollment in the second degree program. Continuation funding for unanticipated additional degrees either priviately, but the host government or by the participating university should be firmly discouraged.

Local and external short-term training is encouraged, both as a means of moderating the costs of training and as one of the most pedagogically effective ways of providing training relevant to specific needs. Short-term training may include periods of internship and observation of relevant institutions and enterprises as well as formal courses and workshops. Such training may be particularly appropriate for individuals (key managers, entrepreneurs, women) who cannot easily arrange time for extended study abroad. Where there is a large or recurrent demand for short-course training in specific fields, either in a single country or in a region or sub-region, establishment of local capacity to provide such training on an on-going basis should be considered.

Post-training followup and professional support should be anticipated, either as a component of participant training projects or as a separate activity. Examples of such followup include support for professional networks, alumni associations or professional journals and information systems.

Technical assistance to establish local scholarship programs is encouraged, either as a component of participant training projects or as a separate activity, for example to assist countries with training needs assessment and planning, or with the development of capacities for the external placement and support of their own students on a continuing basis.

Supplementary Guidance on Private Sector Training Needs

Reimbursable training programs, now managed as part of AID's Office of International Training, will be encouraged both for the middle income countries and as a means of facilitating training sponsored by the private sector.

Private sector views should be sought and included in the assessments of needs and the establishment of priorities. Where the trainees are expected to be privately employed, the employers should play a role in trainee selection.

Privately sponsored training should be encouraged in those countries with a significant private sector. AID support is appropriate as needed to assist private sector training initiatives with logistic arrangements, external placement, planning and assessment. However, the direct costs of local and external training should be met by employers, the business community or the individual to the maximum extent possible.

Privately-employed individuals and local employers of professional personnel should have access to any local training programs, training support services and follow-up professional services (e.g., professional organizations, publications and information services) supported by AID

Private sector employment of AID-financed trainees is consistent with AID development policy, provided that employment is in the country-of-origin and in a field for which the training was originally justified.

PD - 8
July 13, 1983
(TM 1:49)

Where AID programs facilitate privately-sponsored training or include privately-employed individuals in general participant training programs the same guidance as for publicity sponsored or employed trainees applies with respect to ensuring that privately-sponsored or employed trainees return to their home country and to positions in which their skills are employed effectively. Further, the training priorities for privately-employed participants in AID-sponsored programs are expected to be similar to the priorities for the country program as a whole.

Conclusion

It is AID policy to encourage the use of participant training to improve national training capacities, ensure the availability of key project staff and professional counterparts, and contribute to the on-going process of improving the technical, managerial and policy leadership of private and public sector development institutions.

It is expected that participant training will expand, particularly those types of training related to specific sectoral and institutional objectives. While this policy guidance affords considerable flexibility to missions in determining priorities for fields of study, types and levels of training, the guidance required greater attention to the analysis of human resources constraints in all sectors and to the development of cost-effective training strategies.

Assisting countries to develop the managerial, technical and policy leadership required to decide and implement their own development plans in an essential component of AID's development strategy. To be fully effective as a strategic investment for AID, it is also essential that the participant training programs be related as directly as possible to the local processes of policy dialogue, technology transfer and institutional development.

(s) M. Peter McPherson
M. Peter McPherson
Administrator

July 13, 1983
Date

A.I.D. Policy Paper

ENERGY

U.S. Agency for International Development
Washington, D.C. 20523

July 1984

II.L (TM 1:34)
11/9/84

A.I.D. Policy Paper

Energy

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

July 1984

AID ENERGY POLICY PAPER
TABLE OF CONTENTS

I. Summary 1

II. Introduction 1

III. The Policy Setting 1

A. Energy Problems Confronting Developing Countries 2
1. The Ongoing Oil Crisis 2
2. Energy for Domestic Use 2

B. Characteristics of AID-Recipient Countries 3

C. Financing Energy Investment 3

IV. AID Energy Policy 4

A. Guiding Principles 4

B. How AID Can Help 4
1. Individual Country Strategy Orientation 4
2. The Choice of Interventions 5
a. Analysis, Planning, and Policy Development 5
b. Increasing Energy Supplies 5
(i) Agriculture and Rural Development 5
(ii) Biomass Fuels 6
(iii) More Efficient Energy Use (Conservation) 6
(iv) Other Energy Sources 7
c. Training and Institutional Development 7
d. Research and Technology Transfer 7
(i) Policy Research 7
(ii) Fuelwood Research 7
(iii) Research and Field Testing of Energy Systems 8
e. Urban Requirements 8
f. Private Enterprise 8

V. AID's Energy Role in Relation to Other Institutions 9

AID Energy Policy Paper

I. SUMMARY

Energy is a driving force for development. Countries require increasing supplies of energy to support their expanding economies. Without sufficient energy, development lags. Countries with higher levels of development use much more energy per capita than the least developed countries.

The energy constraints faced by most developing countries are severe. These countries, especially the poorest, share the common problem of inadequate energy supplies—to fuel economic growth, and to cook food. These requirements for energy have led directly to unmanageable claims on foreign exchange to import oil, and environmental degradation from an over-exploited traditional fuel resource base.

AID must be actively involved in helping to address these energy problems, which are likely to become more serious in the years ahead. AID will address energy requirements in its programs as a separate sector, fully integrate energy requirements with program objectives in other sectors, and will also address energy concerns with other assistance agencies. AID will tailor energy programs to the needs of individual countries, depending upon their resources and level of development, sources of investment, and the overall program emphasis in the AID Country Development Strategy.

AID assistance in energy has the following long term objectives: to help (i) develop sound national energy policies that are integrated with national economic policies and supportive of sustained economic growth; (ii) expand production of indigenous energy sources, substituting for higher cost imported energy wherever economically justified; and (iii) improve the efficiency of energy use.

To determine how AID objectives can best be achieved, the country CDSS should examine the key role energy plays at both the macroeconomic and the individual project level and indicate how energy components in the program can promote the ultimate program objective of helping poor people.

AID will promote development of the most cost-effective energy supplies necessary for development, especially in rural areas. AID's energy program will offer technical assistance for analysis, planning, and policy development; help to develop indigenous energy supplies; training and institution building; research and technology transfer; and encouragement of private investment from domestic and foreign sources. AID may finance resource transfers in a few selected countries. The program will:

- improve host government policies and programs and raise awareness of how energy is essential for development;
- assist developing countries in the exploration of all energy options, making full use of U.S. technical competence;
- direct significant attention to biomass fuels, and especially fuelwood research;
- tap private sector expertise.

The key energy policy issues to be addressed covering both commercial energy and traditional fuels, are: energy's demand for foreign exchange; market pricing; mobilization of private investment; and conservation (increased efficiency of energy use).

AID ENERGY POLICY PAPER

II. INTRODUCTION

This AID energy policy paper supersedes the policy paper issued in January 1981.

The paper emphasizes technical assistance and AID efforts to complement private enterprise. It recognizes lessons AID has learned about:

- the pervasive effect of energy on the entire economy;
- the importance of understanding how energy is used, and in what form, to support development, especially for the rural economy;
- needs for energy research.

The following sections describe the policy setting and the major energy problems confronting developing countries and set forth guidance for the choice of programs and projects.

III. THE POLICY SETTING

Energy is essential to sustained economic development. Countries require increasing supplies of energy to support their expanding economies and to meet the needs of growing populations. Without sufficient energy, development lags.

Formulating sound energy policies requires an understanding of how energy is used, and in what form. Energy—whether derived from commercial or traditional fuel sources—takes the form of process heat, motive power (shaft power, transport fuels) and electricity.

Developing countries use energy from fossil fuels (oil, natural gas, coal), nuclear processes (excluded from AID assistance), and renewable sources (biomass, hydropower, wind, sun, geothermal). Most countries must import energy to supplement limited indigenous sources.

Most economic sectors in developing countries require a mix of energy sources to meet national energy needs: fossil fuels and electricity dominate modern agriculture, industrial uses, and urban building systems, although charcoal and wood are sometimes used. Oil is virtually the only fuel used in modern transportation, but many people continue to rely on foot travel and animal carts. Electricity is generated from fossil fuels, hydropower, and nuclear energy. Human and animal power are a major source of energy for traditional agriculture. And traditional fuels (fuelwood, charcoal, crop residues, dung) are the principal source of energy for cooking.

A. Energy Problems Confronting Developing Countries

Since 1973, two major trends in energy have negatively affected economic development in developing countries:

- excessive dependence on high cost imported oil to fuel economic growth; and
- depletion of wood and other traditional fuels to supply energy for domestic uses.

1. The Ongoing Oil Crisis

Oil is the predominant source of commercial energy in developing countries. Oil currently supplies over 90 percent of the commercial energy used in Latin America, over 80 percent in the Near East and—excluding two large coal producers, India and Zimbabwe—more than 75 percent in Asia and Africa. Because oil use is closely tied to industrial output and transport, constraints on its availability or affordability can seriously impair export earnings and total economic output. Such heavy dependence on oil can be expected to continue and even increase as countries develop. Economic growth in the developing countries will require substantially greater inputs of fossil fuels for commercial energy.

Except for a few major oil producers, the developing countries import almost all of their oil. The cost of oil has increased about six-fold in real terms over the past ten years, dramatically raising the cost of energy to support the modern sector. The recent $5/barrel decline has brought AID-recipient countries surprisingly little relief because the fall in value of local currency against the dollar generally has offset the nominal price decline. In some countries (e.g. those in The Franc Zone), the real price has actually risen.

The cost of importing oil puts an inordinate strain on the economies of the developing countries. In many countries—for example, Dominican Republic, Morocco, Senegal—oil costs consume 50 percent or more of foreign exchange earnings. Borrowing to pay for oil increases the debt burden, often to unsustainable levels.

If developing countries cannot pay to import oil, they must reduce either investment or consumption; then their economies stagnate.

Some countries have prospects for developing indigenous supplies of oil, natural gas, or coal. The process is capital intensive, requiring large investments from the private sector and/or assistance agencies. Nonetheless, those countries with reasonable prospects (about one-half of AID-assisted countries) are likely to have economic options.

Developing countries have considerable scope for more efficient energy use (conservation), which offers the best short and medium term extension of supply. The developed countries have achieved remarkable energy savings since the 1978-79 oil price shocks, offering the possibility of similar efficiency gains in developing contries because the modern sectors are comparable.

2. Energy For Domestic Use

While countries struggle to meet commercial energy needs, they must also expand the supply of fuel to meet a growing population's energy requirement for domestic use, especially for cooking. Most women in the third world—an estimated 2 billion—cook with traditional fuels (frequently referred to as non-commercial energy, though these energy sources are becoming increasingly commercial, especially in urban areas). Over the next two decades, population in AID-recipient countries is likely to increase by nearly 50 percent, adding a massive new energy demand on presently marginal supplies.

Fuelwood (wood, leaves, branches) is a major source of energy for cooking, because it is an historically available source gathered without cash outflow. Unfortunately, the sustainable supply of fuelwood is declining in many regions as an expanding population clears land to increase food production and supply fuelwood. FAO estimates that 100 million people today live in areas of acute fuelwood scarcity, and the prospects are for the situation to grow even more grave.

The consequences of deforestation not only affect domestic needs. Other results are soil degradation, reduced agricultural productivity, flooding and siltation of reservoirs, and, in extreme cases, desertification.

Obtaining energy for cooking is a labor-intensive task primarily undertaken by women and children. As shortages of traditional fuels increase, more and more human energy is required to collect energy, or to generate cash income to pay for fuel.

For poor people, assuring adequate domestic energy supplies for cooking presents a significant challenge in the years ahead. For many countries, however, the alternatives to using fuelwood for cooking have limitations:

- burning crop wastes and dung deprive the soil of organic fertilizers that, to maintain productivity, must be replaced by chemical fertilizers at considerable cost;

- switching to petroleum products (kerosene, bottled gas) diverts foreign exchange from higher value uses, at costs poor people can rarely afford;

- using less energy for cooking—the likely prospect for many —may mean fewer or less thoroughly cooked meals, or changes in diet, with adverse effects on people's health, nutrition, and productivity.

However, developing countries need to explore all options, particularly the use of biomass and fossil fuels. Countries must use their existing natural resources to the maximum extent feasible.

B. Characteristics of AID-Recipient Countries

Developing countries differ in energy resources, numbers and types of trained people, economic structures (agricultural or industrial), and levels of development. Although there are some important exceptions, most AID-recipient countries can be characterized as having low levels of income, large rural populations, and relatively small but important modern sectors.

In AID-recipient countries, per capita consumption of commercial energy is closely associated with income level. Per capita consumption of traditional fuels follows an opposite pattern, being generally higher in countries with low income and low commercial energy consumption. Accordingly, commercial energy is the dominant energy source in the Caribbean and the Near East, which have relatively more developed modern sectors. Traditional fuels make the largest contribution to total energy use in Africa (65 percent), in Asia (42 percent), and in Central America (53 percent).

Despite their diversity, the developing countries face common energy problems—ineffective policies; limited and costly supplies of fossil fuels; depleting biomass resources; incomplete knowledge of their domestic energy resources and technologies to exploit these resources; shortages of effective institutions, skilled technicians and managers; inadequate understanding of the energy inputs required in agriculture and transport; and most importantly, a lack of capital.

C. Financing Energy Investment

Financing for development of energy supplies strains both internal and external capital sources. The large capital investments required must come from four basic sources: international financial institutions (IFIs) such as the World Bank and the regional development banks; bilateral assistance programs; the private sector (both commercial lenders and operating companies); and the countries themselves (both public and private sources).

Energy is a major claimant on national development budgets: Pakistan, for example, is projecting expenditure of 30 percent of the development funds in its next five-year plan for energy projects. Mobilization of domestic capital will be essential, but extremely difficult. Improvement of energy (and other) pricing policies could help, but the World Bank estimates the developing countries will only be able to furnish half the investments required from now through 1995 (perhaps considerably lower in AID recipient countries). Furthermore, most costs associated with energy supply development—imported equipment and expert personnel—can only be paid in foreign exchange.

Assistance agencies have been paying more attention to the energy sector in recognition of the critical constaints to development imposed by more expensive energy. The IFIs

now devote about 25 percent of total lending to energy, amounting to over $4.5 billion in 1982. Bilateral assistance programs provided approximately $2 billion in concessional assistance, and another $6 billion in export credits.

Hydropower and electricity transmission are the main recipients of assistance, but oil and gas now receive greater attention from IFIs and bilateral programs. All programs include some element of technical assistance, especially planning and assessments, although the primary focus of most of these programs is on resource transfers.

Private investment is the major source of funding for energy in developing countries. External private capital flows are estimated to exceed by a substantial amount the volume of official flows, especially in the middle income countries, including the oil exporters. Few figures are available on the volume of domestic capital mobilized in individual countries, but it is likely such figures would increase the importance of private vis-a-vis official investment.

IV. AID ENERGY POLICY

AID will actively help address developing country energy constraints as these are likely to become more serious in the years ahead and will be a key determinant of future growth prospects. Without focus, AID's efforts would be engulfed by the magnitude of developing country energy requirements. AID will therefore be guided by a set of principles in designing programs appropriate to the needs of individual countries.

A. Guiding Principles

AID's energy programs respond to the mandate of the Foreign Assistance Act of 1961 as Amended to address the development needs of poor people. AID will conduct programs that affect beneficiaries directly as well as other energy activities that affect the entire economy if these have important, even though indirect, effects on the poor. Because of the pervasive role of energy on all economic sectors AID will encourage the development of indigenous energy supplies—fossil fuels and renewables.

As they do for other programs, AID's four cornerstones provide the foundation for activities in energy: (i) policy dialogue; (ii) institution building; (iii) research and technology transfer; and (iv) private sector. And, in the allocation of its resources, AID will select energy programs and projects on the basis of economic viability.

AID's energy activities will be based on the following additional guiding principles:

- the private sector is and should be the primary source of financing for the development of energy supplies;
- developing countries must increase their absorptive capacity to expand the supply and the more efficient use of energy;
- AID will promote the utilization of U.S. technical expertise to assist countries to develop the most efficient energy options for their economic development;
- AID will coordinate and encourage exchange of information among donors for better program planning and sharing of lessons learned;
- AID will promote the most cost-effective energy project alternatives on the basis of comprehensive economic analysis;
- AID will encourage the maintenance of a sustainable natural resource base;
- AID may finance higher risk activities if they have large potential payoffs;
- AID will pay particular attention to gender issues as they affect these activites.

B. How AID Can Help

AID's energy program has the following long term objectives: to help (i) develop sound national energy policies that are integrated with national economic policies and supportive of sustained economic growth; (ii) expand production of economic indigenous energy sources, substituting for higher cost imported energy wherever economically justified; and (iii) improve the efficiency of energy use.

AID will offer technical assistance for analysis, planning and policy development; help to develop indigenous energy supplies; training and institution building; research and technology transfer; and encouragement of private investment from domestic and foreign sources. AID may finance resource transfers in a few selected countries.

1. Individual Country Strategy Orientation

AID energy programs should be tailored to the needs of individual countries depending upon several factors; natural resources, level of development, private sector and other assistance agency investments, and the AID

program objectives set forth in the Country Development Strategy Statement (CDSS).

CDSS should examine the key role energy plays at both the macro-economic and individual project level, and consider giving explicit treatment to the energy sector in USAID programs. This analysis should indicate how energy relates to the overall program objective of helping poor people:

- In some countries, the analysis may dictate a major AID effort in the energy sector to achieve AID objectives.

- In other countries, AID may concentrate on overcoming the energy constraints to achieving the primary program objectives, such as agriculture and rural development, off-farm employment, or concern for the environment.

2. The Choice of Interventions

Within the contexts of the CDSSs of individual missions AID assistance in energy can make a critical difference to AID country programs and the countries overall development.

The following guidance assists in this section:

a. Analysis, Planning and Policy Development

AID attaches high priority to policy and planning assistance to help countries understand the relationship among energy use, the available indigenous and imported resources, and broader development policies in natural resources and environmental planning.

The private sector and the multilateral development banks are the logical sources of capital for major energy development projects. Sound projects, however, require the acquisition of accurate energy and natural resource information, technical knowledge, and the development of host-country analytical and decision-making capability. These are long-term collaborative processes particularly well-suited to AID assistance for planning and management, and complement the UNDP/World Bank Assessment and other bi-lateral programs.

AID energy planning and management assistance can also help foster effective policies and programs (including technology transfer) which support private sector solutions. AID should take care to avoid enlarging public sector bureaucracies unnecessarily, or promoting non-market approaches to energy policy.

AID programs will:

- help countries analyze national energy supply and demand patterns, stressing links of energy to development, the importance of both commercial energy and traditional fuels, and, as an equal priority, environment and natural resource management issues. Particular attention will be paid to the energy requirements of rural areas supporting agriculture and employment as well as to meet the need for domestic fuels;
- undertake policy dialogue and analysis on critical national energy issues;

- underscore the importance of market pricing policies, and the hidden costs attached to subsidies and cross-subsidies which skew investment and consumption decisions;

- identify and encourage the implementation of trade and investment policies (investment laws, review of tax structure and incentives, and contract arrangements) that stimulate the private sector—foreign and domestic—and the operation of market forces to allocate resources;

- provide long term technical assistance in those countries where the objectives of AID's programs support a major concern with energy;

- finance resource assessments when countries need more information about their energy endowments.

b. Increasing Energy Supplies

Although AID may well be involved in a cross-section of activities justified by the country strategy analysis, AID's orientation gives it a particular interest in energy activities directly supporting the rural economy (agriculture and rural development, and biomass fuels). More efficient energy use (conservation) is also a supply option suited to AID assistance.

(i) Agriculture and Rural Development

AID will give special attention to providing cost effective energy supplies for the rural economy, an effort that receives comparatively little analytical attention from other assistance agencies or host countries. Furthermore, agriculture and rural development are the major recipients of AID development assistance funds, and generally make the largest contribution to GNP in AID recipient countries. Moreover, the rural areas are where a large segment of AID's target population lives.

AID programs must recognize a fundamental reality: more energy is required to increase agricultural production. Without increased energy, countries cannot achieve production increases of any significance.

Fossil energy (fertilizer; liquid fuels) is a crucial input to the agriculture sector. Although under current production practices energy constitutes only an estimated 5 percent of the costs of agricultural production, it accounts for perhaps 20 percent when transport, storage, and processing are included.

Rising real energy prices and recurring foreign exchange crises limit the availability of petroleum and fertilizer (also energy-intensive) to supply essential energy for the rural economy. This lack of energy in turn jeopardizes the capacity of less developed countries to achieve production increases, and underscores the interrelationship between a national energy system and support for the rural economy. In many cases, macro-economic or urban activities (expanding electricity supply that powers tube wells, oil pricing, charcoal use) can directly affect the energy availability and prices for rural consumers.

AID will:

- promote policies and programs that provide essential energy for food production, processing, and distribution, and off-farm employment;
- help developing countries undertake primary data collection to understand how much energy is required, in what form, by what groups, and the likely sources to support agricultural and rural development programs;
- help assess gender differentiated roles and responsibilities in the provision of energy;
- consider rural electrification programs, (including resource transfers in selected cases where such activities are consistent with the country program), when the introduction or improvement of electricity supply will enhance agricultural production, and off-farm employment. Rural electrification programs—an important source of commercial energy—must be carefully analyzed, because the opportunity costs of capital intensive projects are very high for capital scarce economies. Issues to be covered include:
  - implications for the national economy and energy supply, particularly if energy to power the system must be imported;
  - evidence of the economic benefits attributable to the electricity provided;
  - the cost comparisons of centralized vs. decentralized systems over the life of the investment;
  - alternative forms of investment that might be foregone.

(ii) Biomass Fuels

AID will direct significant attention to biomass fuels, consistent with AID forestry policy and forestry programs, and the need to supply domestic energy. AID should support efforts to expand production and conversion of fuelwood, crop residues, and possibly energy crops in countries with appropriate resources. For some countries, other energy sources may prove to be the most cost-effective over the long term. Where appropriate, AID should assist in their development and utilization.

Fuelwood, in addition to providing a major energy source for cooking, can be an important commercial energy source as charcoal or burned directly to provide process heat or electricity for rural industries. AID can help governments establish the policies and conditions to enhance supply and efficient conversion—defining the nature and magnitude of the scarcity problem, analyzing distribution and marketing problems, mobilizing political commitment, training people and strengthening institutions, improving seed and seedling availability, and especially supporting research.

AID should give special attention in implementing these programs to incentives for individuals, and involve both men and women in the planning process.

(iii) More Efficient Energy Use (Conservation)

The U.S. expertise in the private sector and experience in achieving significant gains in more efficient energy use offer attractive potential for application in developing countries. These efficiency gains run the spectrum from industrial and commercial practices to more efficient cooking stoves. Developing countries must incorporate, however, the *sine qua non* incentive for efficiency programs—market pricing.

AID can provide access for the developing countries to the considerable US expertise, and finance training and information systems

that have low cost and high return. AID will generally not finance capital investment for conservation; however, AID will assist the developing countries to identify sources of financing for the capital investments required to implement conservation activities. In selected programs, AID will finance resource transfers where they constitute part of a capital investment that will result in a self-sustaining, for-profit private business activity contributing to more efficient energy use.

AID will:

- encourage and assist host government conservation programs to improve energy efficiency—for both modern and traditional fuel systems;
- concentrate on training people and filling information gaps, transferring the successful experience and expertise in the U.S. private sector;
- finance capital investment in selected programs.

(iv) Other Energy Sources

Most nations throughout the world, including those assisted by AID, must depend on a mix of energy sources and energy systems to meet their needs. Both renewable and conventional sources must continue to be relied upon. Increasing emphasis on the development and utilization of indigenous resources and a reduction of reliance on imported oil are challenging goals which require considerable diversity in energy supplies.

The U.S. has a wealth of experience in the research, development and utilization of all energy sources and systems and in analysis and assessment methods to identify a country's viable options.

AID will:

- help to evaluate the nature and extent of indigenous energy resources, including coal, oil, gas, hydro, solar, wind and geothermal;
- help conduct feasibility studies to evaluate the most efficient energy systems options;
- use its "front-end" technical assistance efforts to catalyze and leverage follow-on capital investment by others, especially the international financial institutions.

c. Training and Institutional Development

AID will undertake comprehensive and enhanced training programs integrated with other energy and non-energy activities. The scarcity of trained people, particularly in the poorer countries, inhibits the formulation of effective policies and implementation of expanded or improved energy systems.

AID programs will:

- undertake needs assessments in specific countries to determine what training is needed, for how many people, and who should be trained;
- develop curricula and teaching materials for developing country energy problems, to be used in developing countries and the U.S.;
- finance major programs targeted to identified training needs at the senior and middle level;
- expand ties with U.S. universities, government laboratories, research institutions, consulting engineers, energy companies, and professional societies that can offer expertise to developing countries and establish long term institution-to-institution relationships.

d. Research and Technology Transfer

AID will support programs that assist developing countries in research and risk-taking to help them accelerate the transition to sustainable energy supplies.

Priority areas include:

(i) Policy Research

AID will finance policy research to help officials make informed energy decisions (directly supporting AID's priority attention to energy analysis, planning, and policy development). Energy investments are enormous, investment decisions take up to a decade to implement, and capital stock takes many more years to roll over. The cost of a bad decision, therefore, is a lasting drag on the economy.

Subjects to be covered include, but are not limited to:

- energy requirements for increased agricultural productivity;
- energy pricing;
- methods for mobilizing private investment;
- energy efficiency;
- energy's relationship to the environment.

(ii) Fuelwood Research

AID will undertake a major fuelwood research initiative. AID has designated fuelwood as

one of four agency-wide research priorities, and is presently preparing an implementation plan covering the research program. Substantial returns can be expected from this investment because research (technical, economic, social) into multi-purpose species is beginning to lead to important findings, and needs to be institutionalized.

AID will:

- promote both basic scientific and applied research, and networking in multi-purpose species;
- develop in-country research programs and multi-country networks, through collaborative Mission and centrally-funded efforts emphasizing species assessments and trials, improved management of trees and soils, research on conversion technologies, and strengthening local research institutions;
- analyze economic, financial, social, and institutional issues surrounding fuelwood production, marketing, and distribution.

(iii) Research and Field Testing of Energy Systems

AID will help develop emphasis on energy delivery systems for rural areas. New energy technologies are or will become economic for low-power uses in rural areas of developing countries over the next five to ten years, resulting from intensified research and development throughout the world sparked by the oil price rise since 1973. For many small farmers, appropriate energy systems may offer the only hope of obtaining energy beyond human and animal power.

Appropriate energy technologies will not be promoted on a large scale, however, until they are proved effective in operation over time in a developing country. AID—in close coordination with other assistance agencies—should establish systems to learn lessons from field testing (assess the costs, risks, and uncertainties as compared to the benefits) as a prelude to major investment. This research must encompass gender issues.

AID will:

- select energy systems for research and field testing with the best economic potential (without subsidies) to meet the most significant end-uses;
- field test the technologies under a standardized evaluation system for each technology;
- assure the collection, analysis, and distribution of information to assess the results of the field tests which could justify wide-scale application;
- document and diffuse information on successful project activities, experience gained, and cost-effective and commercially available energy systems matched to development needs;
- finance technical assistance, including feasibility studies for energy systems where they have a potential for making a significant contribution to economic development and where they support the implementation of AID's country strategy.

e. Urban Requirements.

In some countries where the urban energy needs and problems are predominant, AID energy analysis, planning and policy development activities will help determine if AID interventions in these countries are justified.

In these countries AID will provide technical assistance to:

- promote increased energy efficiency in urban applications, especially in industry, buildings and transport systems;
- investigate the use of biomass and other renewable energy systems for urban application;
- assist electric utilities to improve management and efficiency of their systems, and examine means to increase the use of renewable energy sources for electricity generation;
- work with host countries to reduce dependence on imported oil, by examining the feasibility of increased use of coal and natural gas, as well as domestic oil.

f. Private Enterprise

AID will tap the considerable expertise, experience, and financial resources in the private sector, including PVOs and cooperatives, to help developing countries address energy problems. Developing countries for their part must be willing to provide a hospitable climate for private investment.

AID programs will:

- stress policy dialogue, especially pricing and investment incentives, that facilitate private sector investment;

• establish closer relationships with U.S. private firms, trade associations, and utilities to mobilize U.S. expertise;

• encourage indigenous and external private investment in energy resources or systems development by conducting assessments, analyses and feasibility studies integrating the capital investment criteria and informational needs of commercial lenders and energy enterprises;

• tie AID-financed activities for industrial and commercial energy applications to AID's support for private enterprise (U.S. and local);

• consider direct financing of energy production (in selected countries where AID finances resource transfers) when AID funds act as a catalyst for private investment;

• limit assistance to state-controlled corporations except in those cases when the activity directly or indirectly supports private enterprises, or the country is receptive to policy changes to enhance private sector participation or ownership.

V. AID'S ENERGY ROLE IN RELATION TO OTHER INSTITUTIONS

With the need for a focus of effort and resources, AID will work closely with other institutions, both public and private, to help countries make maximum progress in meeting their energy requirements.

In promoting such collaboration, AID will:

• facilitate private sector and other donor investment by identifying opportunities through feasibility studies, analyses, and other forms of technical assistance, conducted in coordination with the "down-stream" financial organizations;

• normally leave infrastructure/capital investments to the private sector and other donor institutions, except in selected countries where resource transfer or energy security issues are in the U.S. interest;

• share information on proposed assistance activities with other bilateral and multilateral donors to help assure activities which are mutually supportive, and focused on the priority energy needs of the host countries.

AID will support the overall U.S.G. policy on financial and technical assistance by multilateral institutions to energy activities in developing countries. As a general rule, the guidance and criteria governing U.S. support of energy projects in multilateral banks (MDBs) should be applied in planning bilateral activities.[1] Exceptions to this guidance must be approved by the Administrator.

[1]State Cable 117912, April 1984

A.I.D. Policy Papers and Policy Determinations

The following reports have been issued in a series. These documents with an identification code (e.g. PN-AAM-323) may be ordered in microfiche or paper copy. Please direct inquiries regarding orders to:

A.I.D. Document and Information
Handling Facility
7222 47th Street
Suite 100
Chevy Chase, MD 20815

Title—Policy Paper	Date	'Fiche #
Bureau for Private Enterprise	May 1982	PN-AAM-325
Domestic Water and Sanitation	May 1982	PN-AAM-323
Food and Agricultural Development	May 1982	PN-AAM-322
Nutrition	May 1982	PN-AAM-321
Private Enterprise Development	May 1982	PN-AAM-324
Recurrent Costs	May 1982	PN-AAM-319
Population Assistance	September 1982	PN-AAM-320
Private and Voluntary Organizations	September 1982	PN-AAM-318
Women in Development	October 1982	PN-AAL-777
Pricing, Subsidies, and Related Policies in Food and Agriculture	November 1982	PN-AAN-373
Approaches to the Policy Dialogue	December 1982	PN-AAM-431
Basic Education and Technical Training	December 1982	PN-AAM-190
Health Assistance	December 1982	PN-AAL-817
Institutional Development	March 1983	PN-AAN-108
Co-Financing	May 1983	PN-AAN-457
Local Organizations in Development	March 1984	PN-AAQ-157
Urban Development Policy	June 1984	PN-AAQ-158
Energy	July 1984	PN-AAQ-160

Title—Policy Determination	Date	'Fiche #
PD #1—Narcotics	August 5, 1982	PN-AAM-443
PD #2—Mixed Credits	September 29, 1982	PN-AAM-444
PD #3—Voluntary Sterilization	September 1982	PN-AAM-445
PD #4—Title XII	October 5, 1982	PN-AAM-446
PD #5—Programming PL 480 Local Currency Generations	February 22, 1983	PN-AAM-591
PD #6—Environmental and Natural Resources Aspects of Development Assistance	April 26, 1983	PN-AAN-375
PD #7—Forestry Policy and Programs	May 16, 1983	PN-AAN-376
PD #8—Participant Training	July 13, 1983	PN-AAP-273
PD #9—Loan Terms Under PL 480 Title I	September 27, 1983	PN-AAN-753
PD #10—Development Communications	February 17, 1984	PN-AAP-616
PD #11—Using PL 480 Title II Food Aid for Emergency or Refugee Relief	July 26, 1984	PN-AAQ-159

II.M (TM 1:45)
June 1988

A.I.D. Policy Paper

ENVIRONMENT AND NATURAL RESOURCES

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

April 1988

I. Executive Summary

Economic growth in most developing countries is possible only with a reliable and sustainable supply of domestic natural resources. Yet the resources essential to economic development are threatened by rapid population growth, extreme poverty, inequitable access to land and other resources, pollution of the air and water, soil toxicity and erosion, short-sighted economic policies,and economic and political instability.

A.I.D.'s environmental and natural resource policies address these fundamental threats to the environment as well as the more immediate consequences of environmental degradation. The Agency's central environmental objective is to promote environmentally sound, long-term economic growth by assisting developing countries to conserve and protect the environment and manage their exploited resources for sustainable yields.

To meet this objective, A.I.D. will:
1) encourage and assist developing countries through bilateral and multilateral policy dialogue to formulate national policies and regulations which a) lead to effective management of natural resources, b) discourage environmentally harmful activities,
c) encourage environmentally beneficial price and market reform for key commodities and resources, d) stimulate private investment in and local management approaches to natural resources conservation, protection, and restoration; 2) assist developing countries in identifying and solving their environmental and natural resources problems by providing technical assistance and helping them strengthen public and private institutional capacities, scientific capabilities, and local skills in resource management; 3) support activities specifically designed to achieve sustained natural resource productivity and managment while protecting or enhancing the environment; 4) ensure that environmental review is fully integrated into all A.I.D.-supported development assistance projects; 5) encourage other national efforts and donor projects which are environmentally sound and which have a positive environmental influence, discourage projects which are environmentally unsound, and collaborate with bilateral and multilateral donors to evolve consistent policies and complementary programs; 6) support systematic planning and improvements in the efficiency of energy production and use, and the application of technologies to reduce environmental impacts associated with energy systems; and 7) support basic and applied research, and the transfer of existing scientific and technological knowledge that promotes environmentally sound economic development.

A.I.D.'s assistance will continue to focus on three broad environmental program areas: sustainable production, maintaining natural ecosystems, and meeting human needs by improving environmental quality. Within these program areas, A.I.D. will support forestry (including natural forest management, reforestation, agroforestry, and multi-purpose tree and agroforestry research), soil conservation and watershed management, resource inventories, environmental planning and education, land use planning, rangeland management, water and wastewater treatment systems, improved industrial and urban pollution control, and coastal resources management. Efforts to protect tropical forests and preserve biological diversity will be emphasized. The strategic focus and program mix will vary from country to country based on local conditions, needs, and areas of greatest opportunity.

II. Background

A. Introduction

Sustainable production of natural resources is essential to the Agency's central goal of promoting economic expansion in developing countries. Most A.I.D.-assisted countries depend principally on their renewable resource endowments for economic growth, and will continue to do so for the forseeable future.

In addition, A.I.D. recognizes that quality of life depends not only on economic and social development, but on environmental quality as well. Clean air and water, fertile soil, and a sustainable supply of renewable natural resources are elements which contribute to the quality of life.

The basic premise that sustained economic growth is possible only with protection and conservation of natural resources underlies the Agency's central environmental objective. This objective is to assist developing countries to conserve and protect the environment and manage their exploited resources for sustainable yields.

In order to accomplish this objective, the Agency developed the environment and natural resource policies that are presented in this document.

The important relationship between the environment and development has been recognized only within the last 15 to 20 years. The relationship is complex and is not completely understood. Research is necessary to advance our understanding of the linkages between environment and development in order to improve the capacity of A.I.D. and developing countries to promote development and protect the environment in the future. The policies described here will adapt and change as research results and lessons learned from practical experience further clarify the linkage between environment and development.

B. Nature of the Problem

Natural resources[1], particularly renewable natural resources, are essential to sustainable development. Agriculture, forestry, fisheries, and tourism depend on the continued functioning of healthy ecosystems. Yet, these vital resources are threatened by extreme poverty, rapid population growth, inequitable access to land and other resources, pollution of the air and water, soil toxicity and erosion, short-sighted economic policies, and political instability.

Growing by over 80 million people each year, the world's population is expected to increase from the current level of five billion to more than 10 billion in the next century. Although the interaction between population growth and the environment is complex, rapid growth exacerbates stress on diminishing resources. Agricultural productivity decreases as more people are forced to place marginal lands under cultivation. Pesticide abuses, watershed deterioration, and destruction of coastal resources increasingly threaten the environment and future economic productivity. Urbanization is proceeding at explosive rates. In many developing countries, urban areas now experience some of the world's worst air and water pollution.

Tropical deforestation and the loss of biological diversity graphically illustrate the magnitude of environmental degradation facing the world today. Since the turn of the century, more than one-half of the world's tropical forests have been lost. More than 11 million hectares of tropical forest are modified, degraded, and converted to non-forest uses each year. A much larger area is damaged to some extent. The erosion, siltation, loss of agricultural productivity, flooding, and fuelwood shortages resulting from massive deforestation adversely affect more than one billion people.

Moist, closed tropical forests cover only about seven percent of the globe's land area, but they provide habitats for more than half of the world's species. It is estimated that between now and the year 2000 nearly one million plant and animal species, or 10 percent of the earth's total, will become extinct. Most of these species will disappear before ever being discovered or classified. The importance of these genetic resources is clear. Wild germplasm is essential for breeding crop varieties with higher productivity and with greater resistance to insects, diseases, and adverse growing conditions. Equally important, tropical forests (as well as aquatic ecosystems) are the source of myriad natural products vital to industry as marketable products (dyes, fibers) or as raw materials for medicines and manufacturing.

C. The Setting

Most developing countries that receive A.I.D. assistance are located in the tropics, the region bounded geographically by the Tropic of Cancer and the Tropic of Capricorn. Potential solar radiation is high throughout the year, subject to varying degrees of cloud cover. Although seasonal fluctuations in temperature are minimal, daily temperature differences in some locations are extreme. The distribution of tropical ecosystems, ranging from arid to humid, is determined by precipitation patterns and physical location. Prvailing wind patterns and sea currents also influence their distribution. A simplified categorization of biogeographic regions is described below.

Humid Tropical Lowlands are characterized by high, evenly distributed annual precipitation (3000 - 4000 mm per year), a continuous growing season, evergreen to semi-deciduous forests, soils of medium to poor quality, and a high diversity of plant and animal species.

Tropical Dry Lands are characterized by medium rainfall (1000 - 4000 mm per year) and deciduous and evergreen forests. Soils are more fertile than in humid tropical lowlands, and thus are subjected to more in-

[1]Natural resources are materials that occur in nature and that are useful to human cultures. These resources are renewable or non-renewable and can be described in terms of classes. Of these, A.I.D. is concerned primarily with soils, water, forests, wildlife, fisheries, energy, minerals, plant and genetic resources, and more broadly, ecosystems.

tense human use. Most of these regions have been cleared for agriculture and human settlements.

Arid/Semi-Arid Lands are characterized by variable precipitation patterns (20 - 700 mm per year), short growing seasons, vegetation ranging from desert shrub to savanna woodlands, low soil fertility, and periods of drought. Historically, use of these lands has been based on nomadic human and long-distance migrating animal populations, particularly in Africa.

Wetlands, Coastal Zones, and Islands include both fresh and saline waters along borders of lakes and rivers, estuaries and off-shore resources, such as seagrasses and coral reefs. Plant and animal productivity tends to be very high. These regions, which support forestry, agriculture, and fisheries, are under heavy urban and commercial development pressure. Islands are of special concern; in addition to the above features, they often contain unique and endemic plants and animals (species not found elsewhere).

Highlands in the tropics and subtropics are characterized by variable climate, soils, vegetation, and growing seasons. These regions often contain the headwaters for major river systems, making watershed management a prime concern.

D. Factors Affecting Environmental Degradation

1. A Short-term Perspective

In many developing countries, the requirement to meet immediate, critical human needs frequently overwhelms available natural resources. This severely limits the ability to plan adequately for the future. Furthermore, many governments and private enterprises often do not preceive the benefits of managing resouces for sustainable yields as outweighing costs, although this perception is changing. Market demands and economic interests in short-term gains severely hinder the development of a long-term perspective. The economic rationale for natural resource conservation must be recognized in developing countries before governments and the private sector will accept sustained natural resource management and environmental protection as essential to growth.

2. Limited Domestic Resource Base in Relation to Demand

Many developing countries do not have sufficient funds or adequate natural resources to meet demands. Although the natural resource endowment is sufficient in some countries, inappropriate economic policies and politics distort the value and usage of resources. For example, land tenure insecurity and skewed distribution can lead to limited availability, in effect creating a shortage of available land. Regardless of the cause, resource shortages exacerbate environmental degradation. For example, deforestation is accelerated through expansion of farming into marginal areas. The resulting decrease in available fuelwood and other forest products perpetuates the chain of destruction as rural people seek to meet their basic needs. Energy supplied by dung, for example, reduces fertilizer availability, which often leads to decreased agricultural productivity. In turn, the demand for more arable land increases. This chain of cause and effect with mutual dependency greatly complicates efforts to protect the environment and manage resources for sustainable yields.

3. Inefficiency of Resource Production and Use

Experience indicates that maximizing efficiency in production and use of resources reduces stress on those resources. Indiscriminate or non-selective production methods greatly decrease yields over time. Felling large areas of forest to log a few valuable hardwood species significantly reduces the yield of forest products. Blast fishing, which indiscriminately kills nearly all marine life in the affected area in order to harvest a few marketable fish, rapidly destroys a productive fishery. Inefficiency in resource use also increases demand for greater production. For example, inefficient methods of burning fuelwood or making charcoal accelerate pressure for fuelwood harvesting.

4. Inadequate Knowledge, Training, and Experience in Resource Mangement

Managing natural resources for sustainable yields requires an understanding and knowledge of the resource itself (life cycles, reproductive strategies, nutrient demands, etc.) and the surrounding physical environment. Effective natural resource management also requires an understanding of the surrounding social, economic, and political environment. Equally important is understanding how the roles of women, men, and children relate to resource use. Appropriate incentives and provision for secure land, fishing rights, and tree tenure are essential considerations in resource management. With these many requirements, developing countries often do not have enough adequately trained personnel to develop and implement

resource managment schemes. In the absence of this requisite experience, the needed resources often are unsustainably exploited rather than managed. For these considerations to be incorporated effectively into management schemes, training and education are critical.

5. **Social and Institutional Aspects of Resource Management**

Indifference and unsustainable resource exploitation arise when host country legal frameworks do not permit individuals or groups clear and secure rights to utilize resources. Moreover, developing countries typically have taken centralized approaches to management, which ignore local arrangements for use rights and local capacity to manage. Increased costs on already overburdened central budgets is often the result. These problems can be addressed through legislative and administrative changes. Broader, clearly defined secure access and use rights, as well as decentralization of authority for resource management and use, are among the necessary changes. Working with local people is an essential component of effective project design and implementation.

Better understanding of the factors affecting the environment has led to greater recognition by developing countries that sustainable resource use and long-term economic development are inextricably linked. A.I.D. is receiving an increasing number of requests for technical and financial assistance to address environmental and natural resource management needs. At the time of the 1972 Stockholm Conference on the Human Environment only 15 industrial countries and 11 developing countries had environment and natural resource management agencies. Just ten years later there were 144 such agencies. Many A.I.D.-assisted countries have now adopted environmental policies and legislation to protect their valuable natural resources.

Many countries are planning, currently conducting, or have completed National Conservation Strategies, country environmental profiles, and other forms of natural resource assessments. More and more countries are already incorporating the resulting information into their national economic planning process. Other donor organizations are also increasing their support for these efforts.

E. Evolution of A.I.D. Programs and Policies

In 1973, A.I.D.'s development assistance focus changed from large-scale, capital-intensive projects to assistance to reduce poverty and improve human welfare through agriculture, health, education, and population planning. This change in focus later facilitated the Agency's efforts to go beyond environmental assessment of development activities to include projects designed specifically to protect and enhance the environment.

In 1976, A.I.D. adopted its first formal environmental procedures, 22 CFR Part 216, commonly referred to as Regulation 16. These procedures, revised in 1980, require a systematic review of potentially negative impacts of all A.I.D. projects. This allows mitigating measures to be included in project design prior to project authorization.

A.I.D.'s environmental policies have evolved in response to host-country needs, initiatives of A.I.D. staff, concerns of the environmental community, and new legislation. Given the magnitude of global environmental problems, the scope and content of A.I.D.'s environmental and natural resource programs are necessarily complex and will continue to evolve. The major events which have influenced A.I.D.'s policies are summarized in Annex I.

This Policy Paper supersedes Policy Determinations 6 and 7. The policies described in this Policy Paper extend A.I.D.'s efforts to identify negative impacts associated with project activities before they occur (the main focus of Reg 16) and promote donor and host-country policies, projects, and programs specifically designed to enhance and maintain natural resource productivity while protecting the environment.

The first and more traditional approach to environmental protection is to prevent negative environmental consequences of project activities. This approach requires the integration of environmental considerations into all projects. For A.I.D., this includes conducting initial environmental examinations (IEEs) and, when appropriate, environmental assessments (EAs) or environmental impact statements (EISs) to evaluate the negative impacts of A.I.D.'s activities. Such reviews enable A.I.D. to consider appropriate alternative project designs and mitigating actions. In addition, this approach incorporates effective management of natural resources into development projects and programs that otherwise do not focus on environmental protection. An example is the use of environmentally sound pest management, utilization of soil and water conservation techniques, or integrating agroforestry components as part of an effort to increase agricultural production.

Monitoring existing projects to measure and ensure compliance with environmental regulations is essential.

The second approach is to support activities which have as a primary objective sustained natural resource management or environmental protection. Such activities, which often are designed specifically for this purpose, include: 1) promoting sound land use planning and increased cooperation and coordination between key ministries and departments (e.g., agriculture, forestry, environment, energy, and industry); 2) promoting reforestration, agroforestry, and watershed management; 3) conserving biological diversity, including the protection of wildlife and plant genetic resources in preserves and parks, and the generation of alternative sources of income to reduce pressure on wildlands; 4) improving water quality in both urban and rural areas; and 5) encouraging private sector participation in profit-generating programs that conserve natural resources. These activities are implemented either as components of large projects or as discrete projects designed specifically to manage natural resources for sustained production.

III. A.I.D. Environment and Natural Resources Program

A. A.I.D. Policy Objectives

A.I.D.'s environmental and natural resource policy is based on the premise that environmental protection and conservation of natural resources are essential to sustained economic and social development. The central objective of this policy is to **help developing countries to conserve and protect their environment and natural resources, and to promote long-term economic growth by managing exploited resources for sustainable yields.**

To achieve this objective, A.I.D. will: 1) encourage and assist developing countries through bilateral and multilateral policy dialogue to formulate national policies and regulations which: a) lead to effective management of natural resources, b) discourage environmentally harmful activities, c) encourage environmentally beneficial price and market reform for key commodities and resources, and d) stimulate private investment in and local management approaches to natural resources conservation, protection, and restoration; 2) assist developing countries to identify and solve their environmental and natural resources problems by providing technical assistance and strengthening public and private institutional capacities, scientific capabilities, and local skills in resource management; 3) support activities specifically designed to achieve sustained natural resource productivity and management while protecting or enhancing the environment; 4) ensure that environmental review is fully integrated into all A.I.D.-supported development assistance projects; 5) encourage other national efforts and donor projects which are environmentally sound and which have a positive environmental influence, discourage projects which are environmentally unsound, and collaborate with bilateral and multilateral donors to evolve consistent policies and complementary programs; 6) support systematic planning and improvements in the efficiency of energy production and use, and the application of technologies to reduce environmental impacts associated with energy systems; and 7) support basic and applied research, and the transfer of existing scientific and technological knowledge that promotes environmentally sound economic development.

B. Environment and Natural Resource Assistance Activities

Over the past decade, A.I.D. has become a leader within the donor community in promoting sustainable agriculture, natural resources management, and environmentally sound economic development. In FY 1987, A.I.D. obligated over $450 million to environmental activities (including ESF support for wastewater treatment systems) in more than 40 countries. During the period including fiscal years 1985 to 1988, A.I.D.'s cumulative assistance for environmental activities was more than any other bilateral donor. Including ESF support, funding exceeded $1.5 billion. Excluding ESF, cumulative support approached $700 million.

Agency programs in environment and natural resources are implemented in collaboration with other U.S. and international agencies and organizations, including: non-governmental organizations (NGOs), private voluntary organizations (PVOs), private enterprises, U.S. universities, the Peace Corps, and U.S. Government technical agencies such as the Environmental Protection Agency, National Oceanic and Atmospheric Administration, Forest Service, Fish and Wildlife Service, National Park Service, and the Geological Survey. A.I.D. also works with other assistance agencies through the Organization for Economic Cooperation and Development (OECD), especially through the Development Assistance and Environmental Committees;

United Nations Development Program (UNDP); United Nations Environmental Program (UNEP); Food and Agriculture Organization (FAO); and Committee of International Development Institutions on the Environment (CIDIE).

A.I.D.'s assistance has concentrated on forestry (including natural forest management, reforestation, agroforestry, and multi-purpose tree and agroforestry research), soil conservation and watershed management, resource inventories, environmental education, land use planning, water and wastewater treatment systems, improved industrial and urban pollution control, and coastal resources management. More recently, greater emphasis has been placed on protecting and sustainably managing tropical forests and preserving biological diversity. The strategic focus varies from country to country depending on local conditions, needs, and areas of greatest opportunity.

These various environmental activities fall within three mutually reinforcing program areas: sustainable production; maintenance of natural ecosystems and ecological processes; and meeting human needs by improving environmental quality. In these areas, A.I.D. has the opportunity to leverage its assistance efforts by facilitating environmental planning at the national level in order to address the cross-sectoral issues which affect the environment.

1. **Sustainable Production**

Promoting sustainable production reflects the critical congruence of the Agency's environmental program and primary development assistance objectives. In many developing countries, most economic goods and services depend on the availability of natural resources. With differing emphases, agriculture, forests, rangelands, fisheries, and wildlife-based tourism are critically important to the economies of most developing countries. Legal trade in wildlife from South to North alone produces greater than $5 billion annually. In 21 A.I.D.-assisted countries more than 75% of energy derives from fuelwood. Forest products, in addition to fuelwood, contribute significantly to income, employment, and trade in most developing countries.

Promoting sustainable production, therefore, plays a critical role in A.I.D.'s economic development efforts. Priority areas include: a) land use planning, management and regulation; b) reforestation and watershed rehabilitation; c) management of natural areas for sustainable yields of resources; d) efficient production and use of energy and the application of environmentally-sound energy technologies; e) coastal resources management; and f) sustainable agriculture and agroecosystem research and planning.

Sustainable Agriculture

Sustainable agriculture is one of the most important aspects of sustainable production. Agricultural productivity must be increased and must be sustainable in order to meet the needs of the world's rapidly growing population. More food must be grown on less land. Expansion of human settlements and other population-related land conversions result in a loss of an estimated eight million hectares of arable land each year.

Current agricultural practices in many parts of the world often are incompatible with sustainable agriculture. These practices result in overgrazing of rangelands, deforestation in mountain and tropical environments, desertification, waterlogging and salinization of irrigated lands, soil erosion, and soil toxification. In turn, these environmental effects significantly reduce agricultural productivity by decreasing soil fertility and reducing land available for cultivation. Every year, erosion, desertification and toxification claim seven million hectares of agricultural land.

Growth in agricultural productivity must occur without depleting the natural resources on which it depends. The Agency's Agriculture, Rural Development and Nutrition program recognizes that maintaining and enhancing the natural resource base is critical to the goal of expanding the availability and consumption of food and increasing the income of the poor majority.

A.I.D.'s efforts to promote sustainable agriculture must incorporate the risk-reducing and resource-conserving aspects of traditional farming. Many farming systems have persisted for millennia through careful management of soil, water, and nutrients. In some environments, however, sustained agriculture has been possible only with the application of high levels of fertilizer and other external inputs. (Future development of plant varieties suitable for adverse conditions may eventually allow for low-input farming where high levels of input are currently necessary). In either low-input or high-input sustainable farming systems, the advances of modern biology and technology must be drawn upon. In addition, development of effective agricultural systems requires the full participation of local people and an understanding of how men, women, and children uniquely contribute to resource

use. These concerns are woven into all of the Agency's agricultural programs and projects.

Also essential to environmentally sound and sustainable agriculture is the proper application, storage, and disposal of agricultural chemicals. A.I.D. policy is to support more natural pest control efforts through integrated pest managment systems. This policy includes efforts to: a) reduce the use of chemical pesticides to the fullest extent practicable; b) use only those pesticides which are proven to be safest to the environment and people; c) discourage general requests for pesticides, and assure that pesticides are used in conjunction with natural control programs; d) develop infrastructures in developing countries for all aspects of proper pest and pesticide management, including regulation of manufacturing, labelling, distribution, worker and public exposure levels, application, storage, and disposal; e) communicate U.S. policies and experience on pest control and pesticide problems to other nations and international organizations; and f) promote the use of supplementary or alternative methods of vector control which are not dependent on the use of toxic chemicals.

2. **Maintenance of Natural Ecosystems**

Security and maintenance of representative and unique ecosystems, habitats, and wildlife are vital to development. Behind the obvious aesthetic and cultural justification is an economic basis. Wildlife attracts tourism, a major source of foreign currency in many developing countries. Preserved ecosystems protect plants and animals of potentially enormous economic value, not only as wildtype sources to strengthen domestic stocks, but as sources of medicines and materials yet to be discovered. Conservation of natural ecosystems is also critical to maintaining ecological processes such as water regulation and soil retention, both within and outside the protected ares. A.I.D.'s programs and policies in protected areas and parks are described in detail below in Sections C(1) and C(2) under Tropical Forests and Biological Diversity. Priorities include protecting undisturbed areas, maintaining natural areas, and managing buffer zones surrounding protected areas for sustainable resource yields.

3. **Improving Environmental Quality: Serving Basic Human Needs**

In many developing countries, rapid rates of urbanization and greater industrialization have exacerbated pollution and health problems. The elevated use of chemical pesticides and fertilizers in rural areas and hazardous materials in developed areas contributes to the pollution problems. Poor air and water quality and exposure to pathogens threaten human health.

The U.S. has a demonstrated capability to mitigate the environmental effects of industrialization. The Agency can use this capability to help developing countries improve regulation of hazardous chemicals and promote industrial health and safety for workers. Worker safety could be enhanced, and the release of pollutants into the environment could be reduced, by adapting lessons learned from U.S. industrial experience to the developing country context.

In the area of health and the enviornment, one of A.I.D.'s traditional strengths has been assistance for low cost water and sanitation programs, mainly in rural areas. In Egypt, substantial levels of Economic Support Funds have been used for urban water and sewage treatment. A.I.D. also supports efforts to diminish contamination of aquifers and water supplies from farm run-off. This is accomplished most directly by decreasing the quantity of agriculturally applied chemicals, a major goal of the pesticide policies described above. A.I.D.-funded research and activities designed to control disease vectors are additional efforts important to improving health in developing countries.

Population assistance is a significant Agency activity relevant to efforts to protect the environment. Although the interaction is complex, population growth compounds many of the environmental problems faced by developing countries. A.I.D's policies regarding population are discussed in detail in the 1982 Policy Paper on Population Assistance.

Energy production and use are also linked to environmental quality. Dramatic increases in the energy requirements of developing countries have the potential to create significant environmental effects, both positive and negative. The particular environmental effects depend on the energy source and specific technology used. A.I.D.'s policies addressing the linkage between energy and the environment are discussed in detail in the forthcoming Energy Policy Paper.

These and other threats to the environment and human health will surely become increasingly severe with time. Mission and A.I.D/W environmental staff may find opportunities to expand activities in the area of environmental quality and pollution control.

C. Special Concerns

1. Tropical Forests

Recognizing the unique role and special environmental characteristics of tropical forests, A.I.D. issued policy and program guidance on humid tropical forests (STATE 328482) in 1984. In this guidance, A.I.D. defines tropical forests as "all forests and shrublands within the geographic tropics and in frost-free areas outside the geographic tropics." Humid tropical forests are defind as "those with continuous canopy comprised of single or multiple layers found in the geographic tropics where the annual biotemperature in the lowlands is greater than 24 degrees centigrade and where annual rainfall equals or exceeds potential evaporative return of water to the atmosphere."

This Policy Paper reflects broader congressional concern for all tropical forests, giving priority to conserving undisturbed forests, finding sustainable ways to manage natural forests in tropical countries, and finding alternatives to the conversion of tropical forests.[2]

It is A.I.D. policy to: a) *engage in policy dialogues* that stress 1) the importance of conserving and managing forest resources for long-term benefit, 2) the importance of appropriate economic incentives and tenure policies, 3) local participation in sustainable management structures, and 4) the key role of the private sector, including farmers, NGOs, and private business, in sustaining forestry programs; b) *promote the management of existing forests for sustainable yields,* including projects that provide extension services on harvesting natural forest products and support for research on sustained-yield timber harvesting for particular forest types; c) *provide alternatives to forest destruction,* encompassing support for projects that offer employment or income alternatives and improved security of tenure to agricultural land to people who might otherwise destroy natural forests, including projects which support, 1) training and education, and alternatives to destructive farming practices, 2) agroforestry on marginal lands to provide permanent, sustainable alternatives to slash-and-burn agriculture, 3) the creation of productive buffer zones surrounding protected forests, and 4) research that would expand knowledge on tropical forests; d) *conserve natural forests* and support the conservation of forested watersheds, establishment of forest reserves managed for research on natural forest processes, and the designation of biosphere reserves that protect ecosystems representative of particular forest types; and e) *restore forest resources* and support efforts to expand tree planting to help meet work, energy, food, fodder, crop enhancement and soil protection needs, and to replenish the productivity of both degraded areas and agricultural lands. Examples include afforestation of areas near refugee camps or agroforestry projects to provide food and income in semi-arid regions.

[2]1986 amendment to Section 118 of the ForeignAssistance Act. See Annex I for details.

2. Biological Diversity (Biodiversity)

Biological diversity, as defined by A.I.D., refers to the **variety and variability among living organisms and the ecological systems in which they occur.** Species diversity, genetic diversity, and ecosystem diversity are included under the term biological diversity.

The fundamental causes of biodiversity loss are unsustainable agricultural, forestry, and other practices that result from inappropriate or unenforced governmental policies and the pressure of people, driven by poverty, seeking to meet basic human needs.

A.I.D. recognizes the importance of maintaining and protecting the world's rapidly eroding biological resource base.[3] Biological resources are critical to worldwide agriculture, public health, economic growth, and social development. However, only by integrating concern for biological diversity into the Agency's overall efforts to improve the environment and conserve natural resources will A.I.D. have a significant impact. An examination of the roles and practices of women, children, and men is necessary. Understanding how humans, as critical elements of the environment, affect habitat destruction and loss of biodiversity is essential. Biological diversity should be viewed not only in the context of the overall environmental program, but also as inextricably linked to A.I.D.'s efforts to improve human health, increase rural incomes, develop sus-

[3]In 1983 Congress authorized the use of FAA appropriations for assistance to countries for "protecting and maintaining wildlife habitats and...developing sound wildlife management and plant conservation programs." In providing such assistance, the legislation directs A.I.D. to make special efforts to a) establish and maintain wildlife sanctuaries, reserves and parks; b) enact and enforce anti-poaching measures; and c) identify, study, and catalog animal and plant species, especially in tropical environments. This legislation also directed A.I.D. to convene an interagency task force to develop the *U.S. Strategy on the Conservation of Biological Diversity* (1985) in developing countries.

tained agricultural and forest production, and restore degraded lands.

To protect biological diversity and promote long-term conservation, A.I.D.'s policies address both the root causes of habitat loss and more immediate protective measures. The former are consistent with A.I.D.'s traditional strengths and have been discussed in their respective policy papers or strategy documents. A.I.D.'s policy on the more immediate and narrowly focused measures to protect biological diversity is to: a) support efforts such as resource inventories and conservation strategies which identify ecosystems or regions worthy of protection; b) encourage the establishment and maintenance of wildlife sanctuaries, reserves, and parks, and promote anti-poaching measures; c) support development of buffer zones and promote alternative sources for products normally obtained in protected areas; d) support efforts which lead to resource management or land uses which protect and conserve the extant flora and fauna; e) support training, education, public awareness, and institution-building specifically to improve the capacity of recipient countries to preserve habitats and adequately manage wild plant and animal resources to prevent species loss; and f) encourage and promote policies and policy dialogue which increase the host-country's national commitment and long-term ability to protect diversity.

Legislation over the past few years has singled out tropical forestry and biological diversity from other environmental problems in order to highlight and focus attention on these two vitally important areas of concern. However, in order to prevent destruction of tropical forests and loss of biological diversity, these issues must be addressed as integral components of A.I.D.'s broader environmental protection, natural resources management, and agricultural production efforts. Integration of special environmental concerns into our overall development effort is critical to the management of a coherent, directed, and effective environmental program.

A summary of guidelines on CDSSs and Action Plan treatment of tropical forests and biological diversity conservation is provided in Annex II.

D. Specific Policies and Regulations Governing Environmental and Natural Resources Assistance Activities

In addition to the fundamental interest in economic development and humanitarian concern that underlie A.I.D.'s efforts to protect the environment and conserve natural resources in developing countries, Agency policies in this area are governed by specific legislation and regulations.

1. Environmental Effects of A.I.D. Actions

Regulation 16 (22 CFR Part 216) provides detailed guidance on evaluating the environmental effects of projects, programs and activities proposed for A.I.D. funding. This regulation formalizes the Agency's commitment to ensure that environmental considerations are fully integrated into the A.I.D. decision-making process regarding all A.I.D.-funded projects and activities. Since adoption in 1976, and revision in 1980, these regulations have required systematic environmental review of the Agency's activities. They ensure that the reasonably foreseeable environmental impacts resulting from A.I.D.'s actions are identified in order to permit consideration of alternatives and mitigating features in project design. Guidance for environmental review provides detailed descriptions of the Initial Environmental Examination, the Environmental Assessment, and the Environmental Impact Statement, and states when each type of analysis is required.

2. Local Currency

Since the mid-1950's, PL-480 and related food-aid programs have been a source of support for natural resources conservation and forestry in developing countries. The Agency's policy is to utilize available PL-480 resources for reforestation, agroforestry, watershed management, soil conservation, and park, wildlife, and habitat protection. PL-480 resources are used to complement and strengthen bilateral efforts in environment and natural resources. These resources often are most effective when channeled through PVOs, NGOs, and the Peace Corps. Strong management attention with technical and other supporting inputs are essential to effective local currency programming and implementation of Title II food-aid activities.

The Agency recognizes that some activities funded with local currencies may have potentially serious environmental consequences. Although A.I.D.'s formal environmental procedures (Reg 16) do not apply to activities funded with host country-owned local currency, the Agency is committed to ensuring, through appropriate alternative environmental procedures, that these activities are environmentally sound. Guidance regarding environmental review of these activities is being prepared and will be made available to all posts.

E. Donor Coordination

1. Bilateral Donors

The environmental activities of any single donor agency will be modest relative to the environmental problems facing the world. Efforts to manage the environment and natural resources for sustainable growth must be coordinated and shared by the global community. Thus, A.I.D. is committed to working with other development agencies to seek consistent policies and procedures in relation to the management of the environment and natural resources.

A.I.D. provides other donors with examples of environmental activities; information in the form of guidelines, country profiles, and assessments is also provided. Whenever A.I.D. is involved in multiple donor-financed projects, A.I.D. participates on the condition that the Agency's environmental concerns are addressed throughout project design and implementation, and that all necessary monitoring and evaluation activities are included in project planning.

2. Multilateral Development Banks

Legislation passed in each of the last several years requires U.S. government agencies to take an active role in reviewing, at the earliest stage possible, the environmental soundness of projects funded by the multilateral development banks (MDBs). The U.S. must also encourage the MDBs to increase their funding for environmentally beneficial projects. A.I.D. works with the Treasury and the State Department in these efforts. Activities that are being reviewed most closely include loans for: agricultural and rural development projects, large dams in tropical countries, and penetration roads into relatively undeveloped areas.

A.I.D. has been actively engaged in monitoring project proposals from multilateral development banks since 1982. In this process, called the early project notification system, A.I.D. solicits comments from its field missions and a small number of U.S. embassies. The primary objective of the review process is to seek changes in proposed projects when serious environmental problems are identified. When serious problems arise, the U.S. government may oppose the project if the development bank does not attempt to address the issues in question.

The process begins one to two years prior to MDB board consideration of key issues, including the impact on the environment, macro and sector policy issues, and project design questions. In response to growing congressional interest, A.I.D. added detailed environmental questions to the system in 1985. Missions are requested to submit information on the extent to which proposed projects may have negative effects on the environment, natural resources or indigenous people. The extent to which these issues have been addressed in the project design is also examined. Being on-site, Missions have a valued perspective on both the environmental and economic development problems of A.I.D.-assisted countries. As a result, Mission comments are the primary source of information used in the review process and subsequent negotiations with the MDBs. Other sources of information include U.S. embassies, a large number of non-governmental organizations (both in the U.S. and abroad) and other interested governments.

IV. Conclusions

Long-term economic growth in developing countries is possible only if natural resources are properly managed. The Agency will continue to expand its focus on natural resources and will increase efforts to assure that natural resource and environmental concerns are integrated into all A.I.D.-supported development activities. The Agency will continue to encourage other U.S. and international organizations to pursue environmentally sound practices. A.I.D. will also continue to support a broad range of institutions and organizations that can contribute to protecting the environment and managing natural resources.

The consequences of the Agency's environmental activities extend beyond immediate environmental and natural resource concerns. Efforts to improve environmental quality and promote sustainable yields of natural resources contribute significantly to the Agency's humanitarian, economic, and foreign policy objectives.

Annex I

Environmental Legislation, Key Publications, and Significant Events Influencing A.I.D.'s Environmental Policies and Programs

Note that the summary of legislation given below is not comprehensive, but is presented simply to provide a general overview. Please refer to the text of the legislation for detailed guidance.

1969

Congress passed the National Environmental Policy Act (NEPA) to "encourage productive

and enjoyable harmony between man and the environment; to promote efforts which will prevent or eliminate damage to the environment and biosphere and stimulate health and welfare of man; to enrich the understanding of the ecological systems and natural resources important to the Nation; and to establish a Council on Environmental Quality.''

1972-1974
U.S. participation in the Stockholm Conference on the Human Environment; initial environmental review of A.I.D. infrastructue projects; environment training begun for all A.I.D. engineering staff; first technical assistance provided in industrial pollution control training, environmental guidelines, and environmental assessments of major, multi-donor river basin programs (the Mekong and Senegal Rivers).

1973
New Directions Legislation

1975
Court approved settlement of litigation regarding the effects of A.I.D. activities on the environment.

1976
With NEPA as a guide, A.I.D. adopted its first formal environmental procedures. These require a systematic review of new A.I.D. actions in order to fully integrate environmental considerations into the A.I.D. decision-making process.

1977
The Foreign Assistance Act (FAA) was amended, giving the President authority to strengthen the capacity of developing countries to manage their natural resource base and take into consideration the environmental consequences of development actions. This legislation also required that specific efforts be directed to maintain, and where possible, restore the land, water, vegetation, wildlife, and other resources that support economic growth and human well-being. When combined with the Agency's own environmental regulations, the essential legislative and policy framework was established to focus attention and financial resources directly on environmental and natural resource problems.

1978
The FAA was amended further to highlight environmental concerns and natural resource issues as critical targets for establishing sustainable growth. FAA section 103, for example, declared that deforestation and its consequences are a threat to improving agricultural production and meeting the basic needs of the poor.

A.I.D. co-sponsored a U.S. Strategy Conference on Tropical Deforestation and began to hire foresters. A policy statement on pesticides was also issued.

1980
A.I.D.'s regulations were revised to allow for greater flexibility, and to incorporate specific procedures on the use of pesticides. The Agency acquired a greater ability to focus on the problems associated with assessing potential environmental impacts of A.I.D.-supported assistance activities. These changes were adapted from improved regulations of the Council on Environmental Quality issued under NEPA, and Executive Order 12114 concerning the environmental effects of major federal actions abroad.

The World Conservation Strategy was issued and a new Forestry, Environment and Natural Resource Office was created in A.I.D./Washington.

1981
Section 118 of the FAA was amended to require environmental assessments for any A.I.D. project significantly affecting the environment. This Act essentially approved and adopted the revised A.I.D. regulations.

A.I.D. co-sponsored the U.S. Strategy Conference on Biological Diversity and issued the first formal Agency policy on forestry.

1983
Section 119, entitled Endangered Species, was added to the FAA. This section stated that the preservation of animal and plant species through the regulation of hunting and trade, limitations on pollution, and the protection of wildlife habitats should be an important objective of U.S. development assistance. Protection of endangered species was also emphasized.

New Policy Determinations on Environment and Natural Resource Aspects and Development Assistance (PD-6) and on Forestry Policy and Programs (PD-7) were issued.

This Sector Strategy on Environment was published.

1984
The Sector Strategy on Forestry was published.

1985
OPIC investment activities were mandated to be consistent with Sections 118 and 119 of the FAA.

U.S. Strategy on the Conservation of Biological Diversity was published.

1986

The FAA was amended to reflect further concern about the environment and natural resources. The former section 118 on environment was renumbered to 117. A new section 118 was added which requires the president to place a high priority on conservation and sustainable management of tropical forests. This section also states the Country Development Strategy Statements (CDSSs) must include an analysis of actions to conserve remaining natural forests. The amendment also mandates that an annual report be prepared documenting how A.I.D. is implementing this section.

Authorization legislation included a $2.5 million earmark for the protection of biological diversity.

Section 119 of the FAA was amended to encourage the participation of local people in all stages of project design and development relating to biological diversity. A.I.D. is required to enter into long-term arrangements in which the recipient country agrees to protect ecosystems, support research, and deny assistance for actions that significantly degrade protected areas. CDSSs are required to include an analysis of the actions needed to conserve biological diversity. Whenever feasible, activities are to be carried out by PVOs.

HR3750, now enacted into law, and Section 537(g) of the 1988 Foreign Assistance Appropriations Act, directed A.I.D. to monitor the economic and environmental soundness of Multilateral Development Banks (MDBs). A.I.D. is required to compile a list of MDB projects which may have adverse impacts on the environment, natural resources, or indigenous peoples.

1988

The A.I.D. Manual for Project Economic Analysis was published. This manual provides guidance on incorporating concerns regarding natural resources and the environment into standard project economic analysis.

Annex II

Summary of Guidance Cable Addressing Biological Diversity and Tropical Forestry in CDSSs and Other Country Plans (STATE 032584, 03 February, 1988).

Background: 1986 amendments to sections 118 (tropical forests) and 119 (biological diversity) of the Foreign Assistance Act (FAA) require, among other things, that CDSSs, Action Plans, or other country plans include an analysis of (1) the actions necessary to conserve biological diversity and tropical forests in that country, and (2) the extent to which current or proposed A.I.D. actions (if any exist in that country) correspond to the actions identified as necessary to conserve diversity.

A.I.D./W recommends that the CDSS, Action Plan, or other country plan analyses also summarize major issues identified in a background assessment (suggested outline below). Actions are recommended for consideration by the Missions and A.I.D./W. Special attention should be given to issues concerning the private sector (including NGOs), the use of local currencies, and collaboration with the Peace Corps. A summary of the biological diversity/tropical forestry sections of the CDSSs, Action Plans, or other country plans will be provided to Congress.

Illustrative Scope of Work For Background Assessment

The Scope of Work should address: 1) the legislative and institutional structures affecting biological resources, including those of the host country government, non-governmental organizations, and international organizations, 2) the status and management of protected areas, 3) the status and protection of endangered species, 4) conservation outside of protected areas, including managed natural systems, impacts of development projects, and ex-situ conservation in zoos, seed banks, etc., 5) conservation of economically important species and germplasm, including land races and wild relatives of agriculturally important crops and livestock, 6) major issues in biological diversity and forest conservation, and 7) recommendations and proposed actions for A.I.D. and other donors.

Assistance Available from A.I.D./W

A number of countries now have local organizations that may be contracted to undertake background assessments. Also, environmental IQCs and other U.S. mechanisms are available for undertaking such studies.

Supplementary short-term technical assistance to Missions for these assessments is available from a number of sources. These include 1) field and A.I.D./W environmental and natural resources staff from Regional Bureaus and their support projects, 2) Bureau for Science and Technology technical support projects, and 3) cooperation with the Peace Corps.

A.I.D. Policy Papers and Policy Determinations

The following reports have been issued in a series. These documents with an identification code (e.g. PN-AAM-323) may be ordered in microfiche or paper copy. Please direct inquiries regarding orders to:

A.I.D. Document and Information Handling Facility
7222 47th Street, Suite 100
Chevy Chase, MD 20815

Title—Policy Paper	Date	'Fiche #
Domestic Water and Sanitation	May 1982	PN-AAM-323
Food and Agricultural Development	May 1982	PN-AAM-322
Nutrition	May 1982	PN-AAM-321
Recurrent Costs	May 1982	PN-AAM-319
Population Assistance	September 1982	PN-AAM-320
Private and Voluntary Organizations	September 1982	PN-AAM-318
Women in Development	October 1982	PN-AAL-777
Pricing, Subsidies, and Related Policies in Food and Agriculture	November 1982	PN-AAN-373
Approaches to the Policy Dialogue	December 1982	PN-AAM-431
Basic Education and Technical Training	December 1982	PN-AAM-190
Health Assistance	December 1982	PN-AAL-817
Institutional Development	March 1983	PN-AAN-108
Co-Financing	May 1983	PM-AAN-457
Local Organizations in Development	March 1984	PN-AAQ-157
Energy	July 1984	PN-AAQ-160
Urban Development Policy	October 1984	PN-AAQ-158
Shelter	February 1985	PN-AAQ-162
Private Enterprise Development (Revised)	March 1985	PN-AAQ-163
International Disaster Assistance	May 1985	PN-AAQ-164
Cooperative Development	April 1985	PN-AAQ-165
Trade Development	July 1986	PN-AAV-461
Health Assistance (Revised)	December 1986	PN-AAV-462

Title—Policy Determination	Date	'Fiche #
PD #1—Narcotics	August 5, 1982	PN-AAM-443
PD #2—Mixed Credits	September 29, 1982	PN-AAM-444
PD #3—Voluntary Sterilization	September 1982	PN-AAM-445
PD #4—Title XII	October 5, 1982	PN-AAM-446
PD #5—Programming PL 480 Local Currency Generations	February 22, 1983	PN-AAM-591
PD #8—Participant Training	July 13, 1983	PN-AAP-273
PD #9—Loan Terms Under PL 480 Title I	September 27, 1983	PN-AAN-753
PD #10—Development Communications	February 17, 1984	PN-AAP-616
PD #11—Using PL 480 Title II Food Aid for Emergency or Refugee Relief	July 26, 1984	PN-AAQ-159
PD #12—Human Rights	September 26, 1984	PN-AAQ-161
PD #13—Land Tenure	May 9, 1986	PN-AAQ-166
PD #14—Implementing A.I.D. Privatization Objectives	June 16, 1986	PN-AAQ-167
PD #15—Assistance to Support Agricultural Export Development	September 13, 1986	PN-AAV-460
PD #16—Program Financing Arrangements with Independent Organizations	October 9, 1987	PN-AAV-463

II.P. (TM 1:35)
8/14/85

A.I.D. Policy Paper

URBAN DEVELOPMENT POLICY

U.S. Agency for International Development
Washington, D.C. 20523

October 1984

II.P. (TM 1:35)
8/14/85

A.I.D. Policy Paper

URBAN DEVELOPMENT POLICY

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

October 1984

TABLE OF CONTENTS

	Page
Executive Summary and Recommendations	1
The Main Recommendations of This Paper	1
I. Introduction: A Framework for Urban Policy	2
A. The Dimensions and Nature of Urban Issues .	2
B. Urbanization and Economic Development	3
II. Urban Development Program and Policy Formulation	3
A. The Major Issues AID Should Address	3
B. Urban Programs and Policies AID Should Consider	4
1. Support for Country Economic Development Policies	4
2. Support for the Private Sector and Job Creation	4
3. Support for Housing Policies and Programs for the Urban Poor	4
4. Support for Development of Human Resources	4
5. Support for Urban Institutional Development	4
6. Support for Hazard Resistant Codes and Enforcement	5
C. The Allocation of AID Resources to Urban Policies and Programs	5
1. Country Selection Strategy	5
2. Urban Locational Strategy Selection Within a Country	5
3. Selection of Developmental Sector Strategies	5
4. Allocation and Resources Constraints ...	6
Appendix	

Urban Development Policy Executive Summary and Recommendations

This paper reviews AID's urban policy and programs and provides a new framework for addressing major urban issues in developing countries.

There are six primary reasons for re-examining AID's current urban development policy:

- Although world poverty remains concentrated in rural areas, such a characterization is not representative of all the coutries in which AID works;
- Urbanization is increasing at such a rapid pace that by the year 2010 the majority of people living in LDCs will live in cities;
- Despite our perception of ourselves as an Agency concentrating on rural development we already have a very large, if somewhat imbalanced, urban portfolio;
- Our focus on private enterprise development, economic policy reform, institutional development, and technology transfer provides us with an opportuntiy to re-examine the linkages between the development of rural areas and rural peoples and the growth of urban areas;
- Urban centers are now consuming large amounts of country resources, the management of which can have substantial positive or negative effects on the achievement of overall national and development objectives.
- Due to population and economic pressures urban populations are locating increasingly in areas and structures which are vulnerable to natural disasters, presenting a significant increase in economic as well as social risk.

Although our re-examination is concerned with all economic and social activities that take place in urban areas, it is not limited to activities which could only take place in urban areas. That is, we are concerned with urban links to the rest of the national economy and to rural areas through the national settlement system.

The Urban Development Policy recognizes that AID's urban programs should focus on activities where we have a comparative advantage in terms of our skills and expertise.

The Main Recommendations Of This Paper Are:

1. That AID Missions, in planning a development stategy, consider programs located in urban areas as part of a total development effort. Before developing such programs, AID Missions using available analytical methodologies and resources should assess broadly the urban context in which policy reforms and institutional development activities are to be implemented. In view of Mission resource constraints, Missions are encouraged to use AID/W skills, expertise, and funding to the greatest extent possible. AID/W has a variety of tools and approaches that can be applied to urban problems and issues.

2. That the issues involving the allocation of resources to urban areas be decided on a country-by-country basis, based on sound socio-economic criteria and a better understanding of the processes of urbanization and economic growth.

3. That AID program acitivities could include:

a. Support for the preparation of country development policies which lead to the appropiate allocation of resources between urban and rural areas in support of national development objectives.

b. Promotion of the growth of the non-farm private sector through activities that improve the working of capital and labor markets so as to enhance the productivity of the private sector in providing employment opportunities and thereby alleviating urban poverty.

c. Shelter policies and programs for the urban poor (particularly sites and services and settlement upgrading programs) which stress affordability and cost recovery.

d. Support for education, health, and community development programs which develop human resources and promote an overall urban development strategy.

e. Support for urban institutional development at the national and local levels of government through programs to increase efficiency, training to strengthen capacity, and modification of policies to better respond to the needs of the urban poor and enhance the private sector contribution to development.

f. As a general rule, AID does not undertake substantial urban infrastructure investments with DA funds. Limited availability of DA funds and the need to utilize such resources in other priority areas require that HG funds and ESF (when appropriate) should be the principal AID resources for such projects.

An exception may be justified if the level of continued emphasis on rural development and increased agricultural production. A

foreign assistance (DA and ESF) exceeds the absorptive capacity of the country in AID's typical technical assistance oriented program. Other exceptions to the general rule include: (i) urban infrastructure which supports in a substantial way the four pillars of the Agency (policy reform, institutional development, technology transfer and private enterprise development); (ii) infrastructure development in support of private productive enterprise which creates new permanent employment opportunities; or (iii) other cases where such infrastructure (water, sewage, waste disposal, roads, and community facilities) are part of a comprehensive strategy for achieving effective policies, managing urban resources, and responding to the needs of the lower income population.

Agency policy requires that the cost of operation and maintenance of urban infrastructure be recovered by some combination of consumers, local organizations and government. Provision for recovery by an urban authority for the capital costs of urban services and facilities financed by DA funds in a predominant AID goal. Accountability of all costs must be an integral part of any project.[1]

ESF funding of urban infrastructure and facilities would be appropriate on a less restrictive basis in cases where substantial development goals can be achieved by applying ESF funds to such projects while still meeting the other political/economic requirements justifying such assistance.

g. If a host government attributes high priority to infrastructure components of development projects in urban areas and wants to finance these capital facilities with the local currency proceeds of DA, ESF or PL-480 financed commodity import programs, the Mission concerned may concur in such uses if they are generally consistent with the criteria described above and with mutually agreed country development objectives.

h. In disaster prone areas, promotion of national and metropolitan policies which encourage the establishment of safe settlements and buildings.

[1] Specific guidance on cost recovery should be sought in other Agency policy papers, including in particular, AID's Recurrent Cost Policy and the Domestic Water and Sanitation Policy.

I. Introduction: A Framework For Urban Policy

It is important to define our framework for urban policy. There is no analytical unit called an "urban sector,"[2]; rather there is a set of activities that take place in urban locations. These activities are usually associated with the traditional development sectors such as industry, agriculture, or transportation, which are of concern in both urban and rural areas. The appropriate policies, programs, and projects within these traditional development sectors are selected in response to city size and growth rates, city economic development functions, and the present deficits and future needs.

That leaves the problem of defining what is meant by the term "urban." It turns out this definitional problem is largely intractable. Urban definitions are country specific and range from "main towns, including suburbs" (Zimbabwe), to "all townships and town-planning areas and all district centers" (Malawi).

There is no universally accepted definition of what constitutes an urban area. For the purposes of this paper we will call"urban" any separately administered population agglomeration in which at least two-thirds of the households derive their main income from economic activities other than farming.

A. The Dimensions And Nature Of Urban Issues

The less developed world has become an increasingly more urbanized society. In 1960, there were three rural people for every urban person in the non-Communist LDCs. By 1980, that ratio had dropped to two to one. In the year 2000, according to current projections, there will be six rural dwellers for every five urbanites. The development challenge and implications of this shift in population are enormous.

In response to the massive dimension of LDC urbanization, there has been a tendency to postulate strategies to slow the urbanization process. This paper argues that this negative view is incorrect and that positive approaches to urbanization are required concurrently with

[2] "Urban" and Urban development are basically spatial rather than sectoral concepts. To the extent that reference is made to an "urban sector", it is intended to include the analytical, institutional, policy and related aspects of urban development, which normally would not be included in describing traditional development sectors.

development strategy that seeks balanced urban and rural economic growth (determined on a country-by-country basis) will reinforce the present AID rural focus and enhance its potential for success. This view is supported by two key principles which have been well established by research:

- Urban economies and rural economies are interdependent; and
- Migration from rural to urban areas in countries that have surplus rural populations and very high person/land ratios is, overall, advantageous both to the rural and urban economies.

B. Urbanization And Economic Development

Although there are many reasons for the development of urban areas (military defense, public administration, religious and cultural activity), the primary motive force is economic. Populations tend to concentrate because perceived economic incentives lead to such a concentration.

Economic growth and development are almost certainly accompanied by increased urbanization. Indeed, the growth of urban areas has been traditionally linked to the growth of agricultural supluses and the increased commercialization of agriculture. Urban growth, due to economics of increased agglomeration, lowers the cost of production of most goods and services which are not location specific. Thus, urbanization is not only inevitable but also beneficial to the economy.

On the other hand, urbanization can be accompanied by excess demand for housing, water, sewerage, and other urban services, and by increasing levels of urban unemployment. These problems may be compounded by poor public policy, such as deep subsidization of services and interference in labor markets. Caps on producer prices for agricultural commodities for the benefit of urban populations reduce incentives to agricultural production.

AID's urban policy seeks to remove these distortions from the urbanization process in order to maximize the contribution of urban development to national economic development objectives.

II. Urban Development Program And Policy Formulation

AID's Urban Development Policy is based on the following operating assumptions:

- AID's urban development initiatives should support the achievement of AID's overall development objectives.
- AID's urban development policy should be centered around the four areas of Agency policy emphasis: private enterprise development, policy reform, institutional development, and technology transfer.
- AID's urban development strategies will vary country-by-country depending on the role of urbanization in achieving overall national development objectives in each particular case.
- AID's urban development policy should seek to address causes and not symptoms at the national and local levels.

In the context of urban issues affecting most of the developing world, these assumptions lead us to the following conclusions regarding AID's urban policy.

A. The Major Issues AID Should Address

There are six basic sets of issues we should be concerned with.

1. National macroeconomic and sectoral policies which affect the efficiency of urban markets and the overall allocation of resources in ways that will achieve a balance between urban and rural development.
2. Policies which hinder the formal and informal private sector in creating the necessary number of jobs to reduce unemployment to a reasonable level.
3. The inability of urban governments to manage efficiently the services they provide and to mobilize the level of revenues necessary to run municipal governments.
4. The inability of urban institutions, both public and private, to provide the level of goods and services (health, education, housing, water and sewerage and transportation) required to meet minimal standards.
5. The fact that the dynamics of population growth and rural-urban migration mean that the requirements for new urban land, shelter, infrastructure, social facilities, and jobs will in many cases exceed the ability of national and local governments to keep pace.
6. Policies which inhibit the potential contribution private sector investments in urban areas can make in stimulating rural productivity.

Some urban problems are the result of low levels of overall development. Countries with

per capita income levels of $200 cannot be expected to provide affordable housing, adequate health care, or formal sector jobs to all, or even a large proportion, of its citizens. But other problems arise from inefficiencies in resource allocation due to institutional weaknesses (including poorly functioning markets) and inappropriate policies on the part of LDC governments at both the national and local levels.

Clearly the urban problem must be solved primarily by the governments and people of the Third World countries themselves. What we need to do is find ways by which AID can help the people of the Third World channel their energies and resources to resolving their urban problems.

B. Urban Programs and Policies AID Should Consider

Working with other development agencies, AID must continue to emphasize policy reforms at the national and local level that will improve the efficiency of the urbanization process and enhance the contribution of cities to national economic development. The appropriate level and range of urban programming should be determined on a country-by-country basis. The specific content of AID urban programming should be related to the four policy emphases of the Agency: private enterprise development, policy reform, institutional development; and technology transfer.

The following are among the kinds of urban programming which can be supported:

1. Support for Country Economic Development Policies

The development of country economic development policies which lead to the appropriate allocation of resources between urban and rural areas in support of national development objectives is of critical importance. Of particular importance, in terms of their distorting effects on both urban and rural areas, are policies that have been designed to effect net resource transfers from the rural to the urban sector. These policies often suppress returns to the traditional rural sector in order to: (a) achieve artificial cost-of-living reductions for urban populations; or (b) artificially manipulate returns in favor of specific interest groups in urban areas.

2. Support for the Private Sector and Job Creation

Programming designed to improve the working of capital, labor, production process, and consumer markets so as to enhance the productivity of the private sector in providing employment opportunities is appropriate. This could include improvement of local credit institutions, including cooperative efforts among small-sale enterprises that will decrease the transaction costs of lending, assistance to local administrations in removing administrative and regulatory constraints on smaller enterprises in the context of on-going programs such as local tax and administrative reform, and creation of increased opportunities for private participation in urban development, including the provision of urban services and those activities supportive of agricultural and rural enterprise.

3. Support for Housing Policies and Programs for the Urban Poor

AID's Housing Guaranty Program is an interesting example of the way in which the four policy emphases of the Agency have been integrated into a comprehensive urban development program that improves the efficiency of urban markets while meeting the needs of the urban poor. By introducing innovative techniques for low-cost housing (sites and services and settlement upgrading programs), and by encouraging governments to adopt standards for such shelter that is affordable by the poor, the HG program makes it possible to reduce housing subsidies and thereby turn over low-cost housing finance and construction to the private sector. This program also illustrates AID's policy preference for avoiding general subsidization of urban infrastructure while ensuring that our assistance will support private enterprise and alleviate problems not adequately addressed through private organizations (e.g., the prevention of disease and the improvement of health conditions through the provision of water and sanitation facilities and services).

Resources

Activities to improve the productivity, efficiency and capacity of human resources may be appropriate for achieving the objectives of the urban development policy. Such programs may include education, health, nutrition, family planning, and vocational training.

5. Support for Urban Institutional Development

The ultimate success of LDCs in responding to their urban development requirements will depend on the capacity and capability of those institutions responsible for the policy, planning, management and delivery of urban services. Selective support for critical urban institutions is an appropriate AID program ac-

tivity. AID activities can usefully be targeted at the modification of institutional policies in order to use capital and human resources more effectively to better respond to the needs of the private sector and the urban poor; to improve institutional efficiency in planning and provision of services, including improved methods of cost recovery through appropriately structured user charges and equitably administered taxes; and to strengthen institutional capacity through appropriately designed training programs.

6. Support for Hazard Resistant Codes

The increasing tendency of national and local governments to allow development in areas prone to high risk from natural disasters, particularly flood, severe storm and earthquake, not only places lives in jeopardy, but also mutiplies the potential for economic loss. AID assistance should encourage settlement and building regulations which will increase the survival rate of buildings and populations in disaster prone areas.

C. The Allocation of AID Resources to Urban Policies and Programs

The allocation of agency resources to urban development should be guided by agency skills and expertise and our comparative advantage, relative to other institutions, in addressing urban problems within the constraints of AID's mandates and development priorities.

This paper suggests a few generalizations to guide the allocation of resources among countries, between rural and urban activities within countries and cities, and among the developmental sectors supported by AID. In general, our conclusion that most resource allocation decisions should be decided on a country-specific case-by-case basis is supported by four observations.

1. Country Selection Strategy

With respect to country selection strategies, it is obvious that countries with large populations of urban poor (as a percentage of total poverty level households) are good candidates, as are countries with increasing land pressure and increasing numbers of people entering the non-agricultural labor force. Countries in which future gains in economic growth will depend on diversification of the economy away from traditional subsistence agriculture are also appropriate candidates. For example, the Sahel countries have very small urban populations but, given the problems with rainfall and transportation costs, it may be that a long-run development strategy that concentrates on the abundant resource (human labor) and not the scarce resource (good agricultural land) would be appropriate, and consequently the development of urban enterprises might be encouraged.

In short, then, our urban programs should be concentrated in countries where the returns (in terms of poverty alleviation and broadly-based sustainable economic growth) are greater when our programs include an urban component.

2. Urban Location Strategy Selection Within a Country

With respect to an urban strategy within any country, it has frequently been suggested that development assistance be used to stem the rapid growth of large metropolitan cities. In the past AID has in fact tended to support regional strategies that would favor secondary cities and market towns in an effort to stem the rapid migration of rural populations to the largest cities. There is little evidence supporting the idea that, by themselves, urban development investments affect migration decisions.

The guiding principle should be to support productive investments in industry, commerce, and services in those urban centers which provide comparative advantage and to ensure that the supporting investments in shelter, infrastructure, and social services are provided in those same locations using appropriate standards which are affordable and provide access to the urban poor.

3. Selection of Developmental Sector Strategies

The selection of the development sectors most appropriate for urban programming should be dependent on the priority needs as identified on a country-by-country basis. In general, the selection of a given development sector strategy will depend on the current deficits and likely future requirements for urban employment, shelter, infrastructure, and social services as compared to expected levels of domestic resources and capacity and/or prevailing levels of international support from other donors in the particular sector. AID's urban programs should also be developed in a manner consistent with our policies on recurrent costs and our sector policies in such areas as education, health, nutrition, and water.

4. Allocation and Resource Constraints

Because urban development encompasses various activities within urban areas, a range of funding options is applicable to urban projects. ESF, local currency proceeds from commodity import or PL 480 programs, HG loans as well as Development Assistance grant and loan funds can be used for urban investments. In addition, where urban projects promote rural development (for example market town development, rural electrification and credit programs), funds authorized under section 103 of the Foreign Assistance Act may be used.

In short, AID commits substantial resources to urban areas. As in several other issue areas considered in this paper, it is suggested that we adjust policy to new circumstances, while ensuring that urban programs are conceived and designed within a broader socio-economic context, taking full account of the concrete realities of the urbanization process in developing countries. This will require that AID expand its conceptual horizons and that Missions understand that their development strategies may include an urban development dimension where such a dimension is justified.

In the future, AID/W will work to improve analytical methodologies in support of the urban policies and programs set forth in this paper. In addition, other policy papers (e.g., on local organizations) will deal at more length with specific issues of urban finance and management as well as policy reforms that will be needed to support more efficient and equitable patterns of urban growth in the developing world.

Appendix

This appendix provides additional background on:

- quantitative dimensions of the problems facing urban populations in developing countries; and
- AID's present policy and programs affecting the urban sector.

A. Quantititave Dimensions of the Urban Problem

As shown in Table 1 below, the less developed world has become an increasingly urbanized society.

Table 1
Urban and Rural Population Projections
Non-Communist LDCs
(millions)

	1960		1980		2000	
	Urban	Rural	Urban	Rural	Urban	Rural
Africa	22.9	169.8	72.8	258.9	221.0	394.4
Near East	38.0	83.1	101.1	106.3	223.3	130.9
Lat Am	105.9	109.8	237.7	126.0	428.4	137.4
Indian Subcon	102.6	489.2	212.7	731.5	476.8	909.5
Other Asia	43.5	170.2	95.9	244.7	194.7	288.3
Total	312.9	1,022.1	720.2	1,467.4	1,544.2	1,860.5

Source: United Nations: "Estimates and Projections of Urban, Rural and City Populations, 1950-2025 (New York, 1982)."

While urbanization is taking place throughout the world, it is occurring more rapidly in the relatively more developed Third World countries. Thus, while the urban population is currently only about one-fifth of the total population in Africa and the Indian subcontinent, it is more than a quarter in the rest of Asia, roughly 50 percent in the Near East, and two-thirds in Latin America. But the rate of growth of urban areas is so great that by the year 2000 there will be almost as many urbanites in sub-Saharan Africa as there are currently rural dwellers. The urban populations of the Indian subcontinent will equal the urban populations of Latin America, and 30 of 66 AID country recipients will have urban populations comprising more than 50 percent of their total populations.

Just as the urban population has been growing more rapidly than the rural population, the number of urban poor has also been growing faster than the number of rural poor. By 1980, there were four AID recipient countries (Tunisia, Panama, Jordan, and the Dominican Republic) where there were more poor people in the cities than in the rural areas. By the year 2000, according to some estimates, there will be more poor families in the urban areas of LDCs than in the rural areas.

The continued population pressure on the land coupled with the perception of better income-earning possibilities in urban areas will likely lead to urbanization growth rates no lower than current rates. For this reason, AID must increasingly focus on the problems of the majority in urban areas.

B. AID's Existing Urban Policy and Program

1. AID's Legislative Mandate

The foundation of our policy is the Foreign Assistance Act of 1961, as amended, (FAA). The major emphasis in that legislation is that:

> The principal purpose of United States bilateral development assistance is to help the poor majority in developing countries... (Sec. 102)

A fundamental question then is "Who constitutes the poor majority?" Both Congress and the Agency have tended to state that the "poor majority" are largely concentrated in rural areas. For example, Section 103 of the Foreign Assistance Act states:

> In recognition of the fact that the great majority of the people of developing countries live in rural areas and are dependent on agriculture and agriculture related pursuits for this livelihood...

Similarly, PD 67, entitled "Urbanization and the Urban Poor", which previously represented the official statement of AID's urban development policy, states:

> The needs of the poor majority are enormous, and AID's resources are limited. Programs are focused on the rural poor, the most numerous and generally the least advantaged of the poor majority.

However, the FAA goes on to say:

> The President is authorized to furnish assistance,...for the following articles...
>
> (5) Programs of urban development with particular emphasis on small, labor-intensive enterprises, marketing systems for small producers, and other institutions which enable the urban poor to participate in the economic and social development of their country. (Sec. 106[c])

Moreover, Congress has from time to time recognized that the problems of rural development are inextricably linked with those

of urban development. For example, the 1978 Senate Report on the Foreign Assistance and Related Programs Appropiation Bill states:

> ...The Committee has found that much of the discussion to date on development efforts to help the rural poor has shown an inadequate appreciation of the relationship between rural dwellers and urban centers located in rural areas.

In examining the legislative basis for AID's perception of itself as a rural development agency, the General Counsel's Office concludes:

> It is clear that beginning with the 1973 New Directions policies AID has interpreted the new mandate for aid to the poor majority as aid to the rural poor. It is our opinion that this emphasis is largely a matter of Agency policy and in no way a statutory exigency. ... It is our opinion that the Congressional mandate to aid the "poor majority" means aid to whoever is determined by AID, in its Agency expertise, to be the poor majority, be they urban or rural poor.

2. AID's Existing Urban Programs

A large portion of AID's resources are devoted to projects which benefit urban dwellers. The HG program is exclusively devoted to addressing urban problems. In the 1983 CP, the Agency requested from Congress (or in the case of the HG Program guaranty authority from OMB) $821 million for activities which directly benefit urban dwellers,[1] as opposed to $1,234.4 million which directly benefit rural dwellers.[2]

In addition, there is an unspecified portion of the $2,433.4 million in DA and ESF, and the $872 million in PL 480 Title I resources which cannot easily be allocated as benefitting either urban or rural peoples. In fact, however, most of the unallocated resources (particularly) PL 480 Title I, commodity import programs, and cash transfers) benefit urban dwellers. Since most nonproject assistance programs are actually programs designed to provide foreign exchange, their primary impact is to expand imports. For most countries, most imports are purchased (and most incomes produced) by urban dwellers. If it were possible to track the ultimate direct beneficiary of each AID dollar, it would not be surprising if there were more urban beneficiaries than rural beneficiaries.

[1] $105 million in DA funds, $555 in ESF funds, and $150 million in Housing Guaranty authority.
[2] $1039 million in DA funds and $195 million in ESF.

The pattern of AID's urban expenditures for the year FY83 is presented in Table II. The bulk of our urban programs are in the Near East and Latin America, areas which are the most highly urbanized. There are few DA programs designed to directly benefit the urban poor. However, there are more ESF funds directly allocated to urban programs than to rural programs. Clearly AID's urban policy should take into account available resources from all accounts (ESF, HG, PL 480 and DA) in the design of effective programs.

The bulk of AID's urban planning expertise is located in the PRE Bureau's Office of Housing and Urban Programs and its overseas Regional Housing and Urban Development Offices which together with their contractors comprise a pool of about 100 trained urban specialists that are available to support the Missions. In addition, the S&T Bureau's Office of Rural and Institutional Development has methodologies and skills, including a network of contractor specialists, for dealing with regional cities and town systems, rural-urban linkages, regional development, employment and small enterprise, and local development administration and finance.

Finally, consideration should be given to the resources available to AID Missions in analyzing urban problems and providing institutional support for viable urban institutions.

To date, the Agency has developed useful guidelines and approaches, and will be developing others. Thus, AID is now prepared to perform:

- urban development assessments designed to facilitate LDC and AID understanding of the urbanization process;
- urban management audits designed to assess the managerial problems on a city-wide or agency-wide basis and recommend institutional development programs;
- urban policy studies designed to assist cities in planning to meet the needs caused by rapid urbanization;
- municipal financial analyses designed to assist cities in revenue generation; and
- urban-rural linkage studies to promote the complementary development of urban centers and their rural hinterlands.

Assessment methodologies are being or have been field tested. Missions considering initiatives in the urban area or conducting these assessments are invited to use the planning skills and assessment methodologies of the PRE Bureau's Office of Housing and Urban Programs and S&T Bureau's Office of Rural and Institutional Development as a basis for their follow-on investment decisions, project design, and program and policy development.

Table 2
Allocation of AID Assistance Between
Rural and Urban Beneficiaries*

	Rural		Urban		Unallocable		
	Million	Percent	Million	Percent	Million	Percent	Total
Asia	$555.1	71.9	87.7	11.4	129.0	16.7	771.8
DA	409.6	75.3	19.7	3.6	114.5	21.1	543.8
ESF	145.5	75.4	33.0	17.1	14.5	7.5	193.0
HG	-0-	0.0	35.0	100.0	-0-	0.0	35.0
Afr	351.2	50.2	168.8	24.2	179.0	25.6	699.0
DA	254.4	78.3	3.8	1.2	66.8	20.6	325.0
ESF	96.8	29.9	115.0	35.5	112.2	34.6	324.0
HG	-0-	0.0	50.0	100.0	-0-	0.0	50.0
N.E.	113.0	5.6	344.5	17.1	1560.8	77.3	2018.4
DA	23.0	50.7	0.4	0.9	22.0	48.5	45.4
ESF	90.0	4.6	334.2	17.0	1538.8	78.4	1963.0
HG	-0-	0.0	10.0	100.0	-0-	0.0	10.0
L.A.	125.0	19.1	188.4	28.8	342.0	52.1	655.4
DA	123.5	45.1	31.9	11.6	119.0	43.4	274.4
ESF	1.5	0.5	101.5	31.1	223.0	68.4	326.0
HG	-0-	0.0	55.0	100.0	-0-	0.0	55.0
Centrally Funded	90.6	27.3	19.0	5.7	222.6	67.0	332.2
Total	1,234.9	27.6	808.5	18.1	2,433.4	54.3	4476.8
Lower Income (1980 per capita income of $500 or less)							
DA	626.0	79.0	13.5	1.7	152.8	19.3	792.3
ESF	194.5	57.4	65.0	19.2	79.5	23.5	339.0
HG	-0-	0.0	25.0	100.0	-0-	0.0	25.0
Total	820.5	71.0	103.5	8.9	232.3	20.1	1156.3
Middle Income (1980 per capita income greater than $500)							
DA	184.2	46.5	42.3	10.7	169.5	42.8	396.0
ESF	139.3	5.7	485.7	19.7	1838.0	74.6	2463.0
HG	-0-	0.0	125.0	100.0	-0-	0.0	125.0
Total	323.5	10.8	653.0	21.9	2007.5	67.3	2984.0

*Numbers approximated from FY84 Congressional presentation.

A.I.D. Policy Papers and Policy Determinations

The following reports have been issued in a series. These documents with an identification code (e.g. PN-AAM-323) may be ordered in microfiche or paper copy. Please direct inquiries regarding orders to:

A.I.D. Document and Information
Handling Facility
7222 47th Street
Suite 100
Chevy Chase, MD 20815

Title—Policy Paper	Date	Fiche #
Bureau for Private Enterprise	May 1982	PN-AAM-325
Domestic Water and Sanitation	May 1982	PN-AAM-323
Food and Agricultural Development	May 1982	PN-AAM-322
Nutrition	May 1982	PN-AAM-321
Private Enterprise Development	May 1982	PN-AAM-324
Recurrent Costs	May 1982	PN-AAM-319
Population Assistance	September 1982	PN-AAM-320
Private and Voluntary Organizations	September 1982	PN-AAM-318
Women in Development	October 1982	PN-AAL-777
Pricing, Subsidies, and Related Policies in Food and Agriculture	November 1982	PN-AAN-373
Approaches to the Policy Dialogue	December 1982	PN-AAM-431
Basic Education and Technical Training	December 1982	PN-AAM-190
Health Assistance	December 1982	PN-AAL-817
Institutional Development	March 1983	PN-AAN-108
Co-Financing	May 1983	PN-AAN-457
Local Organizations in Development	March 1984	PN-AAQ-157
Energy	July 1984	PN-AAQ-160
Urban Development Policy	October 1984	PN-AAQ-158

Title—Policy Determination	Date	Fiche #
PD #1—Narcotics	August 5, 1982	PN-AAM-443
PD #2—Mixed Credits	September 29, 1982	PN-AAM-444
PD #3—Voluntary Sterilization	September 1982	PN-AAM-445
PD #4—Title XII	October 5, 1982	PN-AAM-446
PD #5—Programming PL 480 Local Currency Generations	February 22, 1983	PN-AAM-591
PD #6—Environmental and Natural Resources Aspects of Development Assistance	April 26, 1983	PN-AAN-375
PD #7—Forestry Policy and Programs	May 16, 1983	PN-AAN-376
PD #8—Participant Training	July 13, 1983	PN-AAP-273
PD #9—Loan Terms Under PL 480 Title I	September 27, 1983	PN-AAN-753
PD #10—Development Communications	February 17, 1984	PN-AAP-616
PD #11—Using PL 480 Title II Food Aid for Emergency or Refugee Relief	July 26, 1984	PN-AAQ-159
PD #12—Human Rights	September 26, 1984	PN-AAQ-161

II.S. (TM 1:35)
8/14/85

A.I.D. Policy Paper

SHELTER

U.S. Agency for International Development
Washington, D.C. 20523

February, 1985

II.S. (TM 1:35)
8/14/85

A.I.D. Policy Paper

SHELTER

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

February, 1985

Shelter Policy Paper

TABLE OF CONTENTS

		Page
Preface		1
Executive Summary		1
A.I.D. Shelter Policy Paper		3
I.	Introduction	3
II.	The Shelter Sector Context	3
III.	Framework For Developing Shelter Strategies	4
IV.	A.I.D.'s Shelter Sector objectives	5
V.	A.I.D.'s Instruments for Implementing Shelter Programs	6
VI.	Types of Shelter Programs Appropriate for A.I.D. Support	8
VII.	Determination of Countries Suitable for Shelter Project Loans	8
VIII.	Allocations of A.I.D.'s Shelter Sector Resources within the Recipient Country	10
Appendix—Implementation of The Housing Guaranty Program		11

PREFACE

This Shelter Sector Policy supercedes PD-55, "Shelter Program Objectives" approved on October 24, 1974. This revision reflects the additional experience A.I.D. has gained since then, in responding to the shelter requirements of the LDCs. This policy statement also describes the forms of assistance which may be available for financing shelter projects and sets out the criteria for determining the most appropriate form for individual developing countries. The primary vehicle has been the Housing Guaranty (HG) program. The HG projects are often supplemented by DA or ESF financed capital and technical assistance concerning housing policy formulation, institutional development and training, and the introduction of appropriate technologies in the form of innovative housing design, and support for the private sector as the main vehicle for the delivery of shelter.

EXECUTIVE SUMMARY

The Shelter Context

Spontaneous shelter activities are high on individual priority lists. People throughout the world will invest personal time and energy in the construction and improvement of their own homes. Experience has proven this to be as true in the upgrading of reed huts to tin and ultimately to brick, as it is in the "do-it-yourself" construction activities of developed countries. It is A.I.D.'s policy to take account of and encourage these private energies. They act as a "multiplier effect" on official inputs.

Shelter is a basic human need, following the need for food and clothing. Most LDCs recognize shelter as a priority in their development strategies because it is a basic aspiration of their people.

- Investment in the shelter sector represents the largest capital investment in urban centers. Therefore, shelter policies, planning, and programs which are efficient, affordable, and seek maximum cost recovery are important components of national economic development and urban policy.
- Shelter is one of the highest priorities of low-income households. It represents a household's largest capital asset and is a major stimulus to individual saving.
- Shelter contributes to national economic growth objectives directly, through its stimulation of the construction and building materials sector, and indirectly through the furniture and household products industries. It provides jobs for large numbers of unskilled labor. Shelter construction by the formal and informal private sector accounts for the overwhelming portion of new shelter produced in developing countries.

A.I.D.'s Shelter Sector Objectives

A.I.D.'s shelter sector objectives recognize the relationship of shelter to overall economic development and to the basic priorities of the Agency. They are to:

- Assist in the formulation of rational housing policies.
- Demonstrate the feasibility of shelter solutions poor families can afford.
- Facilitate mobilization of additional local resources for financing shelter.
- Develop sustainable shelter and urban service institutions.
- Increase participation of the private sector, including the informal sector.
- Encourage the use of energy and resource efficient housing designs, technologies and standards consistent with the objective of producing shelter which is affordable.
- Increase the survival rate of people and buildings in disaster prone areas through adoption of appropriate zoning and building regulations.

The overwhelming portion of annual additions to the LDC shelter stock is the product of the effort and energy of the informal private sector. Any shelter program with the goal of meeting minimum shelter needs must acknowledge, facilitate, and support these informal sector efforts.

While significant, the shelter needs of a developing country are solvable within a finite period if realistic and affordable minimum housing standards are established, and appropriate financial policies adopted. Analyses undertaken in a number of countries have shown that basic shelter needs can be satisfied with a marginal increase in national investment, if realistic design standards and financial policies are adopted.

The magnitude of the shelter sector requirements of LDCs far exceeds the resources available from A.I.D. Therefore, it is essential that A.I.D. resources for shelter

be fully exploited as a catalyst to help the LDCs mobilize their own resources for shelter and to use them more efficiently and equitably. It is also important to coordinate our technical and capital assistance with that of other donors to the greatest extent possible.

A.I.D.'s shelter programs must benefit, directly or indirectly, households below the median income level of the country or city of concern.

Programs to meet A.I.D.'s objectives can include: provision of access to secure land tenure for low-income groups; modification of inappropriate building standards which unnecessarily result in structures that poor families cannot afford; strengthening of weak institutional structures; modification of inappropriate interest rates; reduction of indirect or direct subsidies for housing; and emphasis on objectivity of shelter decisions by government.

Forms of Assistance Appropriate for Shelter Projects

Shelter programs should be based on justification in a Country Development Strategy Statement (CDSS). Shelter projects are appropriate for financing with DA, ESF dollars, PL 480 and FAA generated local currencies in all countries. A.I.D. will continue to be sympathetic to requests for assistance for reconstruction of shelter in countries struck with earthquakes or floods, or other disasters. DA or ESF funds may be used for such disaster relief as appropriate to the indvidual country situation, if adequate PL 480 or FAA generated local currency is not available.

Country eligibility for Housing Guaranties (HG) will be based upon the judgment of the Mission, PRE, the regional bureaus, and PPC upon an analysis of the sectoral, economic, and political feasibility of the proposed program. A thorough analysis of the debt servicing capability and record is required for every candidate in order to identify borrowers with doubtful prospects for meeting their loan servicing obligations on schedule. This risk analysis must be undertaken early in the project development process and any issues identified and resolved at the first stages of project preparation. One reason for applying credit worthiness standards to HG loans is to enhance the prospect of timely debt service performance and in this way minimize drawdowns of the reserve fund.

As a general principle, market rate HG loans are not an appropriate form of development assistance for very poor countries. Therefore, countries which receive IDA credits, but not IBRD loans, may receive HG loans only after special justification for the exceptional country is approved by the Assistant Administrator of the Regional Bureau concerned, and the Assistant Administrator for PPC or by the Administrator.

Characteristically, very poor countries, as defined above, have shallow resource bases. Consequently, the prospects are slim for sustained improvement in their export earnings relative to their minimum import needs. In order not to jeopardize their long term development hopes, these countries must exercise caution in mortgaging their prospective export earnings. These countries must examine carefully both the terms of their foreign borrowings and the purposes for which such debts are incurred. The thirty year life and the ten year grace on principal repayments of the typical HG loan are advantageous, but the near commercial interest rate is not appropriate for the world's poorest countries. In ranking competing needs for the small volume of non-concessional foreign loans very poor countries can afford to service, priority over shelter projects must be given to financing the essential imports requirements of highly productive investments which will improve the economy's trade balance and its foreign debt servicing capabilities. Shelter projects require few imports (typically less than ten per cent of the total cost). Hence they can be financed largely with local resources. They will not improve the debt servicing capability of the borrower. Therefore, shelter projects merit low priority in the competition for foreign loan resources.

A.I.D. SHELTER POLICY PAPER

I. INTRODUCTION

"A.I.D.'s goal in the shelter sector is to assist LDCs to develop the institutional, technological, and financial capacity to provide shelter under reasonable conditions for all levels of society, with emphasis on government actions to meet the needs of the poor." This opening sentence from the PD-55, "Shelter Program Objectives", October 22, 1974, still summarizes the overall objective of the Agency. However, in the nearly ten years which have gone by since this last Shelter Policy Paper, A.I.D. has gained substantial experience with shelter programs and projects. It is, therefore, appropriate to redefine A.I.D.'s Shelter Sector Policy in light of this experience and changing conditions.

For over 20 years, A.I.D. has made an important contribution to understanding and designing solutions to the shelter problem of the LDCs. The vehicle has been capital provided through the HG program in combination with grant-financed technical assistance in housing policy formulation, institutional development and training, and the introduction of appropriate technologies in the form of innovative housing designs. A.I.D. has been a pioneer of the sites and services and settlement upgrading concepts and support for the private sector as the main vehicle for the delivery of shelter.

During this 20-year history, A.I.D. through the HG Program, has undertaken 152 projects in 44 developing countries with over one billion dollars in disbursements and $1.5 billion in authorizations. Among donor countries, the United States provides the largest amount of assistance to the shelter sectors of developing countries through the HG program.

II. THE SHELTER SECTOR CONTEXT

Shelter is a basic human need, following the need for food and clothing. Most LDCs recognize shelter as a priority in their development strategies, because it is a basic aspiration of their people and it is an essential component for sustained national economic growth.

Shelter provides essential contributions to overall national economic development which, when combined with its social benefits, justifies a claim on an appropriate level of national and international resources in relation to investment in other sectors. In this sense, shelter and infrastructure contribute toward making investments in other sectors, such as industry and agriculture, more productive. A minimum level of shelter is essential to productive workers.

Well located and designed shelter and urban services and facilities are an essential part of the productive investment base of any modern economy and contribute to the efficiency and productivity of national development programs.

The supply of shelter is critical to the orderly growth of urban areas. Shelter represents a significant share of overall urban investment from both public and private sources. Typically, the informal sector has provided 80 percent of the existing housing stock, without the benefit of formal lines of credit. The efficiency and productivity of this informal investment is of critical importance to individual households as well as to national development.

Shelter and urban services and facilities create demand within the domestic construction and building materials industries. A dynamic construction industry is essential for overall national development. Shelter construction, both formal and informal, can provide major stimulus to the development of skills, entrepreneurship, and the capital investment necessary to make the construction sector a major contributor to national economic growth. It also provides a point of entry into the job market for many unemployed and unskilled workers and can stimulate small-scale and informal private sector contractors.

The maintenance of an adequate supply of well located and affordable shelter contributes to overall worker productivity. The incentive of home ownership can attract otherwise unavailable private savings into the banking system. It contributes to the national capital stock. For most low-income households, home ownership is their most likely means of accumulating capital assets which in turn can be mortgaged to provide working capital for small-scale enterprises and other household economic purposes. Housing contributes to consumer demand for household products and furniture, further strengthening other sectors of the economy.

The scale of the shelter sector challenge in the LDCs is enormous. The United Nations estimates that urban areas in the LDCs will increase by one billion persons between 1980 and 2000. Most of these people will be poor. A.I.D. estimates that 300 to 350 million new housing units will be required as replacement stock and to accommodate new household formation, and between 41,000 and 105,000 square kilometers of new land will be urbanized depending on the densities and policies selected. The World Bank estimates that over $600 billion will be required to meet the water supply and sanitation requirements of the expected population growth.

It is apparent that the selection of appropriate policies, interest rates and standards, the pursuit of cost recovery mechanisms, the mobilization of private savings for investment in shelter, the coordination with other donors, the appropriate distribution of responsibilities between the public to the private sectors, and the efficiency of both the formal and informal shelter sector delivery systems can have a major impact on the ability of LDCs to meet the enormous challenge of urban growth. A.I.D., through its shelter sector programs, can do much to assist LDCs to meet the challenge with technical assistance, training, and selected capital assistance through the Housing Guaranty mechanism.

A.I.D.'s research studies, now in process or being further developed, show that most shelter sector needs of LDCs can be met through the adoption of appropriate policies, affordable standards, and private resource mobilization without adversely effecting other development sectors.

III. FRAMEWORK FOR DEVELOPING SHELTER STRATEGIES

In seeking to improve the physical living conditions of its people, the typical developing country is confronted with a series of difficult problems. In assessing a proposed Shelter program for any country, the Mission should make a judgment on whether its economic policy orientation is consistent with reasonable expectation. Policy dialogue objectives should be considered as part of a shelter strategy. Typical problems to be reviewed include:

1. *Difficult National Economic Conditions*
Inflation, unrealistic interest rate policies, excessive levels of subsidies, low levels of income and employment, and inadequate know-how impede investment in and overall production of shelter. As a component of the development strategy for an individual country, A.I.D.'s involvement in shelter programs can help address some of these economic problems and thereby influence the productivity of domestic savings invested in shelter.

2. *Politically Charged Approach to Shelter Problems*
The combination of limited economic resources, the rising expectations of populations in developing countries, and competition between interest groups, make many aspects of development the subject of vigorous political debates. Shelter is no exception. A.I.D. may help LDCs to avoid the sacrifice of long-term goals in shelter development for short-term political expediency by maintaining a continuous policy dialogue with host country officials, and encouraging the long-term support for technical personnel and the private sector.

3. *Limited Access to Urban Land and Secure Tenure*
Inappropriate urban land policies often contribute to increased land costs to the urban poor, inefficient land use, and increased infrastructure and service costs. Unclear tenure inhibits urban development and limits access of households to more formal lending institutions. Development of simplified procedures to assist in evaluation of satisfactory mechanisms for determining and transferring title are vital to a healthy residential land market.

4. *Inappropriate Physical Development Standards*
The legal standards for physical development of housing units and related urban services and facilities are often too high and therefore too expensive for the majority of the urban population to afford. Since low-income housing is very often built by the occupants themselves, such standards affect low-income groups adversely. Greater inequities in the shelter delivery system are the result. An example is the denial by the government of urban services to self-built homes which are below prevailing legal standards.

5. *Limited Institutional Capacity*
The process of development is frequently hampered by the limited institutional capacity of the host country. Shelter policies and programs, even when well designed, may fail due to the lack of skilled professional personnel, inefficient procedures, dearth of basic data to formulate appropriate policy decisions, and the lack of coordination among various agencies responsible for implementing aspects of a shelter program.

6. *Failure To Maximize Private Savings*
Many LDCs have not yet developed the financial policy framework or institutional structure necessary to mobilize adequate private savings for shelter sector investment. About 80 percent of shelter finance is currently provided through informal channels. The remainder is supplied through formal credit institutions which generally serve middle and upper-income groups. While international transfers, such as the HG program cannot substitute for domestic savings mobilization, they can be used catalytically to assist in mobilizing domestic savings.

7. *Inappropriate Interest Rate Policy*
Host government policies often hamper the mobilization of indigenous financial resources which might otherwise be available for shelter. Ceilings imposed by the government on interest and/or below the reasonably expected rate of inflation (so as to make them negative in real terms), discourage the flow of investment funds into home finance institutions and often lead to their ultimate decapitalization.

8. *Excessive Subsidies*
The needs of the developing countries for shelter are vast compared to the availability of resources for meeting them. Therefore, the prerequisite for any successful housing policy addressing the needs of the poor majority is recognition by the government concerned that programs dependent on public subsidies can only make a small dent in the huge need for improved shelter. Their only realistic goal is to undertake shelter construction at standards which are to be affordable by poor families without the necessity for subsidies. The pre-conditions for self-sustaining programs on a scale large enough to have an appreciable impact on shelter requirements include sound pricing policies and cost recovery. Public housing programs often produce housing units that either require recurrent annual subsidies, which exceed the resources available and compound their budgetary difficulties, or produce completed units which are too expensive for low-income households.

9. *Inadequate National Housing Policies*
Solutions to all of the above problems are made more difficult in the absence of a clear, consistent national housing policy. However, many LDCs do not have explicit housing policies in place. Unfortunately, many of those which do exist are seriously deficient. They frequently do not adequately address the shelter needs of the urban poor, fail to recognize the potential contribution of the informal sector to shelter delivery, do not provide sufficient incentives and opportunities for the private sector to fully participate in all aspects of the shelter sector, and do not reflect the linkage between shelter investment and economic growth.

IV. A.I.D.'s SHELTER SECTOR OBJECTIVES

A.I.D.'s shelter sector objectives recognize the relationship of shelter to the overall priorities of the agency: policy reform, institutional development, private enterprise development, and technology transfer. In the shelter sector, these Agency priorities address the basic problems faced by most LDCs in striving to improve the physical living conditions of their people and reflect the expertise and the 20-year experience of A.I.D.

The objectives of A.I.D.'s shelter programs are to:

1. Assist in the formulation of rational housing policy:

   to encourage the preparation and implementation of national housing policies that reflect A.I.D.'s basic objectives and that provide an internally consistent framework for future housing activities.

2. Demonstrate the feasibility of shelter solutions poor families can afford:

   to promote the selection of appropriate physical standards, building codes, technologies which will help low-income families gain access to secure land tenure, basic services, and housing.

3. Facilitate mobilization of additional local resources for financing shelter:

   to adopt interest rate policies which reflect the real cost of capital, to develop viable institutional systems for financing shelter and urban development, and to minimize the need for public subsidies.

4. Develop sustainable shelter and urban service institutions:

   to develop production and delivery capabilities commensurate with the needs of the population with special emphasis on meeting the shelter needs of the urban poor; encourage appropriate user fees, cost accounting and cost recovery for utility expansion to facilitate more rapid expansion of these services.

5. Increase private sector participation:

   to encourage and facilitate an increased role for both the formal and informal private sector, including cooperatives and other self-help institutions and credit institutions oriented to the homeowner and home improvement credit, in low-income shelter financing, production and delivery and to achieve an appropriate division of responsibilities between public and private sectors. Government interventions should normally be limited to services which people can not provide for themselves, such as infrastructure. HG assistance should be targeted toward expansion of demand for small contractors and other suppliers, including those in the informal sector. Conversely, support of public sector subsidized housing projects should normally be considered as low priority for A.I.D. funds.

6. Encourage the use of energy and resource efficient housing designs, technologies and standards:

   to foster development and application of housing designs that make use of local building materials as appropriate to the varying regions of the country, that generate on-site utilities (e.g., rainwater collection systems) and that encourage and accommodate kitchen gardens, if appropriate.

7. Increase the survival rate of people and buildings in disaster prone areas:

   to discourage development in areas prone to flood, severe storm and earthquake and to encourage adoption of hazard resistant building regulations and codes.

V. A.I.D.'s INSTRUMENTS FOR IMPLEMENTING SHELTER PROGRAMS

A.I.D.'s shelter sector objectives are to be achieved through joint activities of U.S. A.I.D. Missions, their respective Bureaus, and the Office of Housing and Urban Programs (PRE/H) as defined in Handbook VIII. The following program instruments are available to implement shelter programs:

1. **Shelter Sector Assessments (SSAs)**
   For countries where A.I.D. is considering a shelter program, the first step is to conduct a Shelter Sector Assessment in order to obtain an over view of the shelter problems and opportunities. SSAs are designed to identify the problems and policy issues that need to be addressed in the shelter sector as they relate to overall national development objectives and the Mission's Country Development Support Strategy (CDSS). Shelter Sector Assessments are particularly important in those countries where A.I.D. is considering urban programs. PRE/H has prepared a Shelter Sector Assessment methodology designed for this purpose. SSAs have been prepared for most countries in which A.I.D. has carried out Housing Guaranty projects (see Appendix I). Missions are encouraged to use PRE/H skills and expertise. In countries vulnerable to natural disasters, inclusion of appropriate wind and seismic-resistant features should be examined.

2. **Technical Assistance**
   A.I.D. provides both long-term and short-term technical assistance that can contribute to the achievement of shelter sector objectives. Technical assistance is frequently interwoven into the process of preparing and implementing HG loans but can also be provided through grant funds, independent of a capital assistance program. Where country risk of repetitive disasters warrants, assistance may be offered on techniques for reducing vulnerability of the local housing.

   Long-term technical assistance involving resident advisers is usually focused on enhancing institutional capacity, improving the shelter delivery systems and financial structure, or the development of housing policies.

   Short-term technical assistance frequently involves assistance in project design and implementation, and responding to specific needs and requests from participating country institutions and agencies.

3. **Training**
A.I.D.'s shelter training activities are directed toward the development of improved competence and skills in the LDCs; the communication, through training, of A.I.D.'s shelter policies and approaches; and the development of a network of shelter professionals and local institutions linked to U.S. and international organizations engaged in implementing shelter programs.

The range of A.I.D.'s shelter training activities include annual regional conferences, the annual one month Shelter Sector Workshop, support for university short-courses in shelter-related subjects, support for short-term training at regional institutions in third world countries, and the design and presentation of in-country courses and training seminars. Short-term technical assistance to LDC shelter training institutions can also be provided.

U.S. A.I.D. Missions are encouraged to nominate country participants from the shelter sector to participate in these various training activites.

4. **Research and Information Dissemination**
A.I.D. supports a variety of individual research efforts which have been designed to provide LDC technicians with specific, practical information on innovative approaches to shelter sector issues supportive of its overall objectives. For example, A.I.D. has supported research work on the use of indigenous building materials, building standards and designs, temporary housing for disaster victims, use of bonds and secondary mortgage markets, variable payment mortgages, computer applications in the shelter sector, and analytical case study research and evaluation.

A.I.D. seeks to disseminate information on shelter sector issues and innovative approaches throughout the LDCs through publications, newsletters, and sponsorship and participation in conferences and seminars.

5. **Capital Assistance**
The primary mechanism for A.I.D. capital assistance in the shelter sector is the Housing Guaranty (HG) program. This program was developed as part of the U.S. Foreign Assistance Program in 1961. It is a unique A.I.D. activity in which the U.S. private sector provides long-term financing for low-income shelter and urban upgrading programs in developing countries. (See Appendix I for a full description of the HG program with a U.S. Government guaranty.)

If consistent with the country strategy statement, shelter projects are appropriate for financing with DA and ESF resources and PL 480 or FAA generated local currencies in all countries eligible for FAA assistance. Furthermore, A.I.D. will consider sympathetically requests for assistance for reconstruction of shelter in countries hit with earthquakes, floods, or other disasters with whatever resources are appropriate to the individual country's circumstances.

The combination of one of these more concessionary resources with a HG loan has been successfully demonstrated in Zimbabwe, Mauritius, and Costa Rica.

It is recognized that A.I.D. capital assistance is no substitute for locally mobilized finance, but it can meet specific important purposes in advancing A.I.D. and LDC shelter objectives. These include:

- Providing assistance toward reaching A.I.D. objectives over time in the broader national development context. The incremental approach adopted to develop a shelter program, where specific policy objectives are established for each specific loan, provides a forum for on-going policy dialogue and a mechanism to accelerate change.
- Providing capital to create or expand new institutions where necessary and to demonstrate new shelter solutions or programs. Essentially, HG loans assist countries by sharing the risks of innovation and change.

Although the size of any given HG loan must depend on many factors, it is important to recognize that needed change is vastly enhanced by the prospect that a given loan may be part of a continuing series of loans. The series should include mutually agreed policy steps and accelerate problem recognition and design of solutions.

Since HG loans provide untied foreign exchange in excess of the immediate requirements of a particular project, they provide additional foreign exchange resources which can be invested in other productive ventures outside of the shelter

sector. In this sense, HG loans can help Missions achieve the broader economic development objectives established for a given country. However, the basic purpose of HG loans is not to provide balance-payments assistance.

VI. TYPES OF SHELTER PROGRAMS APPROPRIATE FOR A.I.D. SUPPORT

The HG Program can be used to finance the following kinds of shelter related programs for families below the median income:

- Slum and Spontaneous Settlement Upgrading: including the legalization of land tenure, provision of potable water, sewerage, electricity, roads, and drainage. Upgrading projects may also include home improvement loans to residents in project areas. These projects are designed to assist families in the informal sector.
- Sites and Services: involving preparation of vacant land for efficient self-help shelter production through subdivision into individual lots and the provision of water, sewer, and other urban services. This type of project may also include training and building materials loans for self-help builders and small-scale contractors. Sites and service projects, therefore, help members of the informal sector reap some of the economic and social benefits of development.
- Core Housing: including a sites and services approach with the addition of a basic housing shell (typically a bathroom and a small multipurpose living area) on each lot, designed to be improved and expanded by the owner. Building materials loans may be provided.
- Low-Cost Housing Units: in special circumstances in middle-income countries, especially when the focus can be on encouraging private sector attention to low-cost housing for the poor population.
- Support for Improvement to Urban Services and Facilities: physical improvements to urban services such as water supply and distribution, sanitation, trash collection, and road and drainage improvements can improve the quality of life in the predominantly low-income residential neighborhoods, and foster the development of private enterprise.
- In addition, HG loans can be used to finance schools, health clinics, markets, job skill training centers, and other community facilities to support the development of neighborhoods; and acquisition of strategic parcels of land to accommodate long-range demand for land for low-cost shelter.

VII. DETERMINATION OF COUNTRIES SUITABLE FOR SHELTER PROJECTS LOANS

1. Country Need for A.I.D. Resources for Shelter

Sectoral issues which would establish a country's need for A.I.D. assistance include the following:

- Recognition that deficits in shelter and shelter production are adversely affecting economic efficiency and productive potential.
- Reasonable prospects that the LDC will make progress in correcting inappropriate shelter policies, such as the use of unaffordable shelter sector standards, reliance on deep subsidies, or inadequate cost recovery, or other problems that can be usefully addressed by A.I.D. programs which will lead to substantial increased efficiency in the utilization of domestic shelter sector resources.
- An assessment of the LDC's need and willingness to increase the mobilization of sufficient domestic savings to support essential shelter production.
- The identification of opportunities for enhancing the private sector's role in the shelter sector.
- The determination that A.I.D.'s shelter sector initiatives will be supportive of the overall A.I.D. country strategy and the LDC's national development objectives.

2. Country Risk and Capacity to Service HG Loans

The determination of the eligibility of countries for market rate loans will be based on a case by case analysis of their debt servicing capabilities and an assessment of the prospects for timely repayment and of the risk of payment interruptions and consequent drain on HG reserves. The objective is to minimize the risk of lending to those countries which may soon be confronted with

acute balance of payments and debt servicing problems. This analysis should be undertaken early in the project development process and any issues identified and resolved at the CDSS or OYB stage of project preparation.

The analysis required is dynamic in nature. The level and rigor of analysis should be in line with generally accepted professional standards and with those followed by other U.S. Government agencies dealing with international loans. The time frame selected should be based on professional considerations. It should consider, among other factors, the volume of existing and projected debt, its costs, the time profile of servicing obligations, the economy's structural capacity to earn foreign exchange, past patterns and future prospects for economic growth and foreign trade, past management of external debt, and the effect of additional HG debt on its debt structure and debt service. The analysis should also assess whether a potential borrower is operating within an internal policy environment conducive to maintaining or improving its capacity to service external borrowing.

A.I.D. requires as a condition for its Housing Guaranty that the borrowing country either provide its sovereign guaranty or other acceptable guaranty to A.I.D. to compensate A.I.D. for any payments made to investors. The sovereign guaranty of the borrowing country constitutes the maximum assurance A.I.D. can have that HG loans will be repaid in dollars over the long-term.

3. HG Reserves Considerations

The HG loan program is not immune to the foreign debt servicing problems which many of the LDCs experience from time to time. The reason for applying credit worthiness standards to HG loans is to enhance the prospect of timely debt service performance and in this way minimize drawdowns of the reserve fund. As the HG loan from the private U.S. investors is protected 100% by the full faith and credit of the U.S. government, the investors look to the guaranty for the security of their investment and, therefore, perform no meaningful risk analysis on their own behalf. The purpose of the reserve fund is to provide for immediate compensation to the private U.S. investor for any delay in loan service receipts due. It therefore increases the attractiveness of HG loans as a media for investment.

A result of a series of non-performing HG loans (delinquencies, debt reschedulings, losses written off and in rare cases default) would be the ultimate depletion of the reserve fund and the inescapable requirement to ask Congress for appropriations to replenish it. Congress could be expected to take action to preserve the full faith and credit of the U.S. government guaranty backing outstanding HG obligations. However, there is no assurance that such action will result in a higher level of foreign assistance appropriations than would have been authorized in the absence of the necessity to accommodate the requirements of the HG program. Therefore, the accumulative result of non-performing HG loans and the requirement to make good the concomitant guaranties could result in unintended competition for new appropriations between HG loans authorized in the past and urgent current needs. Thus, the major difference between HG loans and ESF or DA loans is the risk that non-performing HG loans will result in the *a priori* attribution of precedence to the HG program over competing development programs, unplanned cuts in high priority items in our appropriations requests, and diminished control over allocations of FAA resources among countries and uses. These are the reasons more vigorous debt servicing capability analysis designed to identify risky countries is required for HG loans than for DA or ESF loans.

4. Ineligibility of Very Poor Countries

As a general principle, market rate HG loans are not an appropriate form of development assistance for very poor countries. Therefore, those countries which receive IDA credits, but not IBRD loans, will receive HG loans only after special justification is approved by Assistant Administrator of the Regional Bureau concerned and PPC, or the Administrator for the exceptional country.

Characteristically, these very poor countries, as defined above, have shallow resource bases and, consequently, slim prospects for improvement in their export earnings relative to their minimum import needs. In order not to jeopardize their long term development hopes, these countries must

exercise caution in mortgaging their prospective export earnings. They must examine carefully both the terms of their foreign borrowings and the purposes for which such debts are incurred. The thirty year life and the ten year grace on principal repayments of the typical HG loan are advantageous, but the near commercial rate interest rate is not appropriate for the world's poorest countries. It is A.I.D.'s general policy to make all of its assistance to the Least Developed Countries in the form of grants if the availability of grant funds permits.

In ranking competing needs for the small volume of non-concessional foreign loans they can afford to service, priority must be given to financing the essential imports requirements of highly productive investments which will improve the economy's trade balance and its foreign debt servicing capabilities. Shelter projects require few imports (typically less than ten per cent of the total cost). Hence they can be financed largely with local resources. They will not improve the debt servicing capability of the borrower. Therefore, shelter projects merit low priority in the competition for foreign loan resources.

Given these circumstances, a market rate HG loan to a very poor country can be justified only if the Mission concerned can demonstrate that the free dollars in excess of the requirement for imports for the shelter projects will be used in support of a sound investment program within the context of acceptable economic policies so that the benefits to the economy in terms of enhancement of its productive base and/or debt servicing capacity will exceed the cost of servicing the market rate HG loan over its life term. Alternatively, a HG loan may be justified if the Mission can demonstrate that the free dollars made available through the HG loans are programmed for investment in a specific set of priority productive projects which will yield high returns in increased production for exports or decreased import requirements, and that these benefits will exceed the cost of the HG loan.

VIII. ALLOCATION OF A.I.D.'s SHELTER SECTOR RESOURCES WITHIN THE RECIPIENT COUNTRY

It is clear that the magnitude of the shelter sector requirements in the LDCs far exceeds the level of resources available from A.I.D. It is important, therefore, to utilize these technical and capital resources selectively to have the greatest impact.

1. **Selection of Low-Income Target Groups**
It is essential to direct A.I.D.'s programming at households below the median income. A.I.D.'s shelter program promotes equitable distribution of benefits in the shelter sector through increased access to land, shelter, infrastructure, and employment for the urban poor.

2. **Selection of City and Town Locations For Shelter Sector Projects**
We should seek to insure that neither shelter developments nor growth directing infrastructure (water and sewer systems as well as transportation arteries) take place or indirectly encourage building in hazard prone areas. Similarly, given the scarcity and productive value of agriculture and forest land in developing countries, our shelter and urban infrastructure interventions should seek to avoid the pre-emption of such lands for urban uses. Moreover, our shelter and urban infrastructure interventions should support higher urban density and greater infill development to the extent that they are viable options to outward urban expansion. So doing would avoid the risk of encroaching on valued agricultural and forest lands and, generally, would serve the interests of economic efficiency as, with high densities and less extensive infrastructure (shorter water and sewer trunklines, etc.), a greater number of inhabitants can benefit from a given unit of infrastructure.

Appendix I gives details on the implementation of HG projects.

APPENDIX I

IMPLEMENTATION OF THE HOUSING GUARANTY PROGRAM

The Housing Guaranty Program involves callaboration between the A.I.D. Mission and a host country housing institution, such as a government ministry, a national housing bank or housing development corporation, a central savings and loan system, a national cooperative organization, or a similar institution in the private sector acting as borrower.

Following a request from the country and the A.I.D. Mission, the Office of Housing and Urban Programs, working with host country officials, will prepare a shelter sector assessment. Based on this analysis, the office and the borrower determine the type of housing program to be financed and the institutional context within which it will be undertaken.

The major areas of concern to both parties at this stage are: (1) the progress which has been made towards the development of a rational shelter policy; (2) the contribution which the program will make towards the creation or strengthening of institutions needed to meet national shelter needs, especially the needs of the poor; (3) the establishment of roles for public and private sector involvement in shelter programs; (4) the capacity of the construction industry to supply housing over a given period; (5) the effective demand for housing at the agreed upon price level; and (6) the ability of the beneficiaries to repay their loans and the ability of the economy to make the dollar repayment.

When a mutually agreeable project has been developed and authorized by the Regional Bureau, the Office of Housing and Urban Programs and the borrower enter into an Implementation Agreement defining the use of the loan. Disbursements under the loan will be subject to the fulfillment of certain conditions as set forth in this agreement.

At the same time, the borrower seeks the most favorable terms available in the U.S. capital markets for a U.S. Government-guaranteed loan. A typical Housing Guaranty loan is a long-term loan for a period of up to 30 years with a 10-year grace period on the repayment of the principal.

The U.S. lender and the borrower then negotiate the terms of the financing including interest rates which reflect the prevailing interest rates for similar maturing U.S. Government debt. These understandings are formalized in a loan agreement between the borrower and the lender, which is subject to A.I.D. approval. In addition, certain provisions with regard to the paying and transfer agent, terms and amortization, prepayment rights of the borrower, and lenders fees and other charges must be included in each loan agreement, or otherwise agreed upon in a manner satisfactory to the Office of Housing and Urban Programs.

The A.I.D. Guaranty

A.I.D. will sign a contract of guaranty upon the signing of a loan agreement, indicating that repayment is guaranteed by the full faith and credit of the U.S. Government. The fees that A.I.D. charges for its guaranty are as follows: 1) a fee of one-half of one percent (1/2%) per annum of the unpaid principal balance of the guaranteed loan; and 2) an initial charge of one percent (1%) of the amount of the loan, which is deducted from the loan disbursements.

Additionally, A.I.D. requires that the government of the borrowing country sign a full faith and credit guaranty of repayment of the loan and outstanding interest.

Lenders

A variety of participants in the U.S. capital markets, including investment bankers, commercial bankers, Federal Home Loan Banks, savings institutions, life insurance companies, and pension funds, have lent funds to host country borrowers as part of the Housing Guaranty Program. To be eligible to participate, lenders must be: 1) U.S. citizens; 2) domestic U.S. corporations, partnerships or associates substantially beneficially owned by U.S. citizens; 3) foreign corporations whose share capital is at least 95 percent owned by U.S. citizens; or 4) foreign partnerships or associations wholly owned by U.S. citizens.

Lender Selection

Lenders are selected by host country borrowers. The Office of Housing and Urban Programs encourages maximum contact between borrowers and lenders to facilitate loan

arrangements that will best meet project needs, and to establish long-term borrower-lender relationships to their mutual advantage. Lenders are typically selected through a competitive negotiation process in which the Office of Housing and Urban Programs requires that lending opportunities be dvertised and that borrowers solicit lending proposals from the largest practicable number of prospective lenders.

A notice of each A.I.D. guaranteed investment opportunity is published in the Federal Register. Notices are also mailed to interested firms or individuals.

In certain circumstances and with the written consent of the Office of Housing and Urban Programs, lenders may be selected through a noncompetitive negotiated process.

A.I.D. Policy Papers and Policy Determinations

The following reports have been issued in a series. These documents with an identification code (e.g. PN-AAM-323) may be ordered in microfiche or paper copy. Please direct inquiries regarding orders to:

A.I.D. Document and Information
Handling Facility
7222 47th Street
Suite 100
Chevy Chase, MD 20815

Title—Policy Paper	Date	'Fiche #
Bureau for Private Enterprise	May 1982	PN-AAM-325
Domestic Water and Sanitation	May 1982	PN-AAM-323
Food and Agricultural Development	May 1982	PN-AAM-322
Nutrition	May 1982	PN-AAM-321
Private Enterprise Development	May 1982	PN-AAM-324
Recurrent Costs	May 1982	PN-AAM-319
Population Assistance	September 1982	PN-AAM-320
Private and Voluntary Organizations	September 1982	PN-AAM-318
Women in Development	October 1982	PN-AAL-777
Pricing, Subsidies, and Related Policies in Food and Agriculture	November 1982	PN-AAN-373
Approaches to the Policy Dialogue	December 1982	PN-AAM-431
Basic Education and Technical Training	December 1982	PN-AAM-190
Health Assistance	December 1982	PN-AAL-817
Institutional Development	March 1983	PN-AAN-108
Co-Financing	May 1983	PN-AAN-457
Local Organizations in Development	March 1984	PN-AAQ-157
Energy	July 1984	PN-AAQ-160
Urban Development Policy	October 1984	PN-AAQ-158
Shelter	February 1985	PN-AAQ-162

Title—Policy Determination	Date	'Fiche #
PD #1—Narcotics	August 5, 1982	PN-AAM-443
PD #2—Mixed Credits	September 29, 1982	PN-AAM-444
PD #3—Voluntary Sterilization	September 1982	PN-AAM-445
PD #4—Title XII	October 5, 1982	PN-AAM-446
PD #5—Programming PL 480 Local Currency Generations	February 22, 1983	PN-AAM-591
PD #6—Environmental and Natural Resources Aspects of Development Assistance	April 26, 1983	PN-AAN-375
PD #7—Forestry Policy and Programs	May 16, 1983	PN-AAN-376
PD #8—Participant Training	July 13, 1983	PN-AAP-273
PD #9—Loan Terms Under PL 480 Title I	September 27, 1983	PN-AAN-753
PD #10—Development Communications	February 17, 1984	PN-AAP-616
PD #11—Using PL 480 Title II Food Aid for Emergency or Refugee Relief	July 26, 1984	PN-AAQ-159
PD #12—Human Rights	September 26, 1984	PN-AAQ-161

III. CROSS-SECTORAL POLICIES

A. Economic Policies

III.A2 (TM 1:34)
11/9/84

A.I.D. Policy Paper

RECURRENT COSTS

U.S. Agency for International Development
Washington, D.C. 20523

May 1982

III.A2 (TM 1:34)
11/9/84

A.I.D. Policy Paper

Recurrent Costs Problems in Less Developed Countries

Bureau of Program and Policy Coordination
U. S. Agency for International Development
Washington, D. C. 20523

May 1982

TABLE OF CONTENTS

		Page
Executive Summary		i
I.	Introduction	1
II.	Definitional Questions	2
III.	Causes of Recurrent Cost Problems	2
	A — Donor Policy	3
	1 — Investment vs. Consumption in Recurrent Cost Funding	4
	2 — Self-Reliance vs. Dependency	4
	3 — Donor Financing and Host Country Commitment	5
	B — Recipient Country Policies	5
	1 — Government Revenues	5
	(a) Tax Revenues	5
	(b) User Chargers	6
	(1) Public Goods Rationale	6
	(2) Merit Goods Rationale	8
	(3) Equity Rationale	8
	2 — Government Expenditure Policies	10
	(a) Government Budget Allocations	10
	(b) Costs of Government Activities	10
	3 — Macroeconomic Policies	11
	(a) Foreign Exchange Constraints	12
	4 — Project Design Failures	13
IV.	Recurrent Cost Analysis	14
V.	Solutions to Recurrent Cost Problems	17
	A — Re-examining the Recurrent Cost Coefficient	17
	B — Increasing Donor Resources Going to Recurrent Budgets of Development Projects	18
	C — Donor Support of Government Sectoral Budgets	18
	D — Reducing the Level of Donor Support	18
VI.	Conclusions and Recommendations	19
	A — Analysis	19
	B — Project Design	19
	C — Policy Reform	19
	D — Recurrent Cost Support	19
	E — Reallocation of Assistance	20
APPENDIX I	— A Simple Model of Recurrent Cost Disequilibrium	21
APPENDIX II	— Numerical Illustration of Project Analysis under a Recurrent Cost Constraint	23

Recurrent Cost Problems in Less Developed Countries Executive Summary

Introduction

There is a growing awareness that many of the poorest countries in the world, particularly those located in sub-Saharan Africa, are not allocating adequate budgetary resources to finance the recurrent costs of their present portfolio of development investments. Existing investments are, therefore, becoming unproductive, and future investments are likely to suffer from the same problem. In light of this situation, donors need to review their current policies to determine how to deal with this "recurrent cost problem." This paper analyzes the nature and causes of LDC recurrent cost problems and suggests a set of responses that Missions should consider in order to improve the effectiveness of A.I.D. programs and projects.

Definition

Recurrent, or variable, costs are defined simply as those costs that recur, as opposed to capital, or fixed, costs, which are concentrated at the beginning of a project's life. Thus, in an agricultural research project, the costs of providing the buildings and equipment, as well as the costs of initial training and expatriate expertise are fixed costs, which occur only in the start-up phase of the project. The annual cost of salaries, utilities, maintenance, materials, and replacement of worn-out capital are recurrent costs which continue as long as agricultural research continues to be carried out.

The Nature of the Problem

An LDC government may be unable or unwilling to finance recurrent costs. There is a recurrent cost problem when finance is lacking for variable inputs even when they are more economically profitable than new capital inputs, either private or public. For instance, suppose a dollar spent on repairing a road increases the present value of total output by two dollars, while a dollar spent on a new road or a new factory increases the present value of total output by only $1.50. Then available resources should be spent repairing the road.[1] If this is not happening, if road repairs are underfinanced even though they are more valuable to the economy than new projects which are being financed, then there is a "recurrent cost" problem.

[1] Economic logic requires that resources be allocated so that the "marginal revenue product" of each activity or use is the same. Streams of revenues and costs over time are measured in "present values," i.e., discounted by a rate which reflects the opportunity costs of capital and the society's rate of time preference.

Why does such a situation occur? Why do governments misallocate resources? The major reasons are poor policy choices, both by the LDC's and, to some extent, by donors.

LDC Policy Failures

LDC policy failures can be grouped into three broad categories:

(1) Inability to raise adequate revenues;
(2) Misallocating public resources between capital and recurrent budgets or among expenditure sectors within the recurrent budget, including the over-staffing of central bureaucracies which have a vested interest in the continuation of subsidized programs;
(3) Project design failures or public policy failures which reduce the likelihood of a project achieving success.

Inability to Raise Revenues. Sometimes, an LDC government's inability to finance recurrent expenditures is a result of its inability to raise sufficient resources, because of, for example, an institutional weakness in its tax system. More often, however, the problem arises from a failure to charge users for government services such as health, education, veterinary services, agricultural extension, transport, and water and sanitation. The failure to charge users for services (and thus the subsidization of those services) is frequently justified on equity grounds. In fact, subsidies, in practice, often tend to be inequitably distributed. For most poor countries, resources are inadeqaute to provide, for example, free universal extension services, while also pursuing other development objectives. Consequently, these services are provided to a chosen few. If however, charges were imposed for the use of the services, the increase in financial resources would enable the government to distribute these and other services more broadly. Subsidies as a "safety net" may be justifiable if they are carefully targetted at the poor. However, the majority of subsidies are imprudent and ineffective.

Misallocating Public Resources. Even when governments have adequate revenues, they are often allocated badly. At times, certain sectors (e.g., agriculture) are underfinanced because of political pressures to provide revenues to other sectors which are more important politically, though less profitable economically. At times, the cost of government provision of services is too high, either because of excessive salaries for government employees or because of inappropriate technologies. Sometimes, government involvement in activities best left to the private sector (particularly marketing and manufacturing) results in substantial operating losses and consequent drains on the treasury.

Project Design and Public Policy Failures. Projects may be underfinanced because the cost of variable inputs is greater than the returns to these inputs. There are three reasons for this situation occurring. First, the project may have been poorly designed. Second, changes in the external environment may have been poorly anticipated at the design stage and consequently, during implementation, the project becomes unprofitable. Third, government policies, both macroeconomic and sectoral, may inhibit the project's success. Whatever the reasons, failure to provide variable inputs to a project when they have a more profitable use elsewhere is a rational response. The problem being faced in this case is not a recurrent cost problem, but a project design or public policy problem, and the solution is project redesign or policy reform.

Donor Policies

Even where LDC policies are appropriate, donor policies may lead to an overinvestment in new projects and an underfinancing of the recurrent costs of existing projects. This is because donors tend to limit their financing to new investments. For many poor countries, the funds available for new capital projects, because they come largely from concessional assistance, are more plentiful than the funds available for financing the recurrent costs of existing projects, which come largely from domestic resources. Thus new roads are built while old ones are not maintained.

This analysis points to four basic responses available to A.I.D., depending on the causes of the recurrent cost problem:

(1) **Project design**

If design is the cause of the problem, USAID Missions and LDC governments should work to design projects so as to assure that their recurrent cost components are consistent with economic feasibility.

(a) In countries suffering from a recurrent cost problem, the economic analysis of projects should use prices for government expenditures and revenues that reflect the scarcity value of government resources;
(b) Projects should be designed, to the extent possible, to maximize the revenues from service charges (and/or contributions in labor and kind) consistent with the capacity of the beneficiaries to pay; and
(c) Where possible, government activities should be turned over to the market economy. This is generally desirable in all agricultural and industrial productive activities as well as marketing, distribution, trade and many services.

(2) **Policy Reform**

In countries where recurrent cost problems are important, recurrent cost issues should constitute a major part of the policy dialogue because of their integral relationship with macroeconomic concerns and the allocation of resources. If LDC policies are the cause of the problem, then Missions should

(a) attempt to persuade governments to make necessary reforms;
(b) enlist the support of the donor community for policy reform; and
(c) provide technical assistance in the form of expertise and training to support reforms, including such areas as fiscal policies and tax administration.

(3) **Recurrent Cost Support**

If recurrent costs constitute a serious problem and LDC government policies are appropriate and projects designed correctly, or requisite steps are taken to move toward appropriate policies and designs, then Missions should consider funding a portion of recurrent costs of host country projects through a variety of mechanisms at the project, sectoral and macro levels for a period up to ten years, providing the country agrees to shoulder an increasing share of total costs over this period. Policy performance should be monitored closely and periodically to determine whether such assistance should be continued.

It is important to note that direct funding of recurrent costs, either at the project or budget level, is only justifiable under fairly narrow conditions. These conditions, which have been spelled out in this paper include:

(a) An acceptable policy framework or clear movement toward such a policy framework;
(b) An assurance that recurrent cost support has higher development impact than new investments;
(c) An inability of the host country to undertake recurrent cost financing;
(d) A carefully phased plan exists for shifting the entire burden to the host government.

(4) **Reallocation of Assistance**

If the host government refuses to take sufficient action on project design and/or policy reform, A.I.D. should seriously consider reducing the level of assistance to the affected sector or country.

The Recurrent Cost Problem in Less Developed Countries

I — Introduction

The past five years have seen a continuation if not worsening of the adverse international economic environment which threatens the ability of the less developed countries to grow at a rate necessary to maintain current levels of economic activity, let alone reduce the level of poverty in which the majority of their populations find themselves. Deteriorating terms of trade brought on by the rise in oil prices together with recession and inflation in the developed market economies has led to stagnation in most of the low income countries of the Third World, and dimmed prospects for future growth.

A 1981 PPC/EA study noted that nineteen out of the twenty-six largest AID recipients are currently undergoing a crisis severe enough to require an IMF standby or Extended Fund Facility agreement.[1] In most cases, such an agreement will require not only improved management of the balance of payments, but a reduction in government expenditures. For low income countries as a group the total standby and EFF agreements have grown from 421 million SDRs in 1977 to 3,382 SDRs in 1980, an eight fold increase. As a result, we can expect that a large number of AID recipients will be finding it increasingly difficult to finance the recurrent costs of their existing development project portfolio, let alone new project starts.

These government budgetary problems can have a devastating effect on AID programs. Roads without maintenance, schools without materials, and clinics without health workers are prevalent enough already. Indications are that these problems are likely to increase rather than diminish. This is particularly distressing for AID, since projects in the sectors of primary concern to the Agency have tended to have high recurrent cost ratios. Table I presents an illustrative summary of the ratio of the annual value of recurrent costs for each dollar of investment ("r" coefficients) over a twenty-year life of project. Note the high recurrent costs of health, education and rural development as compared with those of industry and trunk roads.

As a result of these financial difficulties LDC governments will increasingly be forced to resort to one of the following unhappy choices: (a) shift resources from the capital budget to the recurrent budget; (b) rely increasingly on deficit financing with the consequent inflationary pressures; (c) reduce expenditures on social services and human resource development; or (d) continue to underfinance development projects with the resultant deterioration of services and underutilization of capacity.

There are, of course, other somewhat happier solutions, which may be attempted. These include the improvement of the efficiency of the tax system, reform of economic policies that tend to result in sluggish growth of revenues or rapid growth of expenditures, redesign of projects so as to minimize the recurrent burden, resort to a greater degree to user charges and local financing of development projects, and seek explicit donor financing of recurrent costs. None of these are easy choices, and considerable effort will be necessary both by donors and LDC governments to find solutions. The purpose of this paper is to examine the recurrent cost problem and suggest ways in which AID can respond so as to help LDC's deal with it.

This paper is divided into six sections. The next section discusses definitional problems in addressing recurrent costs. Section III describes the underlying causes of recurrent cost problems.

TABLE I

Illustrative Summary for the Recurrent Expenditure Implications of Projects as a Proportion of Investment Expenditures[a] ("r" Coefficients)

Forestry	0.04
General Agriculture	0.10
Livestock	0.14
Rural Development	0.08 — 0.43
Agricultural Colleges	0.17
Polytechnics	0.17
Primary Schools	0.06 — 7.0
Secondary Schools	0.08 — 0.72
Universities	0.02 — 0.22
District Hospital	0.11 — 0.30
General Hospital	0.183
Rural Health Centers	0.27 — 0.71
Urban Health Centers	0.17
Housing	0.03
Manufacturing	0.01
Feeder Roads	0.06 — 0.14
Trunk Roads	0.03 — 0.07

Source: Peter Heller, "The Underfinancing of Recurrent Development Costs," *Finance and Development*, March, 1979.

[a] These coefficients are drawn from a very restricted sample of developing countries and are meant to illustrate the variability one can observe across sectors and projects. Example: If a polytechnic school costs $1 million to construct and equip, on the basis of an "r" coefficient of 0.17, we can estimate that it would cost on average $170,000 in each subsequent year to pay the teaching staff, to operate the facilities, and to maintain the building.

[1] Tom Morrison, "Major Macroeconomic Issues in AID countries: Implications of the CDSS Review," June 1981.

Section IV is a short disucssion of the methodology to be used in identifying recurrent cost problems. The fifth section is the core of the paper and describes the appropriate responses for AID. The final section summarizes the arguments presented. In addition there are two appendixes, the first of which presents the main argument of this paper mathematically, and the second of which demonstrates how the use of shadow prices for government revenues and recurrent costs might affect the choice of projects.

II. Definitional Questions

Before we begin to consider the difficulties involved in identifying, analyzing and solving a recurrent cost problem it would be well to define precisely and clearly the meaning of two key terms: "recurrent costs" and "recurrent cost problems."

Recurrent Costs are simply those costs of development activities which recur. Thus while the capital cost of any given project, be it a school, a road or a dam, is usually incurred over a short time period, from one to five years, the recurrent costs associated with that asset — teachers' salaries, road maintenance, equipment repair — will be maintained over the lifetime of the asset, from twenty to fifty years or more. Thus capital costs are concentrated in the initial period of any development project; recurrent costs are spread out throughout the project's life, and may, in fact, increase in real terms toward the end of the capital asset's life as maintenance becomes more expensive.

If a government were trying to maximize output given a budget constraint, it would normally allocate resources between fixed and variable inputs such that the present value of the marginal product of an extra dollar spent on the fixed input is equal to the present value of the marginal product of an extra dollar spent on the variable input (see Appendix A for proof of this proposition).[2] Therefore if an extra dollar spent on road maintenance will generate two dollars of additional output while an extra dollar spent on road construction will generate $1.50 of additional output (which would be the present value of the discounted stream of returns), then clearly the government could do better by shifting resources into maintenance and away from new construction.

A Recurrent Cost Problem is a situation in which the government faces such budget stringency that it is unable to finance the recurrent costs of existing development projects when the stream of returns to the recurrent factor of production is much higher than that of new development projects. The last phrase of the preceding sentence is crucial in defining a recurrent cost problem. Failures to fund school supplies or road maintenance or petrol for extension workers may be a rational response to the discovery that these projects are no longer economically viable, either due to poor design or to a change in circumstances such as relative prices. In such cases these scarce resources might be better used to fund recurrent expenditures in other sectors or locales, or in financing brand new capital projects. When, however, the stream of returns to road maintenance is on the order of two to five times that of new construction and yet road maintenance is not being undertaken while new investments are being made, as was found in a World Bank study in the Sahel,[3] then there is undoubtedly a recurrent cost problem.

III. Causes of Recurrent Cost Problems

When a government sets out to promote economic development it has two resources at its disposal — its capital budget and its recurrent budget. In many ways these two resources are substitutes for one another since government resources are, in principle, fungible. There are, however, two restrictions on this general fungibility. There is, in the first place, a technical constraint related to the unidirectional nature of time. A capital expenditure once made can never be converted into a recurrent expenditure ("sunk costs are sunk costs").[4] On the other hand a proposed recurrent expenditure can always be converted into a proposed capital expenditure. In other words, one can always choose to underfund existing projects in order to make new capital starts; one cannot convert existing capital assets into recurrent financing. Secondly, donor policy, which prohibits, in general, recurrent financing, limits fungibility, especially in the poorest countries which are most dependent on foreign aid for their capital budgets. Thus over any planning horizon a government can choose, within the limits imposed by donors, the degree to which it will invest in new projects, and the degree to which it will finance the variable inputs for existing projects.

[2] In order to economize linguistically we will call the present value of the marginal product of an extra dollar spent on an input the stream of returns associated with that input.

[3] C.G. Harral and P.E. Fossberg, "Evaluating the Economic Priority of Highway Maintenance," paper presented to the Pan African Conference on Highway Maintenance and Rehabilitation, Accra, 1977.

[4] It is of course possible to sell certain types of capital, mainly plant and equipment, and use the receipts to finance current expenditures. While this option may not be available to some governments, others, which have embarked on public production of goods better produced by the private sector, could divest themselves of hotels, factories, and the like.

As discussed in the previous section a recurrent cost problem exists when the stream of returns to recurrent expenditures is greater than the stream of return to capital expenditures, or is high relative to the opportunity cost of capital. There are two basic causes for such a problem — donor policy and LDC government policy. We will take each of these up in turn.

A. Donor Policy

The resistance of donors to funding recurrent inputs is a major casual factor of the recurrent cost problem. For a large number of LDC's, foreign assistance and, therefore, government investemnt funds, are a much more abundant resource than are government recurrent resources. For low income A.I.D. recipients, (i.e., those countries with per capita incomes below $400 in 1978) the average excess of investment over domestic savings is 16.5% of GDP; the level of government expenditures on goods and services for these same countries is 15.5% of GDP. Thus, total net foreign inflows available for capital accumulation are greater than total domestic government resources available to service the entire recurrent budget. An estimate of the ratios of development assistance to major government expenditures for low income countries is presented in Table II.

Why do donors limit funding to capital costs? The main arguments seem to be related to the following set of premises:

(1) It is better to provide assistance which is directed toward investment, and thus has growth potential, than toward consumption;

(2) Funding of recurrent costs is an open-ended commitment which leads to dependence rather than self-reliance on the part of the recipient and which commits the donor to certain activities over a longer run than is politically acceptable.

(3) The larger the share of total project costs financed by donors the less interest and commitment does the host government have in the projects' success.

Let us examine each of these arguments.

TABLE II

Ratios of Net ODA Receipts to Government Expenditures, Selected Low Income Countries,[a] 1977 (Figures are in percentages)

	Net ODA GDP	ODA Current Expenditure	ODA Capital Expenditure	ODA Total (Government) Expenditures
Burma	2.67%	22.61%	121.36%	17.80%
Chad[b]	17.40	140.30	644.44	115.23
Ethiopia	2.84	17.75	83.53	14.64
Gambia, The	3.53	16.73	28.93	10.60
India	1.04	8.67	45.22	7.27
Kenya	3.67	21.84	73.40	16.83
Lesotho	9.95	53.20	144.20	38.87
Madagascar	2.48	15.70	52.77	12.10
Malawi	8.97	73.41	115.00	44.85
Mali	11.85	70.96	790.00	65.11
Niger	10.97	61.28	274.25	50.09
Pakistan	3.52	27.29	100.57	21.46
Papau New Guinea	17.18	64.57	477.22	56.89
Rwanda[b]	12.83	145.83	278.91	95.75
Senegal	6.45	45.74	358.33	40.57
Sierra Leone	4.13	23.74	114.72	19.67
Somalia[b]	59.08	204.43	757.43	160.98
Sri Lanka	7.01	39.84	127.45	30.35
Sudan	3.80	24.52	35.51	14.50
Tanzania	9.61	48.54	115.78	34.20
Upper Volta[b]	15.17	120.40	561.85	99.15
Zaire	5.40	21.77	79.41	17.09

Source: OECD, *Geographical Distribution of Flows to Developing Countries* (1980), and Tait, Alan and Peter Heller, "International Comparisons of Government Expenditure." IMF, DM/81/53

a) Countries with per capital incomes below $400 in 1978
b) Countries for which ODA receipts are greater than current expenditures.

1. Investment vs. Consumption in Recurrent Cost Funding

For the accountant the question as to which expenditures are investments and thus belong in the capital account, and which are consumption and thus belong in the current account is a simple one to answer. Any expenditure which purchases something which is not used up in one year is an investment; any expenditure which is used up within the year purchased is consumption. The former expenditures are put in the capital budget, and the latter in the current account. Thus wages which are paid to road builders enter under capital accounts, while wages paid to street cleaners come under current account. However as one probes carefully behind the accounting constructs, a number of anomalies arise.

First, many expenditures classifed as "current" are actually new investments. Education is widely interpreted by economists as a process through which "human capital" is developed. Both the student and the state are employing resources to produce an investment which has a very long gestation period. Producing a skilled worker or producing a road are conceptually the same thing, and it may be that the worker's skills are the more productive. Therefore, should not expenditures on education, and to a large extent health, be considered as capital expenditures rather than consumption? The same argument can be raised for investments in agricultural research institutions. Here the end product, knowledge, has an extremely long life, as well as a long gestation period, and, therefore, costs involved in producing new knowledge should be considered as investments. To state the case even more strongly, the services of extension workers, who are involved in transmitting knowledge, are similar to those of teachers. Although with extension work the gestation period may be short, the new skills and techniques learned by farmers, continue to pay off over a long period of time and thus the costs of extension needed to spread these skills and techniques are investments.

Secondly, maintenance of capital goods, either physical or human, is surely a gross investment if not a net investment. Thus road maintenance, or health care (including labor costs and drugs) represent investment expenditures designed to keep the quantity and quality of the capital stock from deteriorating. While they do not produce increments to capital, they operate to maintain the integrity of the capital stock. Replenishment of the working capital of credit institutions is another important example of a gross, though not a net, investment.

Lastly, the one year distinction between current expenditures and capital expenditures is largely a matter of convention and has no conceptual legitimacy. Any expenditure which provides a stream of services over time is by nature a capital expenditure, and every expenditure which provides services only instantaneously is a current expenditure. The operational question is the length of the instant. The same expenditure can be viewed as a recurrent or a capital cost depending on the point at view. For example, a bowl of rice provides satisfaction for the length of time, a day perhaps, needed to burn off the calories it contains. However, lack of sufficient nutrition may lead to the stunting of physical and mental abilities for a lifetime. If the length of time involved is one year then a vehicle with a three-year life is a capital good; if the standard time period is one month, then fertilizer is a capital good. There is, then, a continuum, with expenditures producing outputs over time, some over long periods of time; others over shorter periods. Any expenditure which produces increases in productivity partakes to some degree in the nature of a capital good. But that "capital-good nature" varies in intensity depending on the length of time that the expenditure continues to provide productivity increases.

What this means is that donors who are willing to provide capital costs of projects, but are reluctant to provide recurrent costs, are suffering from conceptual tunnel vision. The "welfare"/"investment" dichotomy is much less clear-cut than is often perceived. For example, the adage, "Give me a fish and I'll eat today; give me a net and I'll never be hungry," could be converted to: "Give me a fish for the first 15 years of my life and I'll be strong enough and smart enough to build my own nets".

2. Self Reliance vs. Dependency

The capital costs of all projects have a fixed termination date. There is no termination date involved in recurrent costs. If the reason donors shun recurrent costs is that they wish to hold to the idea that development means increasing self-reliance, then the main consideration ought to be the prospects for the LDC to take on all the costs associated with each capital expenditure at some date in the future. Under such a rationale it would make sense to finance recurrent costs if there were a firm expectation that such funding was of a reasonable duration.

Thus, funding the recurrent costs of a research project for a number of years would not be inappropriate if there existed a plan for phasing out this type of assistance. Similarly, macro-level budgetary support of various types—PL 480, cash grants, or C.I.P.'s, also make sense as long as there is a realistic plan to move from this temporary situation to permanent self-reliance. This

is, indeed, the ultimate objective of the entire aid program — development allowed by graduation.

We must, however, be realistic about the time it will take for current low income countries to reach the level of development where they can be graduated. For the poorest LDC's, and it is in these countries where the recurrent cost problem is most severe, there is no prospect for becoming less dependent on aid flows in the near future. If average per capita income is $200 and a per capita income level of $1000 is a reasonable threshold for transition to "self-sustained growth," it will take 54 years at 3% per capita growth rates, and 81 years at a more moderate 2% per capital growth rate to reach that level of income. Only ten of thirty-eight low-income countries have exceeded sustained 2% per capita growth in the period 1960-78, and only four have exceeded 3%. While A.I.D., other donors and the countries themselves hope to improve this performance, and we can undoubtedly expect sectoral successes (such as Indian agriculture) in the medium term, nevertheless, if our objective is to graduate countries from dependence on aid we must be prepared for a long-term donor commitment to low income countries.

3. Donor Financing and Host Country Commitment

There is a danger that as donors pick up a larger proportion of the costs, both capital and recurrent, of a given project that LDC governments will be less involved with, and less committed to the success of that project. It would therefore, be useful to plan a phasing out of donor activities and a phasing in of LDC responsibility, both financial and managerial. If the project is successful, then its support by the LDC government is assured. If it is unsuccessful, that support will not be forthcoming.

The critical question is how success is to be defined. Often donors and recipients have very different objectives, and thus the achievement of one set of objectives may mean the failure to achieve a different set. Only when objectives are congruent and projects are perceived by host governments as successful, will the continuation of project activities be assured. This will tend to be the case whether or not LDC governments have committed their resources to the project.

In fact, the central objective in requiring LDC's to be involved financially in any project is to cause them to reveal their preferences, since the long run viability of any activity depends on the host government's placing sufficient value on project outputs.

Since LDC resources are scarce, host country agreement to fund a portion of any project suggests host country interest in that project.

However, if LDC's believe that the level of total donor financing is unrelated to a particular project portfolio, they will have no reason to conceal their preferences. In other words if a country believes that the U.S. aid level is to be $20 million, regardless of whether the money is put into the health or agricultural sectors, then there will be no reason to hide the fact that they would prefer investment in health. There should, therefore, be little difference in donor and host country objectives, and a financial commitment would not increase the degree of host country interest.

However, if LDC's perceive the total level of assistance as being related to the project portfolio, then they would be more likely to accept donor financing of, for example, a population program, even if they have no interest in it, because they expect that it is the population program or nothing. In this case there is little commitment to the project's success.

It would seem, then, that there is some cogency in the requirement that LDC's be obligated to fund some portion of development activities. (As appropriate, local currency generations of PL 480 programs can be used to fulfill the counterpart requirements of A.I.D. projects.) This need not mean that all, or a major portion of, recurrent costs should be the responsibility of recipient countries. In fact, where the objectives of the donor and recipient are disparate, and donors wish to influence LDC governments to move their objectives closer to those of the donor it may be well to finance some portion of project recurrent costs beyond the development phase of the project in order to develop a coinsistency for project continuation.

B. Recipient Country Policies

Just as recurrent cost problems can be caused by donor policies that limit fungibility, recurrent cost problems are often caused by LDC government policies which create budgetary stringencies or lead to inappropriate projects. We can divide these recipient policy problems into three main areas — government revenues, government expenditures, and project design problems. We will examine each of these in turn.

1. Government Revenues

It is possible that recurrent cost problems are due to the government's inability to raise revenues necessary to fund recurrent expenditures. Domestic revenues can be derived from either general tax receipts or from fees for specific services (i.e., user charges).

(a) Tax Revenues

Most, if not all, LDC's have difficulty mobilizing an economy's resources for the use of the government exchequer. However, there is a wide variety of experience in this respect, and Tait et al

found the Tax/GNP ratio for 1972-76 ranging from 5.37% in Nepal to 37.6% in Iraq.[5] Much of this difference was due to the structure of the economy (mineral-rich countries finding it much easier to raise revenues). They then calculated International Comparison of Taxation (ICT) indices for a sample of LDC's. These ICT's were arrived at by regressing the tax to GDP ratio against a set of exogenous variables, determining what a normal tax effort at a given per capita income would be (given export earnings and mineral production), and calculating a given country's performance as a percentage of the norm. They then identified those countries whose ICT indices were above normal, as well as those below normal. While the underlying implication which follows from the analysis is that countries below normal should be able to improve their tax performance, one must be very careful about such assertions. In the first place, since we are dealing with norms, it is statistically impossible for every country to be performing well (or badly), even though it is conceptually possible. Thus good performance means only that performance which is better than average. Secondly, the regression equations only explain half of the variance, at a maximum; there may be many other factors, beyond the capacity of the country to affect, which determine its performance. Thirdly, certain variables, such as the export ratio, may be determined by government policy rather than independent of policy as assumed by the model. Lastly, superior tax performance, does not seem to be correlated with GDP growth. Indeed, among those countries with low ICT's are Egypt, Ecuador, Malawi, and Togo, all of which have grown rapidly while among those with high ICT's are Algeria, Benin, Congo, Guyana, Sudan, Upper Volta, Zaire, and Zambia, all of which have stagnated. Indeed the growth rate for the low ICT countries is, on average, one-half percent higher than the medium and high ICT countries. This suggests that how governments use their resources and how their policies affect the private sector are more important than total tax effort in generating economic growth.

Their results, for AID recipients, are presented in Table III.

If the country with a low ICT seems to be confronting a recurrent cost problem, then one recourse might be to increase the ability of the government to raise and collect taxes. In such cases, AID assistance to improve tax administration is an appropriate response.

[5] Tait et al, "International Comparison of Taxation for Developing Countries, 1972-76" *IMF Staff Papers*, Vol. 26, No. 1 (March, 1979).

(b) **User Charges**

The general theory of public finance suggests that even in market-oriented economies there is a legitimate role for government provision of certain goods and service. More importantly, it makes sense under certain conditions for these goods to be paid for from general tax revenues rather than from fees paid by users.

The basic question is who is to pay for any particular good or service produced by the government, the taxpayer or the user. If it is to be the taxpayer then that implies a degree of subsidization which has substantial import for recurrent cost considerations. Three arguments have been advanced in the public finance literature for government subsidies or specific taxation (taxes are negative subsidies)—a public goods argument, a merit goods argument, and an equity argument.[6]

(1) **Public Goods Rationale**

Development projects can be divided conceptually along a continuum measuring the degree to which the outputs partake of the nature of a public good. In economic terms, a public good is a good which cannot efficiently be provided by the private economy, because either (1) there is a great difficulty in excluding "free riders" or (2) there are externalities in consumption of the good. For example, fire protection can be justified on externality grounds as a public good because of the danger that a fire in one dwelling can spread to another (on the other hand, smoke alarms which tend to save lives more readily than property are private goods). City streets tend to be public goods while parking places are not, because of the excessive cost of collection as opposed to the value of the good. In other words, toll booths at every intersection would require a payment by the driver, both in time and money, many times the value of driving that city block.

While there is a continuum from "private" to "public" goods, it might be useful to put goods into three discrete categories—public, private, and mixed. An illustrative grouping is provided in Table IV.

The public goods literature argues that on efficiency grounds, public goods should presumably be totally financed out of public funds, private goods should be totally financed out of user charges, and mixed goods by a combination of both. The basic argument underlying this conclusion is as follows.

In a market system, prices are used as signals to both consumers and producers. For a purely

[6] See, for example, John G. Head, *Public Goods and Public Welfare* (Duke University Press, Durham, N.C. 1974).

TABLE III
Summary measures of ICT Indices (47 countries)

Low ICT Index (less than 0.89)	Medium ICT Index (0.89-1.09)	High ICT Index (greater than 1.09)
Bangladesh	Burma	Benin
C.A.R.	Burundi	Cameroon
Ecuador	Costa Rica	Congo
Egypt	Dominican Republic	Guinea
El Salvador	Ghana	Guyana
Gambia, The	Jamaica	India
Guatemala	Jordan	Kenya
Honduras	Mali	Morocco
Indonesia	Peru	Pakistan
Liberia	Senegal	Sudan
Malawi	Sierra Leone	Tanzania
Nepal	Sri Lanka	Tunisia
Nicaragua	Swaziland	Upper Volta
Panama	Thailand	Zaire
Philippines	Yemen	Zambia
Rwanda		
Togo		

Source: Tait, et al (1979), op. cit.

TABLE IV
Public vs Private Goods: Who Should Pay?

Public (totally subsidized)	Mixed (partially subsidized)	Private (no subsidy)
National Defense	Communicable Disease Health Care	Agricultural Credit
Public Health Measures such as mosquito spraying	Agricultural Research	Agricultural Inputs
	Forestry	Non-Communicable Disease Health Care
	Energy Research	Markets
	Sewerage	Irrigation
	Family Planning	
	Agricultural Extension	
	Potable Water	
	Education	

private good, there is no divergence between social benefits and costs and the sum of private benefits and costs. Thus market-determined prices can be used as guides to allocate resources among competing uses. The value to society of an extra bag of maize is measured by the market-determined price of maize. A subsidy (or tax) on maize distorts price signals and would lead to either a greater (or lower) consumption of maize than is economically optimal.

Markets are not likely to arise, however, for public goods because of their nature. For example, households are not likely to purchase mosquito-spraying services on a voluntary basis if they live in close proximity to other households who might not purchase such services. The non-purchasing households would obtain some external "free-rider" benefit and, moreover, there would be much less assurance that the total mosquito population had been eliminated or effectively controlled. Under these circumstances, the private market would tend to provide much less in the way of these services than is socially optimal; namely, total coverage financed by universal fees or tax revenues.

On efficiency grounds, user charges for totally "private" goods, even if produced in the public sector, should be sufficient to cover the costs of production, thus eliminating the need for any recurrent finance out of general revenues. At this level of analysis it makes no difference whether the goods are produced by the government and sold at market prices, or produced and sold on the market by private firms. Since "mixed" goods should be partially subsidized and partially paid for by users, the price of mixed goods would not be sufficient to cover costs and it would therefore be necessary for some measure of recurrent finance. Lastly "public" goods should be totally financed by tax revenues. Again, in each of these

instances, it does not matter conceptually whether the goods are produced by the government directly or by private firms which are then reimbursed by the government for the public portion of their costs, much as the way food stamps are provided in the U.S.

One final note is in order here. In most cases it is inappropriate to involve the government in the provision of, as opposed to the subsidization of, development services which could and should be handled by the private sector. Government enterprises are often run less efficiently than private enterprises. These parastatals are generally insulated from the strictures of the market, by being able to run losses without being forced to cut costs or lower production. Management is frequently accountable to a different incentive structure than profits and losses. The government would be better advised to concentrate on those activities which are purely public or mixed goods, and create an environment conducive to private production of essentially private goods such as fertilizer, credit, or health care which is not related to communicable diseases.[7] LDC's have been pushed into many of these activities by donors who are then surprised when credit funds become decapitalized and physicians not paid.

(2) **Merit Goods Rationale**

In the development context it is frequently argued that because of limited information or education, poor people undervalue certain basic commodities including types of health care, potable water, education, and nutritious foods. This argument requires that, to encourage poor people to consume these goods in greater quantities than they otherwise would, the goods must be partially financed by general government revenues.

A similar argument is made on the production side where producers, particularly smallholders, are allegedly reluctant to adopt new technologies which require substantial purchases of modern inputs such as fertilizers, hybrid seeds, and insecticides. The reasons for this reluctance are a natural aversion to risk, plus a limited amount of information on the relationship between new technologies and increased productivity.[8] The argument is then made that subsidizing modern inputs encourages the adoption of new technologies and is therefore justified.

Both of these merit good arguments maintain that certain goods need to be subsidized for a fixed period of time until experience changes current preferences. It therefore follows that certain subsidies are justifiable if they are imposed for a limited period of time. In other words, subsidies imposed for merit goods should be accompanied by a timetable for their gradual elimination. The political problem is, of course, that it is much easier to initiate a subsidy program than to eliminate one.

In general, the merit good argument has little merit. Although there is some anecdotal evidence of "non-rational" consumption patterns among the poor, most careful budget studies show that poor people spend a very large portion of their income on "basic needs" goods.[9] Table V reproduces an EICEL - Brookings study on consumer behavior in ten South American cities. As can be seen low income consumers in South American cities spend upwards of 85% of their incomes on "basic goods." Without clear evidence that consumer preferences are irrational, subsidy programs could lead to misallocations of resources, producing goods of lower value than non-subsidized programs would.

(3) **Equity Rationale**

In many countries there are large groups of people with incomes so low that they face the ever-present danger of starvation. Governments often find it necessary to provide a safety-net, to insure that the minimum requirements for survival are met. The most efficient means of achieving an income-floor goal is through the use of the fiscal system. Few countries, and fewer LDC's, however, have a fiscal system sufficiently sophisticated to make such a program feasible. Consequently, governments have attempted to alleviate poverty by the direct provision of in-kind goods and services thought to be necessary. While this is clearly a "second best" solution, it may represent the only politically and administratively feasible mechanism for providing the necessary resources to the threatened populations.

The critical problem with subsidies is that they are generally untargetted. The typical policy is **universal** free primary education, or **universal** free health care. Food subsidies are often imposed across the board without any clear distinction between those who are able to pay and those who are not.

For example, consider a country with the income distribution and per capita income of India. Assume that tax revenues are 10% of GDP, and that the recurrent cost of development projects that provide services are $50 per person reached. (India's GNP/capita is $200). Then tax revenues

[7] PPC is currently drafting a policy paper on the role of parastatals in development.

[8] In addition, the weakness of long-term financial markets inhibits the adoption of new technologies because many of these technical packages are associated with negative cash flows during the start-up period.

[9] See David Wheeler and John Harris, "Recurrent Costs and Basic Needs Strategies," (AID/OTR-G-1733, June, 1980).

TABLE V
Basic Needs Expenditures as Percent of Family Budgets for the Lowest Income Quartiles (Ten South American Cities)[a]

City	Mean Income of Lowest Quartile ($)	Percent
Bogota, Columbia	1037	89.7
Barranguila, Colombia	1100	88.7
Cali, Colombia	1029	88.6
Medellin, Colombia	1055	87.8
Santiago, Chile	942	85.7
Quito, Ecuador	845	90.5
Quayaquil, Ecuador	896	91.4
Lima, Peru	1161	80.8
Caracas, Venezuela	1602	80.4
Maracaibo, Venezuela	1452	82.0

Source: Wheeler and Harris, op. cit.

[a] Relevant definitions are as follows:

"Basic" expenditure categories: Food and beverages; housing; clothing; medical; education.

"non-Basic" expenditure categories: Furnishings and operations; recreation and culture; vehicle operation; public transportation; communication; other consumption (tobacco, personal care, ceremonies); insurance; gifts and transfers; other nonconsumption.

will be $20 per person, and given the cost of services, only 40% of all people can be reached if taxes are the sole source of finance. If we divide the population into three groups: the upper group (top 20%) the poor (middle 40%) and the abysmally poor (bottom 40%), and then assume that all the upper group get the services with the remaining recipients divided equally among the two poorer groups, we obtain the result of Table VI, i.e., that 100% of the upper class get the service, while 25% of each of the next two groups get the services (sixty percent of the total population are excluded).

Suppose, however we introduce user charges of $25 for the service (it's half a public good and half a private good). Also assume that every member of the two upper groups is able to pay for the service. If you then provided the service free of charge to the bottom group, you would be able to reach 100% of the upper group, 100% of the middle group, and the same 25% of the bottom group, or 70% of the population. These results are summarized in Table VI below:

While the general level of poverty and tax collection limits the ability of the government to provide the public good to the entire population (the public good costs $50 per person and tax revenues are only $20 per person) coverage is obviously much broader when user changes are imposed on those groups able to pay.

The equity question is not as simple as it first seems. Referring back to our India example we see that resources are only available to provide public goods to 25% of the poor population. Which twenty-five percent? In the absence of a purely political response the choice is arbitrary. The result is like a lottery. Without user charges, only 25% of the poor population will receive public services and there is no rational way of allocating these services among the poor.

By imposing user changes and distributing services to all of the poor community, more people can benefit, though at a lower level of service. While a development project requiring recurrent finance of fifty dollars per year is not affordable for the whole community, one requiring twenty-five dollars might be. The choice becomes one of giving a few poor a high level of service or giving the many poor a lower level of service.

To be sure there are indivisibilities. It may not be possible to provide everyone with piped water or secondary schools. But improved water supplies,

TABLE VI
An Arithmetic Example of the Effect of User Charges on Service Delivery

	Without User Charges	With User Charges
Cost Per Person	$50	$50
Tax Revenue per Person	$20	$20
User Charge Fees per Person	0	$25
Total Coverage	40%	70%
Coverage of Upper Group (P.C.I. = $500)	100%	100%
Coverage of Middle Group (P.C.I. = $175)	25%	100%
Coverage of Bottom Group (P.C.I. = $75)	25%	25%

functional literacy, or primary health care may be affordable for most communities, provided the level of services is consonant with the ability of the poor to pay.

The following general principles apply to the question of subsidies and user charges:

First, that for goods which are purely public in nature, user charges are inappropriate on efficiency grounds, and these goods should be financed by general revenues;

Second, for goods which are partially public, e.g., education, partial financing from general revenues is legitimate, but should be carefully monitored.

Third, subsidies may be appropriate for a limited period of time to induce producers (particularly small farmers) to adopt new technologies.

Fourth, subsidies may be used to alleviate poverty through the provision of goods and services to the poorest in order to meet survival needs. Such subsidies should be limited to the segment of the population whose income needs to be raised, and not be provided across the board;[10] and

Fifth, user charges should be levied on other goods and services provided by government.

2. Government Expenditure Policies

(a) Government Budget Allocations

Even if the government is capable of generating sufficient revenues, there may be recurrent cost problems in development projects, particularly in the health and education sectors, if the government is short-changing these sectors in favor of others. Four principal offenders here are defense expenditures, government enterprises, subsidies of various types, and large prestigious industrial projects. Low income AID recipient governments are spending on recurrent account an average 2.7% of GDP on education, 1% on health, and another 1% on agriculture; whether these are appropriate depends on particular country circumstances. Table VII summarizes available data on budget allocations for these countries.

Alan Tait and Peter Heller of the IMF have developed an "International Expenditure Comparison Index," similar to the "International Comparison of Taxation Index" discussed above. While these comparisons should be treated with even greater caution than that suggested for interpreting the ICT, the results are interesting and in some cases provocative. Table VIII summarizes the results for AID recipients for which these Indices were calculated.

Frequently, a recurrent cost problem in a given sector is an expression of government priorities. Failure to provide school supplies or petrol for extension workers may reflect the government's decision that these activities are less important than subsidizing agricultural inputs or financing a new steel complex. Where requisite steps to meet recurrent costs are not undertaken, A.I.D. should seriously consider reducing the level of assistance to the affected sector. There is little point in developing projects that call for host government resources to be successful, if those resources are not likely to be forthcoming.

(b) Cost of Government Activities

Sometimes government budgets become tight because the costs of producing government goods and services are excessive. This is frequently due to inflated salary schedules, as is particularly the case in much of the Sahel. For example, let us examine primary education in Upper Volta by comparing its situation with that of Burma and Malawi. Burma, with a nominal GNP per capita level similar to Upper Volta's has enrollment levels of 80%, (five times that of Upper Volta) and Malawi with a per capita income level 12.5% higher has enrollment levels of 60% (almost four times that of Upper Volta). How are these countries able to finance the recurrent expenditures and Upper Volta not?

The answer is clear. Upper Volta does every bit as well as Malawi and Burma in generating tax revenue and allocating portions of both government budget and GDP to primary education. The key differences is in per pupil expenditures which are four times that of Malawi and almost seven times that of Burma. Often differences in costs are related to particular resource endowments—either of terrain, population density, or skilled labor. However, in other cases there is no justification for the cost structure of government activities. For example, it has been found that the ratio of public sector wages to the income of a peasant in Mali is approximately twenty to one. In India the ratio is probably closer to six to one. Such a differential may in part be due to the relative shortage of administrative skills, but a larger portion is undoubtedly due to excessive levels of compensation. A clear indicator of the compensation question is whether the private sector or the public sector is exhibiting the greatest shortage of skilled personnel. If the government sector is having difficulty attracting skilled personnel then public wages are not too high. On the other hand if the private sector is having difficulty attracting trained people then government wages may very well be out of line.

[10] There are several ways of targetting subsidies. Food subsidies could be limited to those foods preferred by the poor, such as cassava in many countries. Water piped to a house would not be subsidized while community stand pipes could be. There could be subsidies for certain levels of health care but not for others. These complex issues will be discussed in greater depth in a forthcoming policy paper on subsidies.

TABLE VII
Average Recurrent Government Expenditure
Selectors 1967-1973
(as percent of GDP)

	Agriculture	Education	Health	Total
Bolivia	0.4	3.7	0.8	4.9
Burma	0.9	2.5	1.0	4.4
Burundi	0.6	2.6	0.7	3.9
Cameroon	0.6	2.2	n.a	n.a
Gambia	1.9	2.4	1.7	6.0
Ghana	0.9	3.7	1.1	5.7
Guatemala	0.2	1.7	0.9	2.8
Honduras	0.6	2.8	0.5	3.9
Kenya	1.3	3.3	1.1	5.9
Lesotho	2.3	4.9	2.2	9.4
Liberia	0.4	1.9	1.0	3.4
Malawi	1.2	2.7	1.1	5.0
Mali	0.6	2.4	1.2	4.0
Nepal	0.1	0.3	0.1	0.5
Philippines	0.5	2.4	0.4	3.3
Rwanda	0.4	2.5	0.9	3.8
Senegal	0.9	3.4	1.4	5.7
Somalia	0.8	1.5	1.7	4.0
Sri Lanka	0.6	3.7	1.8	6.1
Sudan	1.7	2.0	1.1	4.8
Swaziland	1.9	3.8	1.7	7.4
Tanzania	1.2	2.7	1.2	5.1
Thailand	0.7	2.2	0.5	3.4
Togo	0.6	1.6	0.8	3.0
Upper Volta	0.5	1.6	0.7	2.8
Zaire	0.2	4.5	0.6	5.3
Zambia	2.7	4.0	1.8	8.5
Mean	0.9	2.7	1.1	4.7

Source: *World Bank Tables, 1976*

Salaries are the main cause of high costs, but inappropriate technologies are also important. A health care sector that is made up of high technology curative hospitals is going to have higher costs per beneficiary than a primary care system. This is true for all sectors from education to rural development to road construction. If costs are out of line on a sectoral basis (due to inappropriate technology) donors should tend to stay out of that sector. If costs are out of line in every sector, then clearly, financing of recurrent costs in any sector would be inappropriate, since it would involve subsidizing those inputs which are priced too high.

3. Macroeconomic Policies

Frequently, recurrent cost problems arise through the failure of government fiscal and monetary policies. For example, an overvalued domestic currency coupled with a government marketing system will destroy a country's fiscal base. In Ghana, for example, where the cedi is overvalued by perhaps 10:1, it is impossible for the government to pay cocoa farmers anything like the true market price. Cocoa production has declined precipitously. This has meant a shortfall not only in foreign exchange, but also in government revenues.

As noted in the introduction to this paper, the economic crises threatening most LDC's have led to the acceptance of IMF stabilization packages with an attendant austere government budget. Consequently, many countries are going to face a reduction in their ability to finance the recurrent costs of their development portfolio over the near term.

There are many instances where an apparent recurrent cost problem is due to an over-optimistic attitude on the part of government as to what it can achieve. For example, Egypt and Mali are committed to hire every secondary school leaver. This results in an overblown public service and a shortage of manpower in the private sector. The recurrent burdens of such a policy are enormous.

Similarly, governments may be too ambitious in addressing the needs of the population given the resources they have available. Universal primary eduction may not be appropriate in poor countries with 25% of their population in this age group. The same argument can be advanced for a

TABLE VIII
International Expenditure Comparison Index, 1977: Functional Categories of Expenditures

	General Public Services	Defense	Education	Health	Agriculture	Transport and Communications
Bangladesh	Low	Low	Low	Average	Average	High
Bolivia	Average	Average	Average	Low	Low	Average
Botswana	Average	Low	High	High	High	n.a.
Burma	Average	High	Low	Low	High	n.a.
Burundi	Low	High	Average	n.a.	Average	n.a.
Cameroon[a]	High	Average	Average	Low	Low	High
Chad	Average	High	Average	Low	Average	Low
Costa Rica	Low	Low	Average	Low	Low	High
Dominican Rep.	Low	Low	Low	Average	Average	Low
Ecuador	Low	Average	Average	Low	Average	n.a.
Egypt	Low	Low	High	Average	High	Low
El Salvador	Average	Low	Average	Average	Low	Average
Gambia, The	High	n.a.	Average	High	High	n.a.
Ghana	Average	n.a.	High	Average	Average	Average
Guatemala	Low	Low	n.a.	Low	Low	n.a.
Honduras[a]	High	Low	Average	High	Low	n.a.
Jamaica	Low	Low	High	High	High	Average
Jordan[b]	Average	High	High	High	High	High
Kenya	Low	Average	Average	Average	Average	Average
Lesotho[c]	High	n.a.	High	Average	High	n.a.
Liberia	High	Low	Average	High	Average	Average
Malawi	Average	Low	Average	Low	Average	Low
Mali[a]	Average	High	High	Average	Low	Low
Morocco	High	High	High	Average	n.a.	n.a.
Nepal	Low	Average	Low	n.a.	Average	n.a.
Nicaragua[a]	Low	Low	Low	Low	Low	n.a.
Niger	High	Low	High	Average	Low	Average
Pakistan	Low	High	Low	Low	Low	Average
Panama	High	n.a.	Average	High	Average	Average
Peru	Average	Low	Average	Low	Average	n.a.
Philippines[a]	Average	Average	Low	Low	Average	High
Rwanda	Low	High	Low	Low	Low	High
Senegal[b]	Average	Low	Average	Low	Low	Low
Sierra Leone[a]	Average	Low	Average	Average	Low	Low
Somalia	High	High	High	High	High	Low
Sri Lanka	Low	Low	Average	Average	Average	n.a.
Sudan	Low	Average	Low	Low	High	Average
Swaziland	Average	Low	High	Average	High	n.a.
Tanzania	Average	Average	Average	High	High	Average
Thailand	Low	High	Average	Low	Average	Average
Upper Volta[c]	Average	High	Average	Low	Low	Low
Yemen	Average	High	Low	Low	Low	Average
Zambia	High	n.a.	High	High	High	High

Source: Alan A. Tait and Peter S. Heller, "International Comparisons of Government Expenditures: A Starting Point for Discussion IMF, Discussion Memorandum, DM/81/53, July, 1981.

Each index runs from zero to four hundred. Any value less than 75 was recorded as "Low", values between 75 and 125 were recorded as "Average", and values greater than 125 were recorded as "High".

[a]1976 [b]1975 [c]1974 [d]1978 [e]1973

variety of activities, some worthwhile but expensive, others worthless and expensive.

The recurrent cost problem is, thus, often due to inappropriate government policy, and the rational donor response is to endeavor to persuade governments to change the policy, or to develop activities the success of which is not dependent on recurrent financing which will not be forthcoming.

(a) Foreign Exchange Constraints

It is generally, though not universally, true that the recurrent cost problem is manifested through the shortage of foreign exchange to purchase important intermediate inputs into the production of government services. Thus, there is more typically a scarcity of drugs than medical officers, of school supplies, than teachers, and of petrol than extension workers. One indicator of

TABLE IX
Comparative Cost Figures for Upper Volta, Malawi, and Burma

	Upper Volta	Malawi	Burma
Per Capita Income (US$)	160	180	150
Per Cent of Population between 5 and 14 (%)	25	25	25
Primary Enrollment Rate (%)	16	62	80
Tax/GDP Ratio (%)	11.3	10.1	7.6
Proportion of Govt Exp to Primary Education (%)	8.8	8.5	10.5
Percent of GDP devoted to Primary Education (%)	1.0	0.9	0.8
Per Pupil Expenditures (US$)	40	10	6
Pupil/Teacher Ratio	46	58	7

country performance in this regard is the ratio of expenditures on other goods and services (largely imported) to expenditures on wages and salaries. The IMF expenditure study referred to above has calculated an international expenditure comparison (IEC) index for both "other goods and services" and "wages and salaries" categories of expenditures. The ratio of these two indices is a useful measure of the degree to which there is apparent underspending on materials and replacement of capital equipment, and thus, a likely foreign exchange constraint. These ratios are presented in Table X.

However, even if the recurrent cost problem manifests itself in terms of a shortage of imported inputs rather than locally financed ones, the analysis and the prescriptions presented thus far in this paper remain valid. A recurrent cost problem is defined as a situation in which the stream of returns to the recurrent imported factor of production is greater than the stream of returns to the fixed imported factor. This situation results from either donor policies or recipient policies, and the situation can be resolved by policy reform.

TABLE X: Ratios of IEC Indices for Other Goods and Services to Wages*

Ratios below one		Ratios greater than or equal to one	
Bolivia	0.66	Botswana	1.11
Dominican Republic	0.51	Cameroon	1.06
Guatemala	0.74	Costa Rica	2.70
Liberia	0.69	Egypt	1.03
Mali	0.33	Gambia, The	1.51
Mauritius	0.59	Honduras	1.16
Morocco	0.41	Jamaica	1.31
Rwanda	0.94	Kenya	1.05
Swaziland	0.90	Malawi	2.21
Tunisia	0.97	Nicaragua	1.41
Turkey	0.58	Niger	1.79
Upper Volta	0.25	Panama	1.16
		Paraquay	1.35
		Philippines	1.28
		Senegal	1.12
		Sierra Leone	2.12
		Sri Lanka	1.07
		Sudan	2.91
		Tanzania	1.11
		Thailand	2.41

Source: Alan A. Tait and Peter S. Heller, "International Comparisons of Government Expenditures: A Starting Point for Discussion," IMF/DM/81/53, July, 1981.

*Low ratios imply either (1) the presence of a foreign exchange constraint or (2) high wage structure or (3) both.

4. Project Design Failures

Capital under-utilization which is particularly concentrated in one development sector indicates that the return to the host government of recurrent expenditures in that sector is less at the margin than was anticipated in the project design. A basic economic principle is that fixed costs are fixed costs. Once a health center has been built its capital costs are zero. The government must allocate its recurrent resources among a large number of activities, all of which presumably have a quantity of capital attached to them. In the project design the returns to the investment were calculated on the expectation that they would be fully utilized through the provision of complementary variable resources—labor, materials, maintenance, etc. However once in place it makes sense for the government to recalculate the social benefits of its allocation of scarce resources among various activities. The new calculation may differ from the original one due to a number of factors, e.g.:

(1) government priorities might change
(2) the original design was faulty
(3) the values of certain variables such as prices were predicted incorrectly.

If road maintenance is underfinanced, while other sectors are operating with little overt underutilization, then a donor should be very circumspect about getting involved in this sector. At the least it should investigate previous road building projects to determine whether the cause for the underfinancing was a low governmental priority or poor design, and redesign its project accordingly. In general, underutilization confined to a particular sector is **prima facie** evidence that the expected rates of return to investments in that sector were much too optimistic. In such cases the appropriate response is much more careful design in order to insure that

investment decisions anticipate likely responses. In particular, costs of recurrent inputs are often underestimated due to lack of donor co-ordination. For example, if a number of donors are doing projects that require skilled workers for maintenance, the sum of their demands might raise the price of these workers well beyond the levels anticipated.[11]

Another problem with project design is the tendency to be overly optimistic about the time necessary for a project to move from the development stage to what might be called the operational stage. During the early stages of a project it is expected that project revenues will be low and expenditures high. It is likely that this situation will continue beyond the typical five year implementation period, thus leading to demands on the public fisc.

In the preceding paragraphs project designs were faulted for failing to anticipate changing environments correctly. Often it is the policy environment that is most at fault. This is particularly the case in income generating projects which should never, if designed correctly, be the source of recurrent cost problems. Any investment is expected to generate a positive rate of return. For an income generation project that return should begin being realized even before the development phase of the project is concluded. Such returns should be more than sufficient to cover the recurrent costs of the project. If a farmer or a herder is increasing his income by a greater amount than the costs of the inputs leading to that increase, he should be willing to pay for it. If a project is not designed so as to capture these variable costs then it is poorly designed.

It is true, however, that many projects will not become financially viable immediately, but require a development phase that allows a time for learning how to use new technologies efficiently. Thus the adoption of new technologies, particularly those with substantial capital costs, such as irrigation or animal traction packages, will have negative cash flows in the start-up or development phase. There is, therefore, a need to develop medium and long-term credit institutions which will provide the resources necessary for investment.

(a) **Local Participation**

Recurrent cost problems, as we have seen, have many causes. Local communities have substantial resources, both in cash and kind, which can be utilized to finance the recurrent and capital costs of development projects.

[11] See A. Mead Over, "On the Care and Feeding of a Gift Horse: The Recurrent Cost Problem and Optimal Reduction of Current Inputs," Williams College, Development Studies Program, Research Memorandum, No. 79, Jan. 1981.

In order to mobilize these resources, local communities need to be shown that it is in their interest, that the benefits of the project exceed the costs. Projects which are designed with the participation of local communities are frequently more responsive to local needs and conditions than centrally designed projects and thus are more likely to elicit local support.

Moreover, leaving maintenance and finance to local communities is likely to increase the commitment of the beneficiaries to the project and therefore to insure its sustainability. If it is the local community that is to maintain irrigation ditches rather than a government parastatal, the ditches are more likely to be maintained.

Local communities are also able to mobilize resources in kind and transform them into cash. For example, a water project which saves women's time might be accompanied by a gardening project which converts that time into revenue, part of which could be used to pay for the water.

IV. **Recurrent Cost Analysis**

There are two somewhat separable issues in recurrent cost analysis—

(1) Is a given country presently suffering from a recurrent cost problem?

(2) Is a given country likely to suffer from a recurrent cost problem in the future? The first question is easy to answer conceptually. Are there sectors or projects where expansion of the use of variable factors of production will generate a stream of returns greater than the stream of returns associated with new capital investments? Is repair of a road more productive than building another one? Is an increase in teachers likely to have a greater impact on education than an increase in schools or is underutilization of capital, as evidenced by shortages of books, health workers, and maintenance, a rational response due to more profitable opportunities for scarce resources in other activities?

Answers to these questions require analytical skill, experience, and judgment. There is no formula which will provide a ready solution. If, however, existing projects are underutilized, while there is great difficulty in demonstrating positive net present value of new projects, then it is likely that a recurrent cost problem exists. This is presumably the case for many AID recipients.

Inflationary finance, substantial levels of short-term borrowing, or consistent underfunding of the recurrent costs of development budgets may be signs of a substantial budgetary problem. This budgetary problem is not necessarily identical to a recurrent cost problem, since it includes both revenue and expenditure responses to a deficit. Indeed, it is possible, that a failure to fund the

deficit through compensatory borrowing would be offset by reductions on the expenditure side. Conversely, short-term borrowing may be a sign of the government's intention to avoid expenditure short-falls in adjusting to a deficit.

How does one identify projected deficits? What are the implications of these deficits for recurrent expenditure shortfalls in the future? The place to begin is by dividing expenditure and revenues into broad categories such as is done in Table XI below. Each of these budget categories can then be associated with critical macro variables. By examining past performance, it is possible to relate each of these budget variables to macro-variables, and then, by estimating the future value of the macro-variable one could estimate the future value of the budget variable. Adjustments must be made for changes in policy or exogenous variables such as the exchange rate.

Table XI
Projecting Budget Deficits

Budget	Associated Macro Variable
Revenues	
Direct Taxes	Gross Domestic Product
Import Duties	Imports of dutiable items
Export Duties	Exports of dutiable items
Excise Taxes	Consumption
Profits of Government Enterprises	Gross Domestic Product
Foreign Assistance	Time Trends plus Commitments
Increases in Domestic Borrowing	Gross Domestic Product
Expenditures	
Subsidies	Output of subsidized sectors
Interest and Debt Amortization	Total Debt
Capital Expenditures	Government Plan
Transfers	Gross Domestic Product
General Administrative including defense	Gross Domestic Product
Recurrent Expenditures on Development Projects	Analysis of recurrent costs of Project portfolio

None of this is easy. It may, in many cases, be just as profitable to merely project current trends into the future. Many categories of both revenues and expenditures show remarkable stability. Table XII presents data on temporal variations of key budget categories for a random sample of eight low income AID recipients.

The information in the table was derived from taking the ratio of each budget variable to GDP across each of the seven years and finding the mean and standard deviation of this set of values. If we assume that the random component of each variable is normally distributed, then one can easily calculate a ninety-five percent confidence interval around the mean. For example, education expenditures in Burma have a value of 18% in the table. This means that in projecting into the future, on the basis of 1967-73 data, ninety-five percent of the time the ratio of education expenditure to GDP will be within 18% of the mean value during the 1967-73 period.

There are several items of interest from the table. First, certain countries have much more volatile fiscal behavior than others. Sudan, for example, has a much larger confidence interval for most variables than the average, while Sri Lanka has a much smaller one. For countries such as Sudan a more careful and sophisticated analysis is in order. Secondly, certain expenditure sectors are much less volatile then others, education expenditures being more constant then those in agriculture. Lastly, the totals tend to be less variable then the conponents. Thus one is more likely to be able to project total revenues than customs duties.

Data like those in Table XII can be used either sectorally or globally. For example, over 1967-73, government revenues in Burundi averaged 10.9% of GDP.

One can expect then, with some confidence, that in 1976, revenues would be somewhere between 9.8 and 12% of GDP (given a confidence interval of 10% of the mean). Of course, if there was a change in tax laws or tax collection procedures these estimates would be less firm. In Burundi, over 1967-73, current expenditures exceeded current revenues in only one year, and that by a mere five percent. Consequently, it is likely that total current expenditures will not be allowed to exceed 12% of GDP in 1976.[12] Therefore if an analysis of the current development portfolio suggests that expenditures well in excess of 12% of GDP are required, there is good reason to expect a recurrent cost problem in the future.

At the sectoral level, there tends to be much greater variation, particularly in the agricultural sector. For Sri Lanka, where agricultural expenditures averaged 0.55% of GDP from 1967-1972, and the confidence interval around that average was 18%, or one-tenth of one percent GDP, the funding of a major rural development program during that period that raised recurrent agricultural expenditures to one percent of GDP, would have required a substantial shift in budget priorities.

[12] While data on current expenditures were not available, government revenues for Burundi during 1976 amounted to 11.4% of GDP, within the projected confidence interval. By 1978, however, current expenditures were 14% of GDP, well in excess of the 12% maximum.

TABLE XII

Variation in Key Budgetary Variables, as a Share of GDP, Selected Countries, 1967-73
(95% Confidence Intervals around mean value in percentages)

	Burma	Burundi	Honduras	Lesotho	Liberia	Sri Lanka	Sudan	Tanzania	Average
Current Revenues									
Income Tax	54	30	18	36	16	32	92	28	38
Sales Tax	24	28	26	—	76	36	52	62	42
Customs Tax	32	22	10	122	16	36	80	36	44
Other Taxes	22	26	32	32	28	14	—	30	26
Non-tax Revenue	72	22	42	18	50	26	24	36	36
Total	24	10	10	74	12	14	32	18	24
Current Expenditures									
Defense	12	34	62	—	34	58	46	84	48
Agriculture	38	28	24	41	96	18	18	28	34
Education	18	16	20	18	68	4	12	20	22
Health	18	28	34	26	42	14	18	44	28
Other	18	20	24	14	22	10	44	28	22
Total	12	8	16	12	10	12	34	20	16
Foreign Grants	40	44	—	106	34	—	—	182	82
Capital Expenditures	22	50	70	56	58	14	30	62	46
Total Expenditures	10	10	26	18	18	10	26	32	18

Source: World Bank, World Tables, 1976.

An exercise of this type represents only the beginning. In order to determine the likelihood of recurrent cost problems in the future, one needs to temper simple projections with a great deal of judgment. Is there a new development plan? Is the plan realistic, and what portion of projected investments are likely to be made and over what time period? What is the expected response of the donor community? Is there likely to be a change in government priorities? In revenue collection or tax laws? What are the best guesses of the rate of growth, over the next five years? Of inflation? What's likely to happen to the terms of trade? How will international price changes effect the government budget? Is there going to be a change in the level and type of subsidization?

Recurrent cost analysis is not a simple procedure. The HIID—CRDE study of recurrent costs in the Sahel required enormous inputs of consultants' time and energies (the seven country study on macroeconomic projections is one thousand pages long).[13] The procedures outlined above can be used to indicate where a problem is likely to exist. A quantitative investigation of the size of the problem would require a much more detailed study.

V. Solutions to Recurrent Cost Problems

As noted in Section III, recurrent cost problems exist either because of host government policies or donor policies. Solutions to recurrent cost problems require either increasing the share of revenues going to the recurrent cost budget, reducing the level of investment, reducing the recurrent costs attached to each new investment, or increasing general government revenues (only after careful review of the potential negative effects on productivity and capital formation).[14]

A. Re-examining the Recurrent Cost Coefficient

Where there is a serious recurrent cost problem, one solution is to re-examine the recurrent cost burdens of the project portfolio. The project mix might be changed in the direction of projects with a lower level of recurrent costs relative to investment costs than others. However, if projects have been chosen rationally, such that the current project mix represents the "optimal"allocation of investments, any restructuring will reduce the expected long-run rate of growth. What is the appropriate trade-off between overall project productivity and recurrent cost economizing?

The cost-benefit technique for analyzing projects is readily adaptable to answering this question. Any project will affect the government's budget in two ways—through increased costs and increased revenues. The "r" coefficient is defined so as to measure the stream of recurrent expenditures related to a given project. There is, similarly, what we might call a "c" coefficient, or a cost recovery coefficient, which represents the increases in government revenues attributable to the project. While the cost data should be readily available from the project documents, the revenues are more elusive.

User charges make up one element of cost recovery. The second element is the increase in tax revenues, both direct and indirect, generated by the project. For example, if the project increases farmer incomes, then part of that income will be taxed directly, through income taxes or export levies. Another part will be spent on inputs and therefore custom duties or goods which have excise taxes on them. Finally, part of the income is used to purchase locally-produced goods thus multiplying the income, as well as income, excise, and customs taxes. In most LDC's, because of substantial foreign trade leakages, this multiplier is not likely to be very large.

Thus, any project may be expected to generate a stream of economic costs and benefits, a part of which are, respectively, recurrent government expenditures and revenues. If the country has a recurrent cost problem, then government finances are a constraint to profitable investment.

The appropriate procedure then, is to perform an economic analysis using a shadow price for government revenues, just as one uses shadow

[13] CILSS/Club de Sahel, "Recurrent Costs of Development Programs in the Countries of the Sahel."

[14] Assume, for example, that government revenues (GR) are 15% of GDP, that the current capital stock in development projects (KD) is 25% of GDP, that the share of government revenues going to the recurrent budget of the development sectors (RD) is a reasonable 30% of government expenditures, and that, due to the government's concern with directly addressing basic needs, the "r" coefficient, the annual value of recurrent expenditures associated with a dollar's investment, is 0.2. Then under current circumstances, government recurrent resources available for development projects are equal to RD x GR, or 4.5% of GDP. On the other hand demand is greater than the supply and a recurrent cost problem exists if these resources are more productive than new investments. Moreover, if new projects will generate greater recurrent costs than they will tax revenues, such a problem will persist.

There is a simple relationship here. The demand for resources equals GDP x KD x r. The supply of resources equals RD x GR x GDP. If there is a recurrent cost problem then:

$$GDP \times KD \times r > RD \times GR \times GDP \quad \text{or}$$
$$KD \times r > RD \times GR$$

The solution then is to either reduce demand by reducing KD or r, or increase supply by increasing RD or GR. In other words, the available options include reducing the level of investment, reducing the recurrent cost coefficient, increasing the share of revenues going into the recurrent budgets of development projects or increasing general government revenues.

prices for labor and for foreign exchange. Sensitivity analysis might be used to examine a range of shadow prices and determine under which set of assumptions a project design is acceptable. An example of this procedure can be found in Appendix II.

B. Increasing Donor Resources Going to Recurrent Budgets of Development Projects

Clearly, the most direct method for alleviating recurrent cost problems is financing recurrent costs explicitly. An earlier section of this paper argued that one of the causes of the recurrent cost problem is the limitations of fungibility caused by donor policies. Donors have open to them the option of increasing that fungibility by increasing the degree to which they are willing to finance recurrent costs.

In general, outside of counterpart requirements, AID has been willing to finance certain recurrent expenditures only during project development. The recent decision to extend life-of-project funding to ten years makes more realistic the length of time needed for a project to move from the development phase to an ongoing, revenue generating project which will generate as much recurrent finance as it will recurrent expenditures. At this point, the LDC government would be more able and more willing to take over the financing. Any arrangements of this type will need a careful stipulation of the way in which AID resources can be phased out and host country resources phased in. Before AID becomes willing to increase its funding of the recurrent costs of a development activity, in fact, before the Agency makes an investment decision, it should be reasonably certain that policies affecting that activity are not likely to lead to the project's failure. Otherwise countries will be just as ill-prepared to assume the total funding of recurrent costs at the end of year ten as they often are now at the end of year five.

C. Donor Support of Government Sectoral Budgets

Since overall recurrent cost problems are due to either donor or LDC policies, it is first necessary to analyze the problem and determine its causes. Where LDC policies are not the main causes, or where policy reform is possible, AID should be willing to consider providing general support to the recurrent budget. Among the instruments available for providing such support are cash transfers, CIP's, and PL 480 local currency generations. Such program support can be directed at a particular sector or at the macro level.

The first step in such a program is a macro-level analysis of the recurrent cost problem. At the least one would need time series on government outlays and revenues; an analysis of the government salary and cost structure vis-a-vis the private sector's costs; a discussion of the extent of reliance on user charges, and a discussion of the government's pricing policy for inputs and outputs in the productive sectors where AID is active. Any project paper designed to provide recurrent cost budget relief must be justified in these terms.

Once the causes of the problem have been identified, a recurrent cost budget support program should include a blueprint for policy reform. These policy changes might include a greater reliance on user changes, a reduction in the subsidy level, a shift of government budget resources between sectors, improvement in tax administration,[15] shifting certain activities from the public sector to the private sector, or a change in technologies (For example where government salaries are out of line, it may be appropriate to introduce new personnel categories with training and salaries more in line with the task. Thus, relatively less trained teachers could be used in certain settings, reducing the cost of delivery of education services.)

Lastly, general recurrent cost budget support programs should be, when possible, developed in concert with other donors. The recurrent cost problem is a result of the activities of all donors. Its resolution should involve the concerted action of all donors. Moreover, AID activities in financially strapped LDC's must be planned in concert with other donor activities, since the recurrent cost problem only becomes manifest through the total development program, and not any single portion of it.

It is important to note, that direct funding of recurrent costs, either at the project or budget level, is only justifiable under fairly narrow conditions. These conditions, which have been spelled out in this paper include:

(1) An acceptable policy framework or movement toward such a policy framework;
(2) An assurance that recurrent cost support has higher development impact than new investments;
(3) An inability of the host country to undertake recurrent cost financing;
(4) A carefully phased plan exists for shifting the entire burden to the host government.

D. Reducing the Level of Donor Support

Where recurrent cost problems are due to LDC government policy, and where that policy is not

[15] AID should be willing, where feasible, to support institutional development in tax administration. Better administration can both alleviate budget pressure and reduce the marginal rate of taxation, thus providing greater incentives for entrepreneurial activity, both domestic and foreign.

likely to change, AID should seriously consider reducing the level of activity in the affected sector, or, if necessary, in the general development program. It makes little sense to invest in programs that are predicated on a given level of recurrent financial support, if that support is unlikely to be forthcoming. AID activities, in such an environment, should be, wherever possible, designed so as to be insulated from government budget problems. Moreover, even small pilot projects are of limited value, if the financial resources are not available to broaden their reach, if they are successful.

VI. Conclusions and Recommendations

We have seen that recurrent cost problems are the result of inappropriate policies on the part of donors or LDC governments. The existence of a recurrent cost problem is **prima facie** evidence of a misallocation of resources.

The recommendations for policy that are suggested by the paper can be divided into five categories: analysis, project design, policy reform, reallocation of assistance, and recurrent cost funding.

A. Analysis

1. In order to argue that a given country is suffering from a recurrent cost problem, Missions must provide evidence (not necessarily quantitative) that indicates that the stream of returns to recurrent financing is greater than that to new investments.

2. In determining whether or not there will be recurrent cost problems in the future, it is necessary to carefully project key *ex ante* budget categories. These include:

(a) taxes by various types

(b) non-tax revenues

(c) foreign assistance

(d) expenditure by type

(e) transfers and subsidies

(f) interest and debt repayment

(g) capital expenditures

(h) recurrent expenditures implicit in the development plan

3. Analysis should also include some discussion of the causes of the recurrent cost problem. It is necessary therefore to discuss:

(a) the efficiency of the tax administration system

(b) the degree of subsidization of various programs

(c) the allocation of government expenditures by various categories

(d) the costs and technologies adopted in producing of government services

(e) the degree to which public sector activities are a drain on, rather than a support of, the economy

(f) the impact of government macro policy on recurrent cost problems

4. All Project papers should analyze the recurrent cost implications of the project.

(B) Project design

If design is the cause of the problem, A.I.D. and LDC governments should work to design projects so as to assure that their recurrent cost components are consistent with economic feasibility.

(1) In countries suffering from a recurrent cost problem, the economic analysis of projects should use prices for government expenditures and revenues that reflect the scarcity value of government resources;

(2) Projects should be designed, to the extent possible, to maximize the revenues from service charges (or contributions of labor or in kind) consistent with the capacity of the beneficiaries to pay; and

(3) Where possible, government activities should be turned over to the market economy. This is generally desirable in all agricultural and industrial productive activites as well as marketing, distribution, trade and many services.

(C) Policy Reform

If LDC policies are the cause of the problem, the Missions should:

(1) attempt to persuade governments to make necessary reforms;

(2) enlist the support of the donor community for policy reform; and

(3) provide technical assistance in the form of expertise and training to support reforms, including such areas as fiscal policies and tax administration.

(D) Recurrent Cost Support

If recurrent costs constitute a serious problem and LDC government policies are appropriate and projects designed correctly, or requisite steps are taken to move toward appropriate policies and designs, then Missions should consider funding a portion of the recurrent costs of host country projects through a variety of mechanisms at the project, sectoral or macro levels for a period up to ten years, providing the country agrees to shoulder an increasing share of total costs over this period. Policy performance should be monitored closely and frequently to determine whether such assistance should be continued.

It is important to note, that direct funding of recurrent costs, either at the project or budget

level, is only justifiable under fairly narrow conditions. These conditions, which have been spelled out in this paper include:

(a) An acceptable policy framework or clear movement toward such a policy framework;

(b) An assurance that recurrent cost support has higher development impact than new investments;

(c) An inability of the host country to undertake recurrent cost financing;

(d) A carefully phased plan exists for shifting the entire burden to the host government.

(E) **Reallocation of Assistance**

If the host government refuses to take sufficient action on project design and/or policy reform, then AID should seriously consider reducing the level of assistance to the affected sector or country.

APPENDIX I

A Simple Model of Recurrent Cost Disequilibrium

Let

V_t = Quantity of variable input at time t into public production (e.g., labor, materials, etc.)

K_t = Quantity of fixed Input at time t into public production (e.g., building, roads, etc.)

Q_t = Quantity of government services produced at time t (e.g., # of students educated)

R_t = Total government revenue available at time t

I_t = The amount of revenue allocated to new investment in fixed inputs at time t

W_t = price of the variable input

P_t = price of the fixed input

At any time, e.g., t = 1, the government must decide how much of its revenue should be allocated to purchasing variable inputs, and how much should be allocated to purchasing new capital. Let us assume the following:

(1) The price of government services is the numeraire good, equal to one. Thus Q_t, the quantity of government output is also the value of government output

(2) Output is determined by the following generalized production function; which we will assume is differentiable.

$$(1) \quad Q_t = f(K_t, V_t)$$

where

$$(2) \quad V_t = \frac{R_t - P_t I_t}{W_t}$$

Now assume that the objective function of the government is to maximize the present value of the stream of government output subject to the production function and total revenue constraints.

Let ϱ = the discount rate of the government

Then

$$(3) \quad Q = \sum_{i=1}^{T} \frac{f(K_t, V_t)}{(1+\varrho)^t} \quad \text{where} \quad K_t = K_{t-1} + \frac{I_t}{P_t} \quad \text{and } V_t = \frac{R_t - P_t I_t}{W_t}$$

or

$$(4) \quad Q = \sum_{t=1}^{T} \frac{f\left(K_{t-1} + \frac{I_t}{P_t}, \frac{R_t - P_t I_t}{W_t}\right)}{(1+\varrho)^t}$$

or

$$(5) \quad Q = \sum_{t=1}^{T} f\left(\sum_{i=0}^{t-1} K_0 + \frac{I_i}{P_i}, \frac{R_t - P_t I_t}{W_t}\right) \Big/ (1+\varrho)^t$$

Taking the partial derivative of Q with respect to I_j, and setting the result equal to zero, we get

$$(6) \quad \frac{-P_j f_{2j}}{W_j (1+\varrho)^j} + \sum_{t=j+1}^{T} \frac{f_{1t}}{P_j (1+\varrho)^t} = 0$$

or

$$(7) \quad \frac{P_j}{W_j} \frac{f_{2j}}{(1+\varrho)^j} = \sum_{t=j+1}^{T} \frac{f_{1t}}{P_j (1+\varrho)^t}$$

where

$$f_{1t} = \frac{\partial Q_t}{\partial K_t} \; ; \; f_{2j} = \frac{\partial Q_j}{\partial V_j}$$

The interpretation of the result seems straightforward. The government should allocate resources until the present value of the marginal value product of an additional unit of the variable input is exactly equal to the present value of an additional unit of fixed inputs.

When this decision rule is not followed, either because of LDC government policy which underallocates resources to the variable inputs, or because donors limit the fungibility of their assistance making it impossible for LDC's to allocate resources efficiently, then there is a recurrent cost problem.

Note that there are really two allocation decisions. The first concerns the amount of resources which is to be allocated to public production as opposed to private production. Up to this point we have not investigated that question in this Appendix. The second allocation decision is the choice between fixed and variable inputs, and in terms of our model, a recurrent cost problem exists when

$$(8) \quad \frac{P_j f_{2j}}{W_j (1+\varrho)^j} > \sum_{t=j+1}^{T} \frac{f_{it}}{P_j (1+\varrho)^t}$$

Let us now consider the allocation of resources between public and private production. It is clear that by allowing revenues to vary, so that the government can compete for scarce resources, the optimal allocation rule is:

$$(9) \quad PVMPV^g_t = PVMPV^p_t; \quad PVMPK^g_t = PVMPK^p_t$$

Where

$PVMPV^g_t$ = the present value of the marginal product of an extra unit of variable input into government production

$PVMPK^g_t$ = the present value of the marginal product of an extra unit of fixed input into government production

$PVMPV^p_t$, $PVMPK^p_t$ have similar meanings for private production.

thus the present value of the marginal product of any input should be equal in the public and private sectors.

If government cannot claim enough resources so that its marginal production is as valuable as that of the private sector, then resource allocation is not optimal. The same result holds if the government claims too many resources.

From the point of view of project analysis we are interested in both allocation questions. If either

$$(10) \quad PVMPV^g_t > PVMPV^p_t \text{ or } \frac{PVMPV^g_t}{W_t} > \frac{PVMPK^g_t}{P_t}$$

then the shadow price of government revenue is greater than one.

In calculating rates of return for new projects, the use of such a shadow price for recurrent expenditures and revenues will enable one to make investment decisions so as to economize on recurrent resources (cf. Appendix II for a detailed example).

The model is easily expanded to include three inputs: a fixed input, a locally produced variable input such as labor, and an imported variable input such as petrol.

APPENDIX II

NUMERICAL ILLUSTRATION OF PROJECT ANALYSIS UNDER A RECURRENT COST CONSTRAINT*

We assume three alternative opportunities for immediate investment (realization assumed to occur at time zero or January 1 of the first year) of one billion francs CFA of foreign aid resources, each having an economic lifetime of ten years and each involving equal annual streams (annuities) of net benefits and, where relevant, government recurrent expenditure, both of which are realized on December 31st of the first and succeeding years. Net benefits and recurrent expenditure are stated below in constant prices as at January 1 of the first year.

The projects differ as follows:

I. **Project A** generates a stream of net social benefits equal to F.CVA 250 million, accruing to members of society at large (i.e., not the government). Its operation and maintenance either involve no recurrent government expenditure at all, or else the project generates in each year net additional government receipts, whether directly or at higher levels of the production and distribution chain, exactly equal to government expenditures on operation and maintenance, so that the net burden on the government's recurrent budget remains zero.

II. **Project B** generates a stream of social benefits, net of all social costs except those corresponding to government recurrent expenditure, equal to F.CFA 500 million. Its operation and maintenance impose an annual recurrent expenditure burden, net of incremental government receipts generated directly or indirectly by the project, equal to F.CFA 200 million.

III. **Project C** generates a stream of net social benefits equal to F.CFA 200 million, realized in the form of a net annual contribution of F.CFA 200 million to the government Treasury (i.e, receipts generated directly or indirectly by the project exceded government recurrent expenditure on its operation and maintenance by F.CFA 200 million.)

The present value of each project's net benefits is given by a standard formula, i.e., that representing the present value of an annuity,

$$\frac{1-(1+d)^{-t}}{d},$$

t being the duration of the annuity or project, here equal to ten years, and d being the discount rate, which we will assume here to equal 0.10 or 10%, the whole expression being multiplied times the constant annual amount of benefits. Interest tables show us that

$$\frac{1-(1.10)^{-10}}{.10} = 6.145.$$

Each project's total net present value, subtracting the cost of the investment, is then given by 6.145 **times** net benefits **minus** F.CFA one billion.

Allowing no premium over the normal value of uncommitted government revenue, which amounts to assigning it an accounting price of 1.0, we obtain the following net present values for the three projects:

Project A: 6.145 X F.CFA 250 million − F.CFA 1 billion = F.CFA 536 million

Project B: 6.145 X F.CFA 300 million (= 500−200) − F.CFA 1 billion = F.CFA 844 million

Project C: 6.145 X F.CFA 200 million − F.CFA 1 billion = F.CFA 229 million

Clearly Project B is the preferred alternative, while C gives the least return of the three.

Now we assume a severe budget crunch, such that the Treasury is forced to ration available revenues among public sector claimants, the result being that a significant amount of public sector capital operates below capacity. Using the example cited in the text, vaccination teams are forced to sit idle at dispensary or health ministry headquarters due to lack of fuel to send them into the countryside. Segments of irrigation schemes are closed down for want of funds to maintain the canals. Lack of maintenance likewise causes roads to become impassable, or at the very least users incur a high cost on account of vehicle wear and tear.

In sum, the situation is such that an additional unit of government revenue allocated to any of these uses would bring an incremental return greater than the marginal return to operation and maintenance expenditure that was anticipated at the time the capacity in question was created. This is because the additional revenue brings into operation capacity that otherwise has to lie idle, whereas the respective project plans assumed that revenue would be available to operate all this capacity at an economic level, and that additional expenditure would make the difference only because operation at economic capacity and operation at a slightly more intensive level.

*This example is taken directly from the CILSS/Club du Sahel Study "Recurrent Costs of Development Programs in the Countries of the Sahel."

We assume that the government's planners, viewing the situation from a perspective that covers the whole public sector, estimate that the average unit of additional government revenue, by activating otherwise idle capacity, will create a net benefit equivalent to 1.50 times its amount (nominal value), i.e., an additional million francs CFA of revenue will generate F.CFA 1.5 million of social benefits. This implies an accounting price of 1.5 for uncommitted government revenue, tantamount to an opportunity cost of F.CFA 1.5 for each franc of domestic revenue expended and not recovered in establishing and operating a new investment project.

The calculus for the three projects then changes as follows:

Project A—no net government expenditure or revenue generation assumed, hence no change in calculation of NPV, which remains F.CFA 536 million.

Project B—the net recurrent expenditure burden of F.CFA 200 million now translates into a social cost of F.CFA 300 million (200 x 1.5), reducing the annual net benefit from F.CFA 300 million to 200 million, giving an NPV of F.CFA 229 million.

Project C—the F.CFA 200 million worth of net revenue generated by the project now has a social value of F.CFA 300 million, raising its annual net benefit by F.CFA 100 million to a level of F.CFA 300 million, giving a new social NPV of F.CFA 844 million.

Thus, use of an accounting price for uncommitted government revenue reverses the ranking of the three projects, making C the most beneficial and B the least beneficial.

The same procedure could of course be repeated using alternative values of the accounting price—e.g. 1.7 or 2.0—in connection with a broader sensitivity analysis.

III.A3 (TM 1:46)

A.I.D. Policy Paper

Financial Markets Development

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

August 1988

FINANCIAL MARKETS DEVELOPMENT POLICY PAPER

Table of Contents

Section		*Page*
	EXECUTIVE SUMMARY	i
I.	INTRODUCTION	1
II.	THE FUNCTIONS AND KEY CHARACTERISTICS OF FINANCIAL MARKETS	1
	A. Mobilizing Domestic Resources	1
	B. The Role of Government	2
	C. Efficiency and Depth	3
	D. Integration	4
	E. Promoting Widespread Ownership	5
III.	STATEMENT OF A.I.D. POLICY AND OBJECTIVES FOR FINANCIAL MARKETS DEVELOPMENT	5
IV.	COMPONENTS OF THE A.I.D. POLICY	5
	A. Financial Markets Development Strategy	5
	B. Policy Dialogue	5
	1. Macroeconomic Policies	6
	2. Encouraging and Mobilizing Domestic Private Savings	6
	3. Credit Allocation Policies	7
	4. Legal and Regulatory Constraints	8
	5. Tax Policies	9
	6. Informal Financial Markets	9
	C. Institutional Strengthening and Development	10
	D. A.I.D. Credit Policy	11
	1. The Provision of Equity and Grants by A.I.D.	11
	2. Interest Rates to Private Enterprises and Other Ultimate Borrowers	12
	3. The Relationship Between Donor Funds and the Cost of Capital to Financial Intermediaries	12
	4. Targetting and Guarantying Loans	14
	5. Lending through PVOs and Nonprofit Entities	15
	E. Financial Training and Standards Development	15
	F. New Financial Instruments and Institutions	16
Annex	Glossary of Financial Markets Terms	17

FINANCIAL MARKETS DEVELOPMENT POLICY PAPER

EXECUTIVE SUMMARY

The purposes of this policy paper are to (a) describe A.I.D.'s policy on financial markets development, and (b) provide guidance on the development of A.I.D.'s programs and projects in financial markets.

Effective financial markets are indispensible to the pursuit of sustained, broad-based economic growth. Unfortunately, financial markets development is one of the most complex areas in the development field. Whether financial systems are relatively simple or highly complex, they perform the same broad functions and share the same key characteristics.

—The primary role of the financial system in any economy is to mobilize resources for productive investment. An efficient financial system channels resources to activities that will provide the highest rate of return for the use of the funds. These resources stimulate economic growth; they provide enterprises with the ability to produce more goods and services and to generate jobs.

—Governments in developing countries can and should facilitate financial markets development and provide a policy and regulatory environment that encourages the appearance of competitive forces, encourages the use of a variety of debt and equity instruments, promotes the growth of different kinds of institutions offering a wide range of financial instruments and services to potential savers and investors, and protects the interests of savers by reducing their risks.

—Efficient financial markets promote more widespread ownership of assets in a society. A larger number of citizens in a developing country will thereby have an opportunity to participate in, and enjoy the benefits derived from, the growth of their country's economy.

A.I.D. should promote a system of financial markets that is integrated and relatively undistorted, one that relies heavily on competitive financial institutions, and on policies to facilitate competition. This system should be capable of effectively mobilizing private savings, allocating that savings to investments yielding maximum returns, and maximizing the participation of the general populace. A.I.D. supports developing countries' efforts to (a) design, adopt, and implement policies conducive to the development of efficient, deep, and integrated financial markets, relying primarily on market rates of interest and other terms for the efficient mobilization of private savings and allocation of credit, and (b) build and promote competition between viable private, profit-making financial institutions. A.I.D. can be a catalyst for financial liberalization in developing countries through both the policy dialogue process and project assistance.

A.I.D. can draw upon a broad range of resources to help developing countries build more effective financial markets. Different countries, depending on their stages of economic and financial markets development, may require different kinds of assistance. The primary policy approaches discussed in the policy paper are summarized below.

—A.I.D. too often has designed and implemented projects without adequately taking into account broader issues involving the financial systems in developing countries. In addition, many Missions manage a variety of "credit" projects and other financial markets activities simultaneously. Missions contemplating, or maintaining a continued presence in, financial markets activities should prepare a comprehensive financial markets development strategy paper before or in conjunction with pursuing additional financial markets activities.

—Failure to consider the macroeconomic setting may obscure the forces behind financial developments and lead to inappropriate policy recommendations. Improvements in policies affecting financial markets is an important objective for Missions that are active in the financial markets arena. In those countries in which the macroeconomic policy environment is not conducive to efficient performance of private financial institutions, A.I.D. should (a) urge the host government to adopt more appropriate policies and (b) consider postponing initiation or replenishment of financial markets activities until evidence exists that the host government is prepared to improve the policy environment.

—Domestic private savings should provide the major source of loan resources for financial institutions. Inappropriate policies inhibit prospective savers from relying on the formal financial system. A.I.D. should help developing countries develop and implement policies to encourage, mobilize, and monetize domestic savings.

—Over-reliance on directed credit results in often severe misallocations of scarce investment resources that undermines the strength and viability of financial institutions and retards the growth of financial assets. A.I.D. discourages developing countries from relying excessively on directed credit. A.I.D. should encourage developing countries to rely on market mechanisms to allocate capital to its most productive uses.

—In many developing countries, governments hold nominal interest rates constant. During periods of inflation, real interest rates fluctuate with inflation, and will become negative if the inflation rate exceeds the nominal rate. When the outright removal of all statutory ceilings to deposit and lending interest rates is not feasible, A.I.D. should encourage the host government to adopt specific reforms that permit interest rates to adjust (within an acceptable timeframe) to market levels in a deliberate and timely way.

—In many cases, the existing legal and regulatory framework restricts the growth of financial techniques and limits the ability of financial institutions to maximize their profits by seeking higher yield investments elsewhere. A.I.D. should engage in policy discussions and offer technical assistance, as appropriate, to reduce imprudent, and strengthen prudent, legal and administrative controls on financial institutions, and streamline and simplify the regulatory and supervisory responsibilities of government agencies.

—Strong institutions are essential parts of effective formal financial systems. Improvements in the institutional framework are a means of attaining the objective of broad-based economic growth. The most effective place for A.I.D. to concentrate its resources, after policy reform, is in assistance to promote the institutional development of financial intermediaries that operate in a free, competitive market and other institutions that operate in the financial system.

—A.I.D. has been active in helping developing countries improve their financial systems through the provision of credit. A.I.D. will not take an equity position in a private enterprise. The interest rate to be charged on A.I.D. resources to ultimate borrowers (a) shall, at a minimum, be at or near the prevailing interest rate paid on U.S. Treasury obligations of similar maturity at the time of obligating such funds, to the maximum extent practicable, and (b) should not be less than terms prevailing locally or a rate that approximates the opportunity cost of capital in that country. At a minimum, the interest rate to ultimate private borrowers should be significantly positive in real terms, i.e., when adjusted for inflation. A.I.D. funds provided to financial institutions should carry an interest rate that (a) is at least equal to the cost of local, nonconcessional sources of capital; (b) approximates the cost of lendable resources of comparable maturities from the local private capital market (if such resources exist); and (c) is based on the appropriate rate to the ultimate borrowers.

I. INTRODUCTION

Effective financial markets are indispensible to the pursuit of sustained, broad-based economic growth.* Unfortunately, financial markets development is one of the most complex areas in the development field. Policy perspectives differ, often sharply, and the costs of establishing and implementing poor policies are high.

The purposes of this policy paper are to (1) describe A.I.D.'s policy on financial markets development, and (2) provide guidance on the development of A.I.D.'s programs and projects in financial markets.** A.I.D. should promote a system of financial markets that is integrated and relatively undistorted, one that relies heavily on competitive financial institutions, and on policies to facilitate competition. This system should be capable of effectively mobilizing private savings, allocating that savings to investments yielding maximum returns, and maximizing the participation of the general populace.

II. THE FUNCTIONS AND KEY CHARACTERISTICS OF FINANCIAL MARKETS

The nature and performance of financial systems in developing countries must be judged in relation to an individual country's level of development. Whether these financial systems are relatively simple or highly complex, they perform the same broad functions and share the same key characteristics. These functions and characteristics are discussed below.

A. Mobilizing Domestic Resources

The primary role of the financial system in any economy is to mobilize resources for productive investment. The financial system provides the principal means to transfer savings from individuals and companies to private enterprises, farmers, individuals, and others in need of capital for productive investment. An efficient financial system channels resources to activities that will provide the highest rate of return for the use of the funds. These resources stimulate economic growth; they provide enterprises with the ability to produce more goods and services and to generate jobs.*

Well-functioning and well-developed financial systems encourage savings and allocate resources to higher-yielding investments. Savers can make their surpluses available to investors by, in effect, purchasing financial assets (from a variety of debt and equity claims including entries in a savings passbook from a commercial bank). The financial system mobilizes savings and increases liquidity by providing asset holders with attractive (in terms of yield, risk, and liquidity) financial claims. In the absence of developed financial systems, only investments financed by individual savers or closely-knit groups of individuals would be possible. Many high-yielding investments would not be undertaken and some capital would be invested in activities yielding low returns.

Well-developed formal financial markets offer to savers and investors a variety of short- and long-term savings and investment instruments (often, but not always) through qualified financial intermediaries that enable individuals to make reasonable judgments about the risk and rewards of saving or investing their funds. These instruments effectively package risk and returns so that individuals who wish to participate in appropriate markets can do so, taking into account their own perceived capacity to accept risk. Individuals are able to borrow funds on terms commensurate with the expected risk and return of the investments they wish to make.

*A financial system is composed of many financial markets, each offering different types of financial services, serving different sets of customers, and operating in particular geographic areas. Markets can be classified as involving debt instruments, equity instruments, or foreign exchange (or some hybrid involving more than one of these, e.g., letters of credit). The policy approaches and principles described in this policy paper are applicable to the development of all financial markets.

**The policy guidance presented in this paper apply to the use of all A.I.D. resources (DA, ESF, PL 480, U.S.-owned local currency) and, when practicable, host country-owned local currency. References to forms of A.I.D. activities (such as "project" and "program") are used interchangeably in this policy paper. The policies presented in this document should be applied in concert with those in the A.I.D. policy papers on Private Enterprise Development (revised March 1985) and Pricing, Subsidies, and Related Policies in Food and Agriculture (November 1982); the Guidelines on Terms of Aid (revised October 1985); and the guidance contained in cables 1986 STATE 259310 and 259314 on the private enterprise local currency lending program described in sections 106 and 108 of the Food Security Act of 1985. Additional guidance on the Housing Guaranty Program is provided in the Shelter Policy Paper (February 1985).

* Private enterprises are defined as privately-owned, for-profit business entities. They should be distinguished from private voluntary organizations (PVOs) that are private, nonprofit entities.

Financial systems transform the size, maturity, and risk characteristics of assets. For example, to reduce their risk, investors who wish to finance the acquisition of long-lived capital prefer to borrow at long term. For similar reasons (to reduce their risk), savers seldom are willing to tie up their funds for the long term. Financial systems mediate, *inter alia*, between the short-term perspectives of these savers and the long-term perspectives of these investors. They do so through (1) direct term transformation of maturities by borrowing short and lending long, and (2) indirect term transformation by buying and selling long-term instruments prior to maturity in secondary markets.

Another way to mobilize domestic resources is through the development of the equity or securities market. Equity financing provides an alternative to debt financing; it also offers new opportunities for investors and for broadening the ownership of economic assets. Expanding popular participation is essential to accompishing the aims of A.I.D.'s policies.

B. The Role of Government

The growing inadequacy of financial systems as countries develop often leads to government intervention in the financial system. To the extent that government involvement in financial systems is misdirected, the development of efficient financial markets will be inhibited and the costs of financial intermediation will be increased. Monetary and financial regulatory policies that stifle financial intermediation, creating "financial repression," are the policies primarily responsible for poorly functioning domestic monetary systems and capital markets, and thus for poor rates of growth. Interest rate ceilings on deposits and loans, combined with inflationary rates of monetary expansion, are the most important policies creating financial repression. Other policies adding to this repression are exchange controls, taxation, credit allocation, and heavy reserve requirements.

Government restrictions on freedom of entry almost always reduce the quantity and quality of financial services available to the economy, and thus hinder or distort economic growth. In contrast, competition in banking and financial intermediation tends to limit the spreads between the interest paid by borrowers and that received by depositors. This serves as an incentive for increasing saving and provides more funds, more cheaply, to investors. This competition, when combined with the adoption of liberalized financial sector reforms, enhances the efficiency with which intermediation is carried out.

At the same time, government plays a key role in assuring that financial markets operate effectively. Governments in developing countries can and should facilitate financial markets development and provide a policy and regulatory environment that encourages the appearance of competitive forces, encourages the use of a variety of debt and equity instruments, promotes the growth of different kinds of institutions offering a wide range of financial instruments and services to potential savers and investors, and protects the interests of savers by reducing their risks. Such actions would serve to decrease the transactions costs associated with financial intermediation.

Government should play an important role in the area of private ownership and property rights. Private ownership and property rights arrangements are important elements in determining the extent of an individual's participation in financial markets. When private property rights exist, an individual has exclusive right to use and derive the income from assets, to transfer the assets voluntarily to others, and to be assured that contracts of exchange are enforceable. The absence of these rights makes it difficult for private enterprises and individuals to participate in the financial system.

The proper role of government is heavily conditioned by one key characteristic of financial markets. Unlike markets in goods and most services (in which there is a simultaneous exchange of value), financial markets involve sale and purchase transactions that are separated in time. In a financial market, the product is exchanged for a commitment (for example, in the savings market, a promise to repay savings deposits plus interest), that is, for a promise to act in the future. Although a certain amount of risk is part of any economic transaction (witness the admonition "caveat emptor"), assessing and coping with risk is the essential component of every financial market transaction. The nature of the product involved is in large part determined by the personal characteristics of the actors involved in the transaction. In the early stages of financial markets development, personal judgments of creditworthiness lie at the core of all financial transactions.

The types of policy approaches available could generally be classified in four categories:

(1) "purely" competitive, where government policy is to rely on market forces with limited government involvement even in matters related to supervising, and establishing solvency requirements for, key participating institutions;
(2) competitive but heavily regulated for soundness through extensive use of supervision and solvency rules;
(3) administered market, where government intervenes by allocating finance and structuring institutions, but lets markets set prices within these parameters; and
(4) managed, where government decisions replace market relationships and the enforcement of supervision and solvency policies is minimal.

The mix or balance of policy approaches could differ in a given market through time and among different markets in a given country. Government policies now generally favor administered or managed systems in many of the developing countries in which A.I.D. operates. Recently, however, several developing countries have liberalized their financial markets. They have implemented reforms to reduce the extent of government intervention through *inter alia* state ownership of banks, directed credit programs, and subsidized interest rates. As a result, financial markets in these countries are less distorted and more integrated; they respond more readily to market signals rather than administrative directives.

C. Efficiency and Depth

Financial markets can be effective to the extent that they are efficient and deep. Governments regulate financial markets to promote efficiency and to avoid volatility.

Efficient financial markets (1) mobilize funds from savings with, at the margin, the lowest opportunity cost (adjusted for perceptions of risk) and (2) distribute those funds to investments that offer, at the margin, the highest potential returns (adjusted for perceptions of risk). Taken together, these are the two characteristics of allocational efficiency. Efficient financial markets also mobilize and allocate funds at minimal cost. This is the characteristic of operational efficiency. It is also important to keep in mind that if there are inefficiencies in the market, then prices or costs would not reflect the real information relevant for financial decision-making (price discovery efficiency).

The depth of financial markets is a measure of their strength: deep financial markets are inherently less fragile than shallow financial markets. A commonly used indicator of formal sector financial depth is the ratio of broadly defined money (currency plus demand deposits) to gross domestic product. A low ratio suggests that the formal financial system is a poor mobilizer of funds; combined with strong demand for funds by the public sector, a low ratio makes credit to the private sector very scarce. In many developing countries, formal financial markets are shallow; relatively few people have access to these markets, and the range of available financial instruments is limited.

Friends, relatives, and moneylenders are the primary sources of external finance in a very shallow system. Savings tend to be placed in real assets such as gold or cattle as a store of value. As the system develops, more options are available for yields, maturities, and risks, leading to higher household welfare.

As the system financial develops, prospective investors increasingly can turn to local financial institutions, national financial organizations and, ultimately, international banks and securities markets for additional funds. Each step leads to a more efficient allocation of capital. The resulting increase in the availability of equity and debt funding will enable developing economies to move towards more balanced capital structures of enterprises.

Shallow, formal financial markets do not adjust well to external shocks without collapsing or displaying excessive fluctuations; they are markets in which, *inter alia*, severe market gyrations are fairly common, institutions too often collapse, and "secure" instruments are not, in fact, safe havens for savings. Shallow financial markets also are rather easily subject to manipulation. Low-income developing countries, with their shallow financial markets, have been found to rely relatively more heavily on administrative allocation systems than high-income developing countries.

However, in most of the developing countries in which A.I.D. operates, government policies now appear overly concerned with curbing volatility and inadequately concerned with promoting operational and allocational efficiency. The quest for greater efficiency in the financial markets of developing countries typically means relying more heavily on

market forces rather than on administrative controls.

There is a risk—due to heightened market volatility—involved in the timing and sequencing of introducing liberal reforms. The recent experience of the Southern Cone countries of Latin America is instructive. The main lessons of that experience are:

- financial liberalization should be accompanied by effective supervision of both public and private institutions to avoid fraud, circumvention of sound financial practices, and misuse of funds;
- financial authorities should devalue an overvalued currency before attempting to reform domestic financial markets. Failing to do so will lead to "excessive" borrowing in anticipation of a real devaluation;
- financial authorities should consider carefully the likely effects of rapid reductions in existing interest rate subsidies. Depending on the context, a sudden shift to high real rates may trigger widespread defaults and lead to a collapse of the banking system; and
- financial authorities should pay particular attention to the sequence—the timing—of reforms. For example, authorities may wish to liberalize the international current (trade) account before liberalizing the capital account. Otherwise, depending on the context, the result may be destabilizing short-term capital inflows that could stimulate rapid unwarranted appreciation of the domestic currency.

D. Integration

Effective financial markets are integrated in two dimensions. First, integration can be "vertical." Vertically integrated financial systems are those in which the three principal market clusters (formal domestic markets, informal markets, and international markets) are closely linked. Second, integration can be "horizontal." Horizontally integrated financial markets are those in which market interest rates typically array themselves around a basic reference rate.

Vertically integrated financial systems incorporate informal and international financial markets with formal domestic financial markets. Informal financial markets are especially important in A.I.D.-recipient countries because these markets provide the credit and savings mobilization functions for a major portion of A.I.D.'s target groups (see section IV.B.6.).

Informal financial markets are highly segmented; moneylenders generally exercise spatial monopoly power. Informal financial markets clearly are "interlinked" markets, in that informal financial transactions spill over into transactions in the local land and labor markets (for example, local money lenders often are members of the landed elite and often hire labor at differential rates depending on the indebtedness of that labor). Although assessing the degree to which these interlinked informal financial markets are integrated with formal domestic financial markets is difficult, linkages between the two markets are greater than may be readily apparent. Informal financial markets have links with formal credit through their lines of credit with commerical and development financial institutions. In addition to serving microenterprises and informal sector enterprises, informal financial intermediaries supply those credit requirements of formal sector enterprises that cannot be met by formal financial institutions.

An effective financial market system also should connect domestic financial markets to international financial markets (and to the related commodity trading systems). The presence of effective financial markets in developing countries will encourage foreign investors to consider providing capital (in the form of both debt and equity) for productive investment. Over time, integration with international financial markets will (1) narrow the differences in the cost of funds between markets in different countries and between different instruments, and (2) spread the risks associated with exchange rate and interest rate fluctuations among a larger number of market participants.

In horizontally integrated and efficient formal financial markets, the reference rate, typically the inter-bank rate, is the market rate of a short-term, low-risk financial instrument. Such an instrument is easily available to financial institutions. It typically provides the basic liquidity for the formal financial system, and central banks often use it to gauge the tightness of monetary policies.

Two markets sometimes are closely integrated because intermediaries operate simultaneously

in both; for example, commericial banks operate in both the savings (deposit) and the loan markets. On the other hand, in most developing countries, the government bond market and the market for housing loans probably will not be very tightly integrated.

E. Promoting Widespread Ownership

Efficient financial markets promote more widespread ownership of assets in a society. A larger number of citizens in a developing country will thereby have an opportunity to participate in, and enjoy the benefits derived from, the growth of their country's economy. Development of the equity securities market, for example, provides a means of distributing the ownership of securities more widely among the public, which increases the probability that business ownership will not be confined to a small number of wealthy families or to big industrial-financial conglomerates. Another way to build up widespread ownership is the establishment of contractual savings arrangements through pension funds.

III. STATEMENT OF A.I.D. POLICY AND OBJECTIVES FOR FINANCIAL MARKETS DEVELOPMENT

A.I.D. supports developing countries' efforts to develop financial markets. A.I.D. will encourage these countries to (1) design, adopt and implement policies conducive to the development of efficient, deep, and integrated financial markets, relying primarily on market rates of interest and other terms for the efficient mobilization of private savings and allocation of credit, and (2) build and promote competition between viable private, profit-making financial institutions. The primary source of capital for economic growth should be private domestic resource mobilization. A.I.D. can be a catalyst for financial liberalization in developing countries through both the policy dialogue process and project assistance.

IV. COMPONENTS OF THE A.I.D. POLICY

A.I.D. can draw upon a broad range of resources to help developing countries build more effective financial markets. Different countries, depending on their stages of economic and financial markets development, may require different kinds of assistance. If that assistance is needed to overcome existing constraints in the policy environment, then that assistance should be designed to help resolve, and not compensate for, those constraints. The policy described in this policy paper is Mission-directed, flexible, and closely guided by detailed and comprehensive country studies. It is expected that Missions will concentrate on policy reforms that emphasize greater reliance on competitive, market-based allocation systems and on project assistance to and through private sector institutions. AID/W will help Missions with technical assistance and other assistance mechanisms where it can.

A. Financial Markets Development Strategy

Missions contemplating, or maintaining a continued presence in, financial markets activities should prepare a comprehensive financial markets development strategy paper before or in conjunction with pursuing additional financial markets activities. This strategy paper should (1) develop a framework for financial markets activities based upon host country conditions and the policy and institutional issues raised in this policy paper, and (2) discuss how existing and proposed A.I.D.-supported financial markets interventions in a country interrelate under this framework.

A review of A.I.D.'s credit projects suggest that A.I.D. too often has designed and implemented projects without adequately taking into account broader issues involving the financial systems in developing countries. For example, A.I.D. often provided credit through public and private development banks, credit unions, and PVOs without exploring the need to mobilize domestic financial resources. A.I.D. projects often implicitly accept interest rate ceilings and administratively determined credit allocation mechanisms as incidental constraints on specific projects. In particular, too little attention may have been paid to the reasons why formal credit was not available.

Many Missions manage a variety of "credit" projects and other financial markets activities simultaneously (involving, e.g., micro-enterprise loans, agricultural credit, mortgage credit, and exchange rate reform efforts). These projects are often channelled through an uncoordinated subset of financial institutions, at a variety of interest rates and conditions. Such efforts may promote a more fragmented domestic financial market than might exist without A.I.D.'s assistance.

B. Policy Dialogue

Improvements in policies affecting financial markets is an important objective for Missions that are active in the financial

markets arena. Missions must assess realistically the influence they have in encouraging host country governments to adopt sensitive reform packages. It may be difficult to leverage significant financial policy reforms with sharply limited resources or through a single project affecting only a vary narrow part of the financial system.

Missions should solicit a broad range of local private sector views to ensure that suggested policy changes are responsive to the broader needs of the private sector as well as to the requirements of economic efficiency, and encourage a continuing dialogue between government and the private sector. In a number of developing countries, important elements of the business community believe that their governments do not adequately understand their needs and their roles in the development process. Missions may wish to encourage host governments to publicly develop a strategy to promote their financial markets through an appropriate set of policies. Such a commitment, as well as a continuing dialogue on matters relating to financial markets development, may improve saver and investor confidence.

Missions should coordinate their efforts in financial markets development with multilateral agencies and other bilateral donors. Multilateral agencies and other bilateral donors are working with many developing countries to help improve their financial systems. Multilateral agencies in particular often are especially well-positioned to advocate politically sensitive policy reforms.

1. Macroeconomic Policies

In those countries in which the macroeconomic policy environment is not conducive to efficient performance of private financial institutions, A.I.D. should (a) urge the host government to adopt more appropriate policies and (b) consider postponing initiation or replenishment of financial markets activities until evidence exists that the host government is prepared to improve the policy environment. If a Mission wishes to initiate or replenish a financial markets activity when the macroeconomic policy framework is inadequate, suitable documentation should clearly demonstrate that the Mission has analyzed the effect of the existing policies on the activity's ability to achieve its purpose. Failure to consider the macroeconomic setting may obscure the forces behind financial developments and lead to inappropriate policy recommendations. Among the policies that may need attention are monetary policy, fiscal policy, exchange rate policy, import and export barriers, credit controls, and access to foreign exchange. The reform of a particular policy should be undertaken carefully and in concert with other actions.

Missions should encourage developing countries to adopt investment policies that attract foreign investors and increase the contribution of foreign and local investment to economic growth. Opening markets to foreign direct investment provides ways for these countries to diversify their economies and increase their capital inflows. Efforts to attract foreign investment will, if properly conceived, also mobilize local investment. A.I.D.'s policies on foreign investment are presented in the Trade Development Policy Paper (July 1986).

2. Encouraging and Mobilizing Domestic Private Savings

A.I.D. should help developing countries develop and implement policies to encourage, mobilize, and monetize domestic savings. A.I.D. should encourage developing countries to eliminate interest rate ceilings, which inhibit capital formation and individual savings and encourage capital outflow, and adopt policies that allow interest rates to fluctuate in response to market forces.

Domestic private savings should provide the major source of loan resources for financial institutions. Inappropriate policies inhibit prospective savers from relying on the formal financial system. Instead, they hold more traditional forms of wealth such as land, animals, jewelry, or gold. The result is an aggregate level of savings less than that which could be achieved given improved financial markets policies. Inadequate information, distrust of large and centralized institutions, and various cultural considerations are other important factors that inhibit savers from relying more fully on formal financial markets.

Empirical evidence strongly supports the assertion that the poor in developing countries save. The poor often rely on informal institutions such as investment clubs, savings societies, and rotating credit associations for saving. The informal institutions involved frequently are effective mechanisms for channelling those mobilized savings to

productive uses. Mobilization of domestic private savings is dependent on efficient financial markets and profitable uses of the mobilized funds.

Several actions are needed if a savings mobilization effort is to be successful. Two are particularly important. First, effective interest rates paid to savers should be sufficient (normally positive in real terms, that is, adjusted for inflation) to attract an increasing inflow of funds from private savers; artifically low interest rates produce a bias in favor of current consumption and therefore reduce the incentive to save. Second, the services offered by financial institutions must be easily accessible and otherwise attractive to savers.

Combining savings and lending activities of financial intermediaries offers many benefits, and demonstrates the importance of savings to institutional viability. It reduces some costs, including those of establishing creditworthiness, since financial intermediaries will have better information on and be better acquainted with borrowers through their role as savers. Saver-dominated financial institutions also tend to show steady growth in assets and liabilities, lower loan delinquency, and greater efficiency and financial viability. Borrower-dominated financial institutions tend to show higher rates of loan delinquency, poor rates of growth, perennial liquidity problems, and other weaknesses associated with dependence on external sources of funds.

3. Credit Allocation Policies

a. Directed Credit

A.I.D. discourages excessive reliance on directed credit. A.I.D. should encourage developing countries to rely on market mechanisms to allocate capital to its most productive uses.*

Administrative allocation mechanisms are particularly appealing to governments of very low income countries where money markets are typically very shallow and highly fragmented (between geographic regions, urban and rural borrowers, different loan purposes, large and small enterprises, and classes of borrowers). Governments generally pursue these mechanisms because of political, social, or distributional considerations.

Over-reliance on directed credit results in often severe misallocations of scarce investment resources that undermines the strength and viability of financial institutions and retards the growth of financial assets. Persistent and usually subsidized directed credit programs typically do not adequately reach their intended beneficiaries, limit the access to (and make more costly) credit of firms not in government-designated "priority" sectors, create "moral hazard" on the part of private investors who operate under the expectation that government support will ward off failure, reward inefficient capital-intensive patterns of investment, require administrative burdens that most developing countries are particularly ill-equipped to handle, and discourage savings intermediation. In addition, the allocation of credit may often be compensating for deliberate or accidental inadequacies in the host government's own policy actions.

b. Government-controlled Interest Rates

When the outright removal of all statutory ceilings to deposit and lending interest rates is not feasible, A.I.D. should encourage the host government to adopt specific reforms that permit interest rates to adjust (within an acceptable timeframe) to market levels in a deliberate and timely way.

In many developing countries, governments hold nominal interest rates constant. During periods of inflation, real interest rates fluctuate with inflation, and will become negative if the inflation rate exceeds the nominal rate.

Countries that have consistently maintained positive interest rates and have an adequate number of institutions that issue attractive financial instruments show a higher rate of growth in their financial assets and have deeper financial intermediary systems than countries that have low and/or widely fluctuating levels of real interest on deposits. Positive market-determined real interest rates generally are associated with the development of sound and self-sustaining financial systems.

Interest rate ceilings often are imposed by governments to protect the borrower from "unscrupulous" lending practices. Yet, lending to large numbers of small and widely

*The "market-determined" or "market-clearing" rate for credit is used throughout this paper, even though its common meaning (the rate at which the supply and demand for credit are in balance with a minimum of government interference) is often not applicable in developing countries where governments exert a great deal of control over financial and related markets.

dispersed borrowers (e.g., small, rural entrepreneurs) normally involves relatively high administrative costs per loan that cannot be passed on to the end-borrower because of the interest rate ceiling. Consequently, it becomes unprofitable for financial institutions to lend to these borrowers.

Imposing interest rate ceilings, no matter how well-intentioned, often results in reductions—not increases—in the availability of formal credit for specific target groups. Local financial institutions handling the subsidized credit can be expected to allocate the credit in accordance with their appraisal of risk and profitability for themselves and thereby improve the quality, but not expand the dispersion, of their loans. Subsidized interest rates also encourage greater use of capital-intensive production techniques by making loans for capital equipment less costly, and, consequently, decrease employment per unit of capital employed.

c. Credit Collateral Requirements

A.I.D. should encourage financial institutions to seek alternatives to fixed and high collateral requirements (such as adopting flexible collateral requirements, charging higher interest rates, lending to groups of borrowers, or establishing special small loan windows).

Formal lending institutions (e.g., banks, credit unions, savings and loans, and finance companies) frequently establish loan collateral requirements that effectively direct credit to favored groups of individuals or enterprises. Collateral requirements often are very high (ranging from 150% to 200% in most developing countries) and may be limited to certain types of collateral (e.g., land). Where interest rates are artificially low, collateral acts as a screening mechanism to discriminate among prospective borrowers. High collateral requirements also may be derived from lender concern about political and economic uncertainty and a lack of familiarity with certain potential borrower groups.

4. Legal and Regulatory Constraints

A.I.D. encourages host country governments to review the legal and regulatory framework affecting their financial systems. A.I.D. should engage in policy discussions and offer technical assistance, as appropriate, to (a) reduce imprudent, and strengthen prudent, legal and administrative controls on financial institutions; (b) streamline and simplify the regulatory and supervisory responsibilities of government agencies; and (c) improve the capabilities of regulatory bodies to enforce appropriate laws and regulations.

In many cases, the existing legal and regulatory framework is designed to ensure proper banking practices. However, some controls often restrict or repress the growth of financial techniques and limit the ability of financial institutions to maximize their profits by seeking higher yield investments elsewhere. These controls include, *inter alia,* time limits on deposits; maximum amounts for certain deposits; restrictions on the types of institutions that can receive certain types of deposits; and entry requirements in the banking sector. Some of these measures manifest themselves as implicit taxes on financial intermediaries (see section IV.B.5).

Legal codes and regulations of developing countries are often inadequate on such issues as security of assets, title to property, property transfer, taking possession of collateral on loans in default, and sharing ownership of assets. The result is that under existing laws (a) it is often difficult to broaden the range of financial instruments and securities available in the market; (b) there are limits on when and at what price companies can issue securities in public offers (inhibiting public offerings), and interest that can be paid (discouraging savings); (c) securities cannot be easily transferred among holders, and often a company has the power to refuse transfer; and (d) investors have inadequate rights and protections.

Proper government regulation is beneficial to lenders, borrowers, and investors. For example, regulation of securities may increase investor confidence in equity shares. Reasonable standards of investor protection, such as adequate accounting standards and rules of financial disclosure, protect securities investors and are critical to the successful functioning of a capital market. Fair enforcement of contracts protects investors, lenders, and borrowers. Deposit insurance encourages individuals to save and deposit their funds. The removal of market entry barriers and the resulting increased competition in providing financial services generally increases the quantity and quality of financial services available to savers and investors. Responsible regulation of private banking and other financial institutions may remove some of the host government's excuses for nationalization of financial

institutions and resistance to privatization of state-owned financial institutions.

It should be recognized also that the judicial and enforcement systems are weak and inadequate to settle disputes. Enforcement of rules and regulations can be just only with a fairly administered adjudicatory mechanism including means of appeal.

5. Tax Policies

As part of their financial markets development strategy, Missions should review their host country's tax structures to assess their roles in the development of the financial system. Missions should encourage host governments to change restrictive tax laws and adopt tax policies that provide a suitable tax environment for financial markets development.

In some countries, tax measures inhibit financial markets development and restrict capital formation by increasing the cost of financial intermediation and reducing the financial system's flexibility due to the reduced amount of funds available for lending and, in turn, for investing. Financial intermediation is subject to explicit and implicit tax measures that are not applied to other sectors of the economy. For example, some governments impose an explicit transactions tax on the value of each financial transaction undertaken by a financial institution. Implicit taxes consist primarily of requirements for the maintenance of high reserve levels and forced portfolio investments on low yielding government securities.

In addition, special tax preferences for certain forms of investment discourage savers from investing in those that are not so favored.

A number of tax measures may improve financial intermediation and capital formation. These include, *inter alia*, lowering the explicit and implicit taxes levels imposed on financial intermediaries, and adopting lower marginal tax rates for corporations (which promotes economic efficiency and equity investment, and may reduce capital outflows), and for individuals (which encourages savings rather than consumption). In the absence of lower tax rates, numerous measures can be explored that could encourage greater savings and investment. These efforts will involve substantial policy debate, as financial markets development may conflict with other host government goals, such as raising short-term tax revenue.

6. Informal Financial Markets*

A.I.D. should encourage the host government to adopt specific reforms that increase access to formal sources of credit. A.I.D. should sponsor studies on the nature and functions of informal financial markets. As appropriate, those lessons should inform the design of projects and programs involving formal financial markets.

In many developing countries, the common requirements and practices of formal financial institutions make access to credit and other financial services difficult and expensive. As a result, there remain in place often sizeable informal financial markets. Typically, informal financial markets comprise professional and nonprofessional money lenders (often relatives and friends), local bankers-cum-merchant middlemen, private pawnshops and finance firms, personal and business fixed fund and rotating savings and credit associations, landlords, and the more prosperous agriculturalists. Although heterogenous in composition, these intermediaries share some typical economic characteristics including the predominance of cash transactions, freedom from official registration and regulation, ease of entry or exit, small scale of operations, and the multiple-interest relationship (financial and socio-cultural) between lenders and borrowers. They are found in both rural and urban areas, and can be national in scope, such as the curb market in South Korea, or international in scope, such as the Hundi system prevalant throughout South Asia.

Informal financial markets transactions generally take place in an unregulated environment. Some elements of these transactions may be very efficient. They have at best limited connections with monetary authorities (for example, they are not subject to reserve requirements and governments exercise no direct fiscal controls over their activities). However, information of the nature and functions of informal financial markets is woefully inadequate. Important lessons may be derived from careful study of their behavior.

The activities of moneylenders in informal financial markets are often abhorred since interest rates charged in the informal financial markets often are higher and for shorter

*The informal sector refers to those business entities that operate outside formal economic and governmental structures and range in size from the small and labor-intensive enterprise to relatively large and capital-intensive enterprises. Women are widely represented in the informal sector, particularly at the small-scale range of the spectrum.

terms than in the formal markets. Yet, growing evidence suggests that the implicit and explicit costs and difficulties associated with formal credit sources often are higher than are the nominally higher costs for funds obtained in the informal markets.

A.I.D.'s assistance to the informal sector has historically been in the form of project-based credit and technical assistance. Although many A.I.D. programs directed at micro-enterprises and informal sector enterprises have demonstrated that these enterprises are reliable borrowers and can be reached cost-effectively, studies have shown that providing credit alone to microenterprises only rarely produced self-sustaining gains; increases in income were short-lived.

Informal sector enterprises often face a policy and administrative environment that contains serious market access and entry barriers. Some macroeconomic policies have a negative impact on informal enterprises and serve as entry barriers to the formal sector. These issues should be addressed within the framework of A.I.D.'s assistance to the informal sector.

A.I.D. should also continue to encourage formal financial institutions to serve the same clientele served by the informal financial markets. In the process, the more efficient formal markets gradually displace less effective informal markets. The best examples are those involving the extension of formal financial systems to better serve the growing financial demands of small farmers and small-scale entrepreneurs. This approach depends for its success on the truth of an assumption that formal financial markets are more effective than informal institutions under appropriate circumstances. Although this assumption is generally borne out over the long run, it may not be correct in some markets in the short run.

To facilitate graduation to commercial borrowing, A.I.D. should foster the involvement of formal financial institutions in the informal system. For example, it may be useful to have a representative from a local private bank involved in an A.I.D.-sponsored informal sector lending program conducted through a PVO. This might facilitate an informal enterprise's graduation from the A.I.D. program to commercial banks by increasing the bank's familiarity with the borrower (and much of that segment of borrowers) while establishing a credit history in which the bank has confidence.

C. Institutional Strengthening and Development

Strong institutions are essential parts of effective formal financial systems. The most effective place for A.I.D. to concentrate its resources, after policy reform, is in assistance to promote the institutional development of financial intermediaries that operate in a free, competitive market and other institutions that operate in the financial system. It should be kept in mind that improvements in the institutional framework are not ends by themselves, but only a means of attaining the objective of broad-based economic growth.

Although particular country situations differ, private sector financial institutions are generally more efficient than public institutions for channelling assistance to individual private enterprises and for mobilizing domestic resources in support of financial markets because they:

- have to depend to a greater extent on their capacity to attract nonconcessionary savings and to engage in new financial activities because of their more limited access to concessionary resources;
- are more innovative in reducing transaction costs and spreading the costs of bearing risks; and
- have been able to better avoid projects of dubious profitability (although sometimes to an imprudent extreme).

A.I.D. should give priority attention to strengthening the private financial system (through which A.I.D. resources should be channelled) and those private institutions that have a reasonable prospect of being self-sustaining. It is preferable to expand the capabilities of existing private financial institutions rather than establish new institutions. A.I.D. should encourage well-run, existing financial institutions to add new types of financial activities to their traditional operations rather than create new institutions to accomplish particular development objectives. Diversification allows institutions to overcome the problems of scale associated with over-specialization, especially in low-income countries with small financial markets.

Greater attention should be directed to structuring assistance to financial institutions to improve their (1) prospects for viability after A.I.D.'s assistance has been terminated, and (2) operations in ways that would enhance their own financial strength, growth prospects, and contribution to savings mobilization and credit allocation performance. Examples of measures meriting close attention

include cost controls, loan application appraisal techniques, reasonable collateral and other safeguards to protect loan contracts, good collection records, business services, and deposit-taking functions. For self-sustaining viability, financial institutions in developing countries should move toward mobilizing their funds from the domestic economy.

Missions should be alert to the risks of overemphasizing the supervision of the uses of credit, as this sometimes results in the neglect of potentially more important objectives of credit projects. External assistance, in the form of technical assistance or staff training (rather than capital for making loans) may help these institutions develop their own capabilities.

In a free market, financial institutions generally organize themselves according to the opportunities they see to meet the different needs of savers and users of funds as well as the changing patterns of savings, fiscal conditions, and institutional arrangements. A.I.D.'s programs and projects should be sufficiently flexible to allow for the disbanding of inefficient entities, restructuring, or the merger of institutions as appropriate. For example, institutions may properly merge or go out of business when there is insufficient market demand to support many separate institutions.

On a case-by-case basis, A.I.D. may help to establish new financial institutions (including special purpose institutions) in areas where private institutions have not been established despite a favorable policy environment and other supporting factors. However, A.I.D. should carefully study each situation and weigh available alternatives prior to proceeding with the new entity. Where existing private financial institutions are capable of performing the desired activity, the establishment of a new trust or trust fund to serve as a financial intermediary for on-lending or equity investment should be avoided.

An unwarranted increase in the number of financial institutions can reduce the success of institutional development. Since financial systems in most developing countries are shallow, special purpose institutions could affect adversely the ability of commerical institutions to attract natural clients. The creation of parallel and costly institutional structures should, therefore, be discouraged, particularly in smaller countries.

Before establishing new financial institutions, A.I.D. should review the existing financial system to determine whether: (1) financial intermediation is being provided at a reasonable cost; (2) financial institutions are providing an appropriate mix of services for market demands; (3) the level of competition among various institutions is adequate; (4) the financial stability and structure of the various institutions is appropriate for their types of financial activities; and (5) experienced management is available.

D. A.I.D. Credit Policy

A.I.D. has been active in helping developing countries improve their financial systems through technical assistance, training, studies, policy dialogue, and the provision of credit. A.I.D.'s credit programs and projects (1) support new development finance institutions; (2) help existing banks expand their traditional short-term lending operations to add medium- and long-term lending; (3) increase the credit resources available for financing priority development activities; (4) eliminate impediments to capital movement among regions or sectors; and (5) open up access to formal credit to disadvantaged borrowers.

1. The Provision of Equity and Grants by A.I.D.

As established in section 635(g) (3) of the Foreign Assistance Act of 1961, as amended, and section V.D. of the Private Enterprise Development Policy Paper, A.I.D. will not take an equity position in any private enterprise.* Grants to private enterprises in developing countries are permitted to finance direct training and technical assistance, although such assistance should be programmed in a way that provides competitive access for many enterprises rather than one enterprise.**

Owners' equity is important during the start-up phase of an intermediate financial institution (IFI) or other private enterprise as it

* Section 635(g) (3) of the FAA restricts A.I.D. from directly purchasing equity securities, although A.I.D. does have limited authority to purchase convertible debt securities and may convert them or otherwise obtain equity securities through such means as the enforcement of liens and pledges. Legislative guidance on this subject extends back to the Mutual Security Act of 1954, as amended, and the Development Loan Fund, one of A.I.D.'s predecessor agencies.

** This language refers to private enterprises that are not IFIs. A permitted use for grants to IFIs is discussed in section IV.D.3.a. below.

provides permanent finance with no contractual payments. Owners' equity is the financial stake put at risk by each of the owners, originating from each owner's desire to earn a return on his share of equity higher than alternatives for which he could have used the funds.*

A number of reports have characterized A.I.D.'s involvement in IFIs as providing "quasi-equity." The quasi-equity instruments usually referred to, such as debentures, are debt instruments. Any confusion between equity and quasi-equity may have arisen because A.I.D., in the short run, may perform like an owner of equity by insisting that a portion of an IFI's on-lending portfolio (generally the capital available from A.I.D.) contain loans to an A.I.D. target group.

2. Interest Rates to Private Enterprises and Other Ultimate Borrowers

The interest rate to be charged on A.I.D. resources to ultimate borrowers (a) shall, at a minimum, be at or near the prevailing interest rate paid on U.S. Treasury obligations of similar maturity at the time of obligating such funds, to the maximum extent practicable (it should be borne in mind that use of the U.S. Treasury rate is moderately concessional); and (b) should not be less than terms prevailing locally or a rate that approximates the opportunity cost of capital in that country. If interest rates, collateral requirements, or repayment periods are administratively imposed by the government, the terms agreed to in A.I.D.-supported activities will be part of a planned effort to encourage governments to move progressively toward market terms. At a minimum, the interest rate to ultimate private borrowers should be significantly positive in real terms, i.e., when adjusted for inflation.**

Where practicable, the interest rates and associated fees charged to the sub-borrower by an IFI should cover all of the IFI's costs of lending, such as the costs of funds mobilized or borrowed; the normal premiums for the higher risks of term loans or devaluation risks for loans denominated in foreign currency; a loan loss reserve; the administrative costs of providing loans to end borrowers (which usually are high as A.I.D. generally tries to service the credit demands of a large number of small borrowers); any extraordinary costs of non-bank services furnished the sub-borrowers or of supervising the sub-loans; and a reasonable profit margin for the IFI. Interest rates to be charged on A.I.D.'s direct loans to private enterprises should be set within the context of this effort.

Special circumstances for concessional assistance are discussed the Private Enterprise Development Policy Paper (section V.D.); however, concessional rates should not be used to encourage private enterprises to undertake activities that are not commercially feasible at market rates. If there is little expectation that a needed product or activity is not commercially viable, then Missions should consider the use of a contracting mechanism to one or several firms to undertake the particular activity, rather than introduce new distortions into the financial market.

Experience shows that in countries in which private business is overshadowed by subsidized state-owned enterprises (SOEs), the financial market is severely handicapped and limited. SOEs often consume much of the total domestic credit available. When A.I.D. extends credit to SOEs, loans to SOEs will be at the same rate charged to private enterprises, and are to be provided in the context of the privatization guidance contained in the Private Enterprise Development Policy Paper (section V.F.).

3. The Relationship between Donor Funds and the Cost of Capital to Financial Intermediaries

a. Interest Rates

A.I.D. funds provided to financial institutions should carry an interest rate that (1) is at least equal to the cost of local, nonconcessional sources of capital; (2) approximates the cost of lendable resources of comparable maturities from the local private capital market (if such resources exist); and (3) is based on the appropriate rate to the ultimate borrowers. All IFIs (regardless of whether the owners are public or private, joint public/private, or PVOs) should be treated as private enterprises for

* A donor, such as A.I.D., has two immediate problems in trying to use its funds as equity. First, a donor's principal motive is not to earn more than an average return on its funds. Second, a donor sees itself as a catalyst to an IFI or a private enterprise, not a long-term member of the board. A.I.D. cannot act as an owner of equity unless it internalizes market-based, entrepreneurial behavior in its involvement in the business entity. A.I.D. would then have to direct its funds to the business entity that offers A.I.D. the best prospects for the highest return.

**The opportunity cost of capital represents the value of the best alternative use of the capital, or the opportunity that is sacrificed for a particular use of the capital.

the purpose of determining interest rates on loans to them because they are selling services in commercial markets and are capable of earning revenue.

Market-based interest rates on loans to IFIs are an essential component of financial markets development. Historically, A.I.D. projects that provided low interest (or interest-free) loans to IFIs have developed maintenance of capital value problems in later years. These relatively low nominal interest rates were often combined with moderate to high level of inflation and resulted in negative real rates of interest. Consequently, these projects have built-in automatic financial drains. Interest rate subsidies lead to substantial recurrent cost problems. It is difficult to wean IFIs from subsidies.

A financial institution's usual sources of capital for on-lending are equity capital, debt instruments, borrowings from the Central Bank, and retained earnings. The provision of donor funds provides three initial benefits. First, donor funds provide additional capital to a financial system that has little or no access to external funds and cannot meet capital demand with its domestic resources. Second, the addition of donor funds to the capital base decreases the aggregate cost of funds in the economy. Third, donor funding to the financial sector provides new foreign exchange to the Central Bank.

When a donor provides capital to an IFI at terms below that which the IFI must pay to attract depositors, the IFI may deemphasize its acquisition of deposits from local sources and seek to increase its access to additional donor resources as deposits become relatively more expensive. At the same time, a relatively large spread between A.I.D.'s loan terms to the IFI and the on-lending terms may enable IFIs to operate profitably with a significant percentage of their loan portfolio in arrears or default, and will reduce the pressure on the institution to expand volume and services. This large spread may reduce the IFI's overall market effectiveness and efficiency, and discourage its aggressiveness in other financial activities. A.I.D. needs to balance this cost against the goal of wanting these IFIs to develop a more aggressive risk profile in their loan portfolios.

A.I.D. needs to make more realistic determinations of the costs of carrying out A.I.D.-required activities when developing credit projects. If it is necessary to make adjustments (concessional assistance) in the terms of A.I.D.'s assistance to the IFI to hedge agreed-upon risk (although not necessarily the total risk) or cover the costs arising from meeting A.I.D.'s programmatic objectives, then the value of the adjustments shall be equal to, but not greater than, the actual costs incurred by the IFI.* This will enable the IFI to cover the costs of A.I.D.-sponsored activities and earn a return that, since it is comparable to other returns earned by the IFI, will not discourage the IFI from pursuing its non-A.I.D. activities (such as deposit-taking).

If the cost of the institution-building activities (such as training IFI employees) occurs primarily in the early stage of an IFI project, it may make sense to identify such costs as separate components of a project and to finance these with grant funds, rather than have such costs spread over the term of loan repayment. This approach may be preferred if it is desired that the institution-building activities should proceed before the on-lending activities can generate revenues. Another approach is to provide technical assistance to reduce loan transaction costs in the credit delivery system. A concessional loan would not be appropriate for handling long-term differences in transaction costs between loans to different types of end-borrowers.

If the A.I.D. loan to the IFI is to be concessional, then the grant component of the loan should be identified, analyzed, and its value fully reflected in program or project documents. A.I.D. must justify fully, on a case-by-case basis, the use of loan subsidies (and, as appropriate, grants) to IFIs (including PVOs that act as IFIs).

If the spread between the cost of the funds from A.I.D. and the IFI's on-lending rate is too large, then the IFI receives a windfall profit. If the spread is too small, then the IFI will not disburse the funds, or will not disburse them to the clientele targeted by A.I.D. Thus, the interest spread is a critical financial

*These costs generally include the costs of analyzing and monitoring loans and maintaining a loan loss reserve. The adjustments to A.I.D.'s assistance generally include grants, reduced interest rates, or extended grace periods. Programmatic objectives may include making credit available to private enterprises that would not be able to obtain formal financing in the absence of A.I.D. support (additionality), encouraging an IFI to provide term loans, or providing services to a borrower that are not normally part of a loan agreement (such as business advisory services). Determining these costs may be a difficult task; Missions may wish to obtain expert assistance to conduct the appropriate analyses.

parameter in an IFI project. Missions may wish to consider lending their funds to an IFI at a floating interest rate if A.I.D.'s funds are to be disbursed over a long period of time.

b. Foreign Exchange Risk

The issue of foreign exchange risk presents a special problem. There are certain situations in which private financial institutions are unwilling to accept dollar loans because of the risk of devaluation. They are also afraid that they will be unable to convert their local currency repayments into dollars because of foreign exchange limitations. There are several ways to deal with this problem.

A.I.D. often utilizes a two-step loan that passes its financing through a host country's government entity (e.g. Central Bank) before the funds are on-lent to ultimate borrowers. The dollar loan is made directly to the government which assumes responsibility for its ultimate repayment and the dollars or the local currency equivalents are then on-lent through the IFI to the ultimate borrowers. This procedure allows internal on-lending arrangements to be structured so that the government can continue to bear all the risk of devaluation, or can pass all or a part of the risk to the IFI and then to the ultimate borrowers. In this two-step process, the interest rate charged to the IFI by the government entity could reflect the real cost of loanable capital to the IFI within that developing country, including the foreign exchange risk. Alternatively, the foreign exchange risk can be shared in varying proportions between two or all three of the participants. It should be noted, however, that in some instances the involvement of the host government in the transaction may discourage private IFIs from participating in the A.I.D.-sponsored activity.

The A.I.D. dollar loan also may be made directly to the IFI. The loan arrangement should be structured to adequately protect the IFI from the high risk of future currency devaluation and to insure the IFI's solvency. Therefore, the credit program should be structured so that all or most of the risk is shifted forward to the sub-borrowers. In high-risk situations this could restrict on-lending to export activities that would earn the foreign exchange needed for repayment.

In both the two-step or direct loan approach, the charges to the end borrower of a loan denominated in local currency may include a contribution to a reserve fund held by the IFI that could be used to offset any deficiency in the local currency loan service receipts in the event of devaluation. Also, in both approaches, the on-lending rate to the ultimate borrower should still be determined by the guidance in section IV.D.2.

Many ultimate borrowers do not require dollars. In these instances, they are unwilling to accept the foreign exchange risk associated with dollars. A.I.D. should utilize local currency financing wherever possible in credit projects.

c. Parastatal Financial Institutions

Many governments own or control many of the suppliers of finance in their respective countries. Missions should refer to the Private Enterprise Development Policy Paper (sections V.D. and V.F.) for additional guidance on dealing with parastatal financial institutions. The guidance in section V.D. states that "A.I.D. funds provided to financial institutions should avoid introducing government ministries or parastatals into the on-lending approval process where such involvement does not now exist. Furthermore, such projects should seek to extract government ministries and parastatals from the process if they are now so involved."

4. Targetting and Guarantying Loans

Targetted credit projects typically enlarge the role of government in financial markets and further distort, or continue to displace, market allocation of capital. Missions should consider such projects (a) after they have determined that there are no policy, institutional, or cultural constraints discouraging the extension of credit to the target group, or (b) as a way of encouraging host governments to correct policy and other constraints where they exist and helping private financial institutions develop some expertise and experience with delivering financial resources to intended target groups (possibly with the concomitant provision of training and technical assistance).

Directed credit projects appear to be attractive mechanisms for assisting A.I.D.'s target groups. However, there is some skepticism over whether targetting of A.I.D. loan resources actually accomplishes its intended purpose.

The fungibility of money makes it difficult, if not impossible, to attribute measurable increases in the output or incomes of targeted borrowers to A.I.D. credit activities. In

addition, directed credit activities may contravene efforts designed to improve the market behavior and performance of the financial system and mitigate the likelihood that, over time, A.I.D.'s directed assistance will be replaced by the capability and interest of the indigenous financial system itself to service the needs of the target group. Great care must be exerted to ensure that A.I.D.'s assistance is designed in a way that does not discourage or preempt private sector initiative in this area (especially where this initiative has developed without A.I.D. assistance). Studies have also found that the costs associated with the administration of targetted loans through rural finance institutions, for example, are many times larger than the estimated private lender costs for the simpler task of establishing creditworthiness of borrowers. Finally, the time associated with monitoring and recordkeeping for the donor diverts the time and skills of the financial institution's staff away from profit-generating activities.

A.I.D.-sponsored guaranty activities also risk distortions of market forces and the efficient allocation of capital. For instance, A.I.D.'s objective in a guaranty project designed to redirect credit to rural enterprises (covering the extra risks of lending to the target group), usually requires that credit be redirected away from urban enterprises and towards rural activities. This may reduce much-needed investment funds in urban areas where unemployment rates are extremely high.

Yet, guaranties may be appropriate when the general policy and institutional environment is supportive and lenders retain their traditional inhibitions in developmentally important areas (such as encouraging new, higher-risk, longer-term lending, or lowering or changing collateral requirements). Since guaranty programs should facilitate breakthroughs in new lending patterns and are not meant to substitute for unaddressed structural inadequacies in financial markets, the case for their introduction must be well-justified and the size and duration of such programs should be limited.

5. Lending through PVOs and Nonprofit Entities

A.I.D. should rely upon PVOs and non- or not-for-profit groups for lending only when private, for-profit financial intermediaries capable of performing the desired activity do not exist, or when PVOs are used as part of a Mission's financial markets strategy to involve the private financial banking system in on-lending to the target group (in a way that does not discourage or preempt private sector initiative in this area). PVOs or other non- or not-for-profit groups are not to be utilized for making equity investments. PVOs should lend at rates consistent with the guidance stated in section IV.D.2.

Some private voluntary organizations (PVOs) have special advantages in working with micro and small-scale enterprises because the PVOs are flexible and in touch with the poor and their problems. Some PVOs can offer financial assistance to enterprises or individuals not reached by formal sector credit markets and can collaborate with banks and local financial institutions to establish credit systems for those needing small or short-term loans. The use of PVOs and a combination of technical assistance and credit are often effective in reaching A.I.D. target groups such as rural enterprises and women.

Establishing financially autonomous institutions to manage credit, training, and technical assistance programs and projects often is an important component of a good financial markets development project. To the extent that PVOs act as IFIs, they should follow lending and repayment collection practices based on market-oriented and capital preservation principles. In situations where there has been no experience with lending to micro and small-scale enterprises, PVOs can demonstrate to financial institutions how lending to the poor may be profitable. Where feasible, A.I.D.-financed projects should include mechanisms to graduate beneficiary enterprises from utilization of resources provided from PVOs to borrowing from formal sector institutions.

E. Financial Training and Standards Development

A.I.D. should emphasize to a developing country's public and private sectors the importance of (1) adopting adequate training requirements for accountants and auditors; (2) establishing generally accepted accounting principles and auditing standards, and comprehensive uniform financial reporting and public disclosure requirements; and (3) maintaining a proper balance between self-regulation and public regulation of these matters. A.I.D. also should support efforts to train accountants, auditors, and others involved in finance. Adequate accounting, financial analysis and reporting, and auditing are critical to a properly functioning market-

based financial system. Without these skills, it is not possible to determine the true position and profitability of enterprises. Accounting and auditing principles should be standardized and widely accepted.

F. New Financial Instruments and Institutions

As economies develop, credit demands become more complex and the expanding demand for physical capital requires credit that varies by the length of time required (short-, mid- or long-term) as well as the end-use (consumer, investment, risk capital, venture capital, mortgage, etc.). Where delivery and marketing systems and government policies are satisfactory, formal financial institutions generally evolve to satisfy these more complex needs. However, in most developing countries the strength of demand for different types of credit exceeds the financial sector's capacity to diversify and develop the institutions needed to respond.

As appropriate, Missions should develop and pursue a policy dialogue agenda with host governments that encourages development of capital markets and associated intermediaries in, for example, equity securities. In most poor developing countries, securities markets are effectively absent and their development is not a high priority. Capital market intermediaries (primarily primary and secondary securities markets) are often inadequate for the development of new equity instruments and the transfer of equity shares and bond instruments. Even in some relatively sophisticated countries securities markets are extremely thin: transactions in stocks are negligible; medium and long term bond markets are shallow; and institutional investors are not a major presence. Therefore, capital markets have little opportunity to contribute to savings mobilization and economic growth and enhance the country's participation in international capital or equity transfers. A sustained effort to develop securities markets may be warranted in many A.I.D.-assisted developing countries. Some preliminary work to promote the concept of securities markets development may be useful in the poorer developing countries.

A.I.D. encourages developing countries to develop and utilize new debt and equity instruments for directing scarce capital resources into productive investments. Among the instruments and techniques for mobilizing capital for productive investments that should be explored are commercial paper and bonds, term lending*, debentures, government securities, trade (or supplier) credit, debt-equity swaps, mortgage bonds, agricultural production contracts, variable interest rate structures, and deposit insurance. These and other financial instruments enable the financial market to spread risk among a variety of instruments, thereby reducing exposure to market volatility, and to be more flexible and responsive to the users of financial instruments.

Missions should ensure that the proper policy conditions exist for venture capital activities prior to, or in concert with, the provision of any support to venture capital firms. Funds lent to venture capital firms should be at market rates; grants or equity contributions are not permitted.

In some A.I.D.-assisted developing countries, A.I.D. may wish to explore activities involving venture capital. These activities may wish to emphasize the policy environment. Among the impediments that should be addressed in support of venture capital activities are: (1) the lengthy government approvals process required for the start of new ventures; (2) unfavorable tax laws; (3) failure to give adequate legal recognition to venture capital firms; (4) requirements for court or government approval to merge or sell out the company when successful; (5) absence of an adequately organized or liquid securities market into which the venture capitalist may sell his shares; (6) government control of when public offerings may be conducted and at what price; and, for foreigners, (7) restrictions on repatriation of profits.

An alternative to fixed-rate loans for venture capital activities may be variable-rate loans based on the internal rate of return or equivalent financial performance of the venture capital enterprise. This arrangement would reflect the relatively high degree of risk and uncertainty attendant in venture capital

*Private lending institutions in many developing countries avoid making long-term loans because they lack access to resources with the longer maturities appropriate for supporting term lending. They also consider such lending to be less profitable or more risky than alternative investment opportunities, and often face an uncertain policy environment. Other major factors that limit the ability of these financial institutions to undertake long-term financing are the institutions' own shallow resource bases; preferences for fast recovery of funds; inexperience with term loan instruments; and limited local markets for large, long-term financial assets. Furthermore, the unreliable accounting practices commonly followed by many private enterprises contribute to the reluctance of commercial financial institutions to extend credit to new and unfamiliar enterpreneurs.

approaches in developing nations, and would avoid burdening the venture with a large fixed obligation that might inhibit risk taking.

A.I.D. supports the use of debt/equity conversion programs as an important financial markets instrument.

Debt/equity conversions, or the capitalization of foreign obligations, are gaining considerable momentum in business and policy circles. A debt/equity conversion (commonly referred to as a debt/equity swap) is essentially, through a series of complex and interrelated steps, the conversion of an external debt obligation into an equity stake in a company.

Debt-equity conversion programs contribute to economic growth in several ways, including the promotion of policy reforms that support growth and investment, and the reduction or containment of immediate foreign exchange debt servicing burdens. Use of debt/equity swaps also has the effect of increasing levels of private investment in productive enterprises, facilitating financial arrangements for privatization, encouraging the return of flight capital, and rebuilding confidence between commercial banks and debtor countries.

The cumulative impact of debt/equity swaps depends on available opportunities for investment in developing countries, the depth of their capital markets, and the ability of the local economy to absorb additional credit.

ANNEX

GLOSSARY OF FINANCIAL MARKETS TERMS

Asset—Anything that is owned by an individual or business that has commercial or exchange value. Assets may consist of specific property or claims against others, in contrast to obligations due others. The principal asset categories are: *current assets*, the sum of cash and short term investments, accounts receivable (trade and other), merchandise inventories, advances on merchandise, and listed securities not in excess of market value; *fixed assets*, permanent assets required for the normal conduct of a business (furniture, land, buildings) and generally referred to as illiquid or capital assets: and *deferred assets*, assets that are not, in the ordinary course of business, readily convertible into cash, subject to current settlement.

Assets may also be classified as tangible and intangible. *Tangible assets* include physical or material assets, e.g., real estate, buildings, machinery, and cash, as distinguishable from *intangible assets* that represent rights or economic benefits that are not physical in nature, e.g., goodwill, patents, franchises, and copyrights.

Bankers' acceptance—A bill of exchange drawn on or accepted by a bank to pay specific bills for one of its customers when the bill becomes due.

Collateral—Security given by a borrower to a lender as a pledge for payment of a loan. Principal kinds of collateral are real estate, bonds, stocks, and chattels. Although any kind of property that has a ready and stable market may be employed as collateral, the collateral value of different kinds of property is subject to wide fluctuation depending upon the readiness and steadiness of the market and the ease of title transfer.

Commercial paper—All classes of short-term negotiable instruments (notes, bills, drafts, checks, deposit certificates, and acceptances) that arise out of a commercial transaction.

Common Stock—Securities that represent an ownership interest in a corporation. That part of the capital stock of a corporation that represents the last claim upon assets and dividends.

Convertibles—Securities (generally bonds or preferred stocks) that are exchangeable at the option of the holder into other securities of the issuing firm.

Credit controls—Quantitative and qualitative control exercised by the monetary authorities over the volume and nature of credit and over interest rates. These controls can affect the quantity and cost of credit available to domestic and foreign borrowers in the country's capital markets, and can strongly influence the direction of the national economy.

Debenture—A classification for all forms of unsecured, long-term debt whether for corporate or civil obligations, although it is usually applied to a certificate of debt issued by a corporation.

Equity—The net worth of a business, consisting of capital stock (preferred and common), additional paid-in capital, retained earnings, and, occasionally, certain net worth reserves, and/or adjustments. When used in a

financial sense, equity means the value of property beyond the amount of all claims and liens against it.

Financial markets—The money and capital markets of the economy. Money markets buy and sell short-term credit instruments generally for working capital to enterprises that require funds to manage their current affairs. Capital markets buy and sell long-term credit and equity instruments generally for fixed or permanent capital formation that enables businesses to be established or to expand their operations.

Foreign exchange rate—The price of one currency in relation to that of another, or the number of units of one currency needed to purchase one unit or another.

Intermediation—The investment process in which savers and investors place funds in financial institutions in the form of savings accounts and the financial institutions in turn use the funds to make loans or other investments.

International financial markets—An all-encompassing term that refers to all international or multinational markets for short-, medium-, and long-term securities and loans, forward and swap contracts, financial futures, and foreign currencies.

Letter of credit—Instrument by which a bank substitutes its own credit for than of an individual, firm, or corporation, to the end that domestic and foreign trade may be more safely, economically, and expeditiously conducted.

Loan—A business transaction between two legal entities whereby the lender agrees to "rent" funds to the borrower, to be repaid with or without interest.

Net worth—The owner's equity in a given business, represented by the excess of the total assets over the total amounts owing to outside creditors at a given moment of time.

Preferred stock—Corporate stock whose owners have some preference as to assets, earnings, etc., not granted to the owners of common stock of the corporation.

Primary markets—The "market" in which financial assets (i.e., stocks) are originally issued.

Risk—The possibility of loss; specifically, the chance of nonrepayment of debt.

Secondary market—The "market" in which primary market instruments (e.g., stocks) are traded after they have been issued by corporations in the primary market.

Securitization—The broad process whereby capital financing occurs through securities issuance rather than bank financing.

Subordination—Acknowledgement by a creditor, in writing, that the debt due him from a specified debtor shall have a status inferior or subordinate to the debt which the debtor owes another creditor.

Term loan—A loan provided for an extended period of time, generally with a maturity greater than one year and for such purposes as an increase in working capital or the purchase of equipment or other fixed assets.

Trade credit—Credit on goods purchased by a company from its supplier (also called supplier credit or accounts receivable credit). The use of trade credit brings different types of companies, including many nonfinancial companies, into the credit system and may, in fact, increase a firm's sophistication in the uses of credit.

Trade finance—The financing, usually characterized as short-term, of import-export trade transactions.

Venture capital—Capital to provide funds for start-up situations ("seed capital") or for existing high-risk small businesses suffering from capital deficiencies but having high profit potential as emerging growth companies.

Yield—The rate of return from one's investment in a specific security or specific piece of property.

A.I.D. Policy Papers and Policy Determinations

The following reports have been issued in a series. These documents with an identification code (e.g. PN-AAM-323) may be ordered in microfiche or paper copy. Please direct inquiries regarding orders to:

AID Document and Information Handling Facility
7222 47th Street, Suite 100
Chevy Chase, MD 20815

Title—Policy Paper	Date	'Fiche #
Domestic Water and Sanitation	May 1982	PN-AAM-323
Food and Agricultural Development	May 1982	PN-AAM-322
Nutrition	May 1982	PN-AAM-321
Recurrent Costs	May 1982	PN-AAM-319
Population Assistance	September 1982	PN-AAM-320
Private and Voluntary Organizations	September 1982	PN-AAM-318
Women in Development	October 1982	PN-AAL-777
Pricing, Subsidies, and Related Policies in Food and Agriculture	November 1982	PN-AAL-373
Approaches to the Policy Dialogue	December 1982	PN-AAM-431
Basic Education and Technical Training	December 1982	PN-AAM-190
Institutional Development	March 1983	PN-AAN-108
Co-Financing	May 1983	PM-AAN-457
Local Organizations in Development	March 1984	PN-AAQ-157
Energy	July 1984	PN-AAQ-160
Urban Development Policy	October 1984	PN-AAQ-158
Shelter	February 1985	PN-AAQ-162
Private Enterprise Development (Revised)	March 1985	PN-AAQ-163
International Disaster Assistance	May 1985	PN-AAQ-164
Cooperative Development	April 1985	PN-AAQ-165
Trade Development	July 1986	PN-AAV-461
Health Assistance (Revised)	December 1986	PN-AAV-462
Environmental and Natural Resources	April 1988	PN-AAV-464
Financial Markets Development	August 1988	PN-AAV-465

Title—Policy Determination	Date	'Fiche #
PD #1—Narcotics	August 5, 1982	PN-AAM-443
PD #2—Mixed Credits	September 29, 1982	PN-AAM-444
PD #3—Voluntary Sterilization	September 1982	PN-AAM-445
PD #4—Title XII	October 5, 1982	PN-AAM-446
PD #5—Programming PL 480 Local Currency Generations	February 22, 1983	PN-AAM-591
PD #8—Participant Training	July 13, 1983	PN-AAP-273
PD #9—Loan Terms Under PL 480 Title I	September 27, 1983	PN-AAN-753
PD #10—Development Communications	February 17, 1984	PN-AAP-616
PD #11—Using PL 480 Title II Food Aid for Emergency or Refugee Relief	July 26, 1984	PN-AAQ-159
PD #12—Human Rights	September 26, 1984	PN-AAQ-161
PD #13—Land Tenure	May 9, 1986	PN-AAQ-166
PD #14—Implementing A.I.D. Privatization Objectives	June 16, 1986	PN-AAQ-167
PD #15—Assistance to Support Agricultural Export Development	September 13, 1986	PN-AAV-460
PD #16—Program Financing Arrangements with Independent Organizations	October 9, 1987	PN-AAV-463
PD #17—Microenterprise Development Program Guidelines	October 10, 1988	PN-AAV-466

III.A5
(TM 1:40) 8/20/87

POLICY DETERMINATION
Agency for International Development

PD-14

June 16, 1986

Implementing A.I.D. Privatization Objectives

PD-14

June 16, 1986

Implementing A.I.D. Privatization Objectives

PD-14
June 16, 1986

A.I.D.

POLICY DETERMINATION

IMPLEMENTING A.I.D. PRIVATIZATION OBJECTIVES

1. Introduction. The Deputy Administrator, speaking for the Administrator, announced the following Agency objective for privatization at the International Conference on Privatization (February 17 - 19, 1986). He said:

> "... To take advantage of the momentum generated by this conference, the Agency for International Development is setting a goal for itself. We have substantial staff and resources in about 40 countries. We will ask each of those missions to engage in discussions with their countries about privatization. Our goal will be for A.I.D. to be involved in an average of at least two privatization activities in each of these missions by the end of fiscal year 1987. Now I say average because we recognize that not all countries are going to be interested, but, clearly a number of countries are very excited..."

The Agency's privatization objective is based upon the pragmatic realization that the entrepreneur and the private sector are the most appropriate mechanisms for economic growth. A healthy independent private sector and secure individual economic freedoms also serve as a strong base from which to ensure that democratic institutions are brought into existence and remain free from centralized political control. Privatization of functions, activities, or organizations currently in the public sector should contribute to the achievement of these goals.

Implementation of the privatization objective must begin with the determination of which public activities are appropriate for the private sector. The appropriateness of public versus private sector should be determined on the basis of which sector is more likely to produce a higher level of economic efficiency, innovation, and incentive, and, therefore, the greater economic benefit. Experience has demonstrated that a private enterprise (rather than a wholly or partially state-owned enterprise

or parastatal), operating in a truly open and competitive environment, is usually the more likely to meet goals of economic efficiency and growth.

The purpose of this Policy Determination is to provide (1) additional policy guidance on implementing A.I.D. privatization objectives and (2) information on sources of technical assistance for Missions undertaking privatization activities. This PD and the revised Private Enterprise Development Policy Paper (March 1985), which discusses the privatization technique of divestiture, should be used as companion documents in developing privatization plans and activities.

2. Definition. For the purposes of Agency policy, privatization is defined as the transfer of a function, activity, or organization from the public to the private sector. (Related activities discussed in Section 4B of this paper, but not falling within this definition, may be justified with reference to the revised Private Enterprise Development Policy Paper.) The major techniques for privatization, for the purpose of complying with this PD, are discussed in section 4A below. The term "privatization" is not synonymous with private enterprise. Privatization is an important and unique aspect of our private sector program in that it brings together policy reform, institutional development, and utilization of the private sector. Our private enterprise goals and program are described in the Private Enterprise Development Policy Paper.

3. Policy Guidance.

A. Existing Agency policy. Previous Agency policy guidance on privatization is contained in sections V.F. ("Parastatals and Government Authorized Monopolies") and V.D. ("Assistance to the LDC's Private Sector") of the revised Policy Paper on Private Enterprise Development (March 1985). The guidance in section V.F. of that policy paper is limited to the privatization technique of divestiture. Briefly stated, that guidance stipulates that "A.I.D. assistance to or through a parastatal should be given in the context of exposing the parastatal to market forces and scheduled divestiture of the government interest ... A.I.D. projects designed to improve parastatal performance must have identifiable benchmarks upon which substantive progress towards divestiture can be measured." The latter sentence is the ultimate condition upon which assistance is to be granted. In other words, the selected

benchmarks must represent substantive evolutionary progress in moving the parastatal towards market-based operations and divestiture in order to qualify for A.I.D. assistance.

Missions have, in the past, utilized technical or capital assistance to make state-owned enterprises (SOEs) more efficient, more responsive to market forces, or more attractive for buy-outs. It should be recognized, however, that enormous amounts of donor funds committed to help SOEs meet the goal of greater efficiency have been largely unsuccessful. There is no reason to believe that new A.I.D. resources will be better spent for that first goal unless the process is linked clearly to both making the SOE more responsive to market forces and actual divestiture. Therefore, the use of A.I.D. funds in a manner that only improves the capability of the parastatal to respond to market forces in the absence of true policy reforms (such as improving an SOE's accounting procedures as opposed to revising the tax code for all enterprises in a particular industry) does not comply with this policy.

The guidance in section V.D. deals with parastatal financial institutions and applies the privatization technique of partial divestiture. The guidance states that "A.I.D. funds provided to financial institutions should avoid introducing government ministries or parastatals into the on-lending approval process where such involvement does not now exist. Furthermore, such projects should seek to extract government ministries and parastatals from the process if they are now so involved." Based upon this guidance, the responsibilities of the parastatal financial institution would be separated into its purely public functions, which it would retain, and functions that can be carried out by the private sector, which are divested to the private sector.

B. Coverage and scope of new policy. This PD and its targets apply to the A.I.D. Missions listed below. Each of these Missions is directed to engage in discussions with its host country about privatization, with the objective of having at least two privatization activities in each Mission by the end of fiscal year 1987, and two new privatization activities every year thereafter. Although adherence to the guidance is not mandatory for non-Mission field operations (A.I.D. representatives, A.I.D. affairs offices, sections of embassies, and regional offices), it is hoped that those overseas operations will attempt to implement this guidance.

Missions Subject to Guidance

AFRICA	ANE	LAC
Botswana*	Bangladesh	Bolivia
Burkina Faso*	Egypt	Costa Rica
Cameroon	India	Dominican Republic
Ghana	Indonesia	Ecuador
Kenya	Jordan	El Salvador
Lesotho*	Morocco	Guatemala
Liberia*	Nepal	Haiti
Malawi	Pakistan	Honduras
Mali	The Philippines	Jamaica
Mauritania*	Sri Lanka	Panama
Niger	Thailand	Peru
Senegal	Tunisia	RDO/C
Somalia	Yemen	
Sudan		
Swaziland*		
Zaire		
Zambia		
Zimbabwe		

* These Missions are exempted from complying with the PD for FY 87. The application of the guidance to these Missions in FY 88 will be reviewed at a later date.

C. Short-term and Long-term reporting requirements. It is expected that privatization will become an integral part of each Mission's programming. Therefore, both short-term and long-term reporting requirements are described below.

(1) Overview. Missions may submit an overview of their plans for meeting the Agency's privatization objective in the 1987/1988 budget submissions due in June 1986. The overview should contain (a) your current privatization activities; and (b) your strategy and schedule to achieve the privatization objectives. Annex L of the ABS has been reserved for the overview. (Submission of an overview is optional.)

(2) Short-term. Missions are requested to submit detailed privatization plans in an amended Annex L by July 1. These plans should identify (a) short- and long-term targets of opportunity for privatization; (b) the Mission's proposed strategy for addressing privatization; and (c) a projected timeframe for achieving the goals of the privatization plan.

Missions may also wish to take this opportunity to develop their medium- or long-range privatization strategies. An essential first step towards framing a privatization program and determining priority actions would be to assess and lay out an overview of the relative role and influence of private and public sector institutions and organizations in individual countries. Some of the considerations listed in section 9 of this guidance would be important elements in these plans.

(3) Long-term. Following submission of the initial privatization plan in the 1988 ABSs, Missions are required to integrate their privatization plans into the regular reporting system for ABSs, CDSSs, and Action Plans.

4. Techniques for privatization.

A. Primary techniques for privatization. The successful privatization process, which depends upon the country strategy for privatization and the reasons privatization is being undertaken, involves selection and implementation of an appropriate privatization technique. Privatization can take a range of forms, some of which involve change of ownership status and transfer of decision-making authority from the public to the private sector (complete and partial divestiture) while others entail only the transfer of decision-making authority (contracting out and partial privatization). The major techniques for privatization, for the purpose of complying with this PD, may be classified as:

(1) complete divestiture - in which an SOE is
(a) sold, operationally intact, to a private sector entity (such as another firm, individual investors, the firm's own managers or workers, or the general public through a stock offering or auction); or
(b) operationally terminated and liquidated, with its business operations halted and its assets sold off piecemeal. Complete divestiture is the preferred Agency approach to privatization of SOEs.

Liquidation should be considered as a positive form of privatization as it (a) relieves the recurrent cost burden of an unproductive asset on the host country budget; (b) ends the need for special subsidies or incentives for noncompetitive SOEs; and (c) contributes to a greater market allocation of resources.

(2) partial divestiture - in which (a) the host government enters into a joint venture with private investors (with the government retaining only a minority equity position that allows actual control to pass to private hands and the enterprise to operate as a private entity); or (b) responsibilities of the SOE are separated into purely public functions, which are maintained by or absorbed into the Government (such as setting quality control standards for agricultural products), and functions that can be carried out by the private sector, which are turned over (or "spun off") to the private sector (such as the sale of agricultural inputs that currently may be under the control of a ministry or government-owned or -controlled marketing board).

(3) contracting out of service delivery - in which the responsibility to provide certain public services (and, in some cases, ownership of the assets) is retained by the host government, but the implementation of certain functions (typically operation and maintenance of facilities and equipment) is delivered by private entities through such mechanisms as service contracting, franchise agreements, or lease, or reliance upon such instruments as a voucher system or regulatory and tax incentives.

(4) partial privatization - in which the Mission encourages reduction of the public sector role through privatization of (a) different activities in the SOE such as management (by hiring a private company to conduct management - e.g., in the U.S., many public hospitals have contracted out management to a private company), production (by contracting output and services), and finances (by requiring users to pay the real (unsubsidized) costs associated with provision of the product or service that they receive); or (b) entire subsidiaries of vertically integrated firms (such as fertilizer importation and retail distribution). Partial privatization should be viewed as a short-term or interim approach, and should be utilized as part of a longer-term process leading to complete divestiture within the life of the same particular privatization project or activity.

A variety of factors in the host country influence the country's privatization strategy as well as the privatization techniques chosen. These factors include the: (1) purpose for undertaking privatization;

(2) business climate; (3) commercial viability of public enterprises; (4) availability of capital (locally or internationally); (5) availability of local managerial and technical talent; (6) side effects (such as displaced labor); and (7) sociopolitical environment of the country.

B. Other options. Missions are encouraged to be innovative and realistic in developing their privatization projects. In those instances where the host government has stated that it is unwilling to divest SOEs to the private sector or transfer functions to the private sector, there are still options available to Missions to comply with this PD. One option is to encourage direct competition to the SOE by private firms by deregulation of markets. Another is to seek to change the policy environment to allow for competition by persuading the host government to (1) eliminate all market entry and protectionist barriers, subsidies, and other measures that reduce competition; (2) reduce government monopolies; and (3) force its SOEs to operate more like private entities in a free and competitive market environment.

Where there is no permitted private sector alternative and the SOE or parastatal is not likely to perform competitively or to be privatized, the Mission should seek to remove itself from those sectors of the economy in which such functions are non-competitive and exclusively public. They should shift to other sectors of the economy where A.I.D. may more effectively operate.

5. Policy conditions important for privatization. Commitment to privatization, in any form, must be accompanied by the adoption of a policy environment that allows for competition and the operation of market forces in the sector in which the enterprise exists or an activity is performed. Economic activity must be open to competitive market forces (with no laws, regulations, or subsidies which would deter competition with what was the SOE). Governments must be made aware that if industries are protected from market forces, little will be gained from privatization.

Policy reform is essential for the success of all techniques of privatization. The policy conditions needed for privatization to be successful include (but are not limited to) market-based prices (and the concomitant removal of price controls); low, common tariff levels; prompt and fair enforcement of contracts; equal application of controls (in those cases where elimination of these

factors is not feasible); equal access by all to credit and to foreign exchange (where exchange market manipulation is practiced); the elimination of protectionism; market-based interest rates; reform of employment or labor codes; and elimination of any other policies that would inhibit the emergence of lower-cost and, therefore, more efficient competitors. Reform of the legal framework, investment code, licensing procedure, and tax code are also critical to the success of privatization.

For example, for Employee Stock Ownership Plans (ESOPs) to be a useful divestiture tool, it is generally necessary to change a country's tax code. Changes in the legislative or administrative laws of a country may be needed to provide incentives for the firm's current owners to distribute stock shares to their workers and for the employees to purchase the stock. (ESOPs are encouraged as a method of transferring parastatals to private ownership in section V.F. of A.I.D.'s revised Private Enterprise Development Policy Paper.)

6. Divestiture and ownership issues. Private ownership and control of a firm are critical issues in privatization of SOEs. In some instances, it is possible for control of an enterprise to be transferred to the private sector without the transfer of ownership. These instances, in which ownership and control are divisible, through establishment of management contracts, should be viewed as short-term or interim approaches, and should be utilized as part of a longer-term process leading to complete divestiture. In that interim, the management of the SOE should be expected to exercise the same type of authority as the management of a privately-held firm. However, it is preferable for ownership and control to be transferred together whenever possible.

The new owners of a former state entity, and the managers employed by them, must have the right or freedom to undertake actions they deem important to respond to competitive conditions in a timely manner, including restructuring of the firm, altering the firm's product and its price, changing lines of activity, using subcontractors, and expanding some activities while closing down others. Other areas in which the owners should not be restrained are employment and compensation decisions, sourcing, production engineering, cost structure, financing, investment, and innovation. Such flexibility comes with private sector ownership and control. It is rare under public ownership.

Preference for simultaneous transfer of both ownership and control is based on other considerations as well, including: (1) the tendency, where ownership remains with the public sector, or when clear title is ill-defined, for property assets to be undervalued by the private sector; (2) the possibility that the motivations of the firm's owners (the state) may still be more socially-oriented than profit-oriented and that this may lead to less efficient allocation of resources; and (3) the fact that public ownership might affect or distort the judgments made by the firm's managers on such critical issues as assessing political risk.

A critical issue associated with divestiture in LDCs is who is allowed to buy the SOEs. For a variety of political and social reasons many LDCs exclude certain groups from purchasing SOEs (especially foreign businesses, multinational corporations, and some local entrepreneurs of certain minority or ethnic groups). These people are often excluded by the political process, explicitly or implicitly, from the purchase of state enterprises. This issue is largely irrelevant in industrial countries, where the major issues are building a constituency for privatization and utilizing the appropriate sale mechanism.

There is some concern that these foreign-owned enterprises or local individuals or firms (who may already own or control a large share of the LDC's economy) will, in fact, purchase the parastatals and increase their control of the LDC economy. Their predominant role in the LDC economy and potential participation in the privatization process is, in the view of some LDCs, contrary to public policy.

Missions should encourage LDC governments to accept all potential buyers into the privatization process and not exclude any potential buyers on the basis of race, nationality, or economic position.

7. Private delivery of services. The conventional approach to providing many services is for government to collect the revenues needed to support the service and to deliver the service as well. The implicit premise in this view is that local public services are all "public goods" (i.e., goods or services that can only be produced and paid for collectively). Yet, most local public services have few attributes of true public goods. Most of them (including garbage collection, transit, and aspects of police and fire protection) have specific, identifiable users, who are the services' principal beneficiaries. To

the extent that discrete beneficiaries or users can be identified, these services are viable targets for privatization. Moreover, even for services that are closer to being pure public goods, it is not at all clear that government must be the deliverer of the service.

Many national, state, and municipal governments are discovering that public services do not necessarily have to be delivered by government or paid for by taxes. Many studies have found that the services provided via privatization are generally produced more cost-effectively than services provided by tax-funded local monopolies. Privatization of public services offers governments a way to decrease the cost and improve the quality of services.

8. A.I.D. instruments and resources for implementing privatizations. Missions should encourage, where possible, the private sector (indigenous and other) to undertake the entire range of activities related to privatization without A.I.D. assistance. In those instances where that is not possible, A.I.D. has a variety of instruments available for privatization. These instruments are technical assistance that prepares an SOE for divestiture or assists a public organization in achieving private delivery of its services, and financial assistance in the form of loans and grants.

A. Technical assistance. Preparing a country privatization strategy (and, therefore, preparing SOEs for divestiture and public organizations to privatize their services) is a complex task. Therefore, the technical assistance needs associated with privatization may cover a wide range of topics. Some of these include: (1) sector- or industry-specific analyses, including financial, agricultural, industrial, transport, service industries, etc; (2) enterprise-specific analyses, including organization, production processes, finance, audit, marketing, personnel, restructuring, etc; (3) policy/legal/ regulatory analyses; (4) project design, implementation, and evaluation related to privatization; or (5) determining the appropriate brokerage mechanism for the sale of SOEs.

B. Financial assistance. A great deal of risk and expense are involved in financing privatizations, and Missions should proceed with care. A.I.D.'s financial assistance for privatization is limited to loan and grant activities (as described below). Consistent with A.I.D.'s revised Private Enterprise Development Policy Paper and the Foreign Assistance Act, A.I.D. will not take an equity position in a private enterprise.

Missions should encourage the private sector to undertake the entire privatization financing package without A.I.D. assistance. If a Mission decides to participate in providing loan funds for privatizations, it should: (1) maximize its catalytic role in stimulating private capital by minimizing the percentage of loan funds it contributes to financing the privatization; and (2) direct the bulk of its capital assistance towards assisting the private sector purchaser, as opposed to the government seller, in the transaction. A.I.D.'s involvement in this type of privatization financing should be designed to maximize private sector participation in this activity.

There may be instances when some grant assistance could be provided to a buyer to cushion a burdensome covenant imposed upon him by the seller for political purposes (such as a requirement to continue all current employees for a limited time). As execution of the covenant may be considered a grant from the buyer to the seller, an off-setting A.I.D. grant to the purchaser may be appropriate. In such instances, A.I.D. should first encourage the seller to accept a lower sale price as a condition for acceptance of the covenant and only as a last resort provide a one-time, directed grant to the purchaser. (For example, if the purchaser must provide job retraining to X number of employees as a condition of the sale, and the privatization depends upon the acceptance of that requirement, A.I.D. may consider providing the funds for the training.) Missions should investigate such cases as they arise and identify these issues when they submit their privatization activities to AID/W for approval. Missions should not develop a broad-based project that provides for grant assistance in anticipation of instances such as those described above. The availability of such funds may distort market forces and private sector decisions in privatization.

C. Resources for privatization. Sources of technical assistance is found in the Annex to this PD. Resources additional to OYB levels will not be made available for privatization. We recognize, therefore, that some Missions will have to adjust or amend existing priorities and programs to meet the new Agency privatization objective. (This should not present an obstacle to Missions that have already initiated privatization efforts.) It is assumed that Missions will make funds available to support privatization from all appropriate accounts.

9. Conclusion. All too often governments have tended to see divestment as a simple process of announcing a willingness to sell and finding a suitable buyer at the price the government was willing to accept. One of the more difficult tasks facing Missions will be to convince governments that privatization is not a process in which only one side sets the terms, and it may be a long, slow and often frustrating activity.

In formulating and implementing privatization plans and activities, Missions should be aware of the following considerations:

- The process of privatization is essentially political although economic forces may prompt it. Prior understanding of the local political situation, the power bases, and the sources of influence must be achieved before explicit proposals for privatization are laid before the government. Missions should develop a conceptual dialogue with the host government, be understanding of the political risks the host government will be taking on when it embarks upon privatization, and be able to suggest ways of mitigating these risks.

- Privatization plans are more likely to be seriously considered by political decision makers if they contain a variety of options rather than a single course of action.

- Before embarking on privatization a government must have a clear idea of its objectives for the program and why it is being undertaken. Countries may engage in privatization for a variety of reasons, such as to generate immediate cash income, immediate foreign exchange, or future cash income; settle foreign debt; encourage industrial development; encourage foreign investment; improve or create efficiency of operations; develop capital markets; or pursue a free market philosophy.

- Governments tend to be most sensitive to the fiscal and employment aspects of privatization. It becomes important, therefore, to design options which will reduce the subsidy burden without seriously undermining current levels of employment.

- Any strategy for privatization must take into account the groups whose interests may be harmed if

divestment is successful. These may include labor groups and current managers of the firm, bureaucrats whose positions and power may be eliminated, political groups that favor public enterprises, local private enterprises that will suffer competition if the sale is to non-nationals, and enterprises which are protected from competition through their relationship with the public institution. A divestment program must include strategies to deal with these opposing groups.

ANNEX

AID/W offers a variety of services to provide USAIDs with the technical assistance and information needed for achieving successful privatizations. These include privatization services available in PPC, PRE, S&T, and Africa bureaus, as discussed below; the briefing book and background papers prepared for the International Conference on Privatization, which have been pouched to all Missions; and the report on the conference, which will be made available to Missions later this year.

A. Agency-wide Resources - PPC. In addition to providing policy guidance on privatization and working with PRE, PPC offers a variety of independent assistance to Missions in their efforts to assist with country divestment and privatization plans. PPC has available a privatization specialist who will respond to requests from Missions for advice on proposed privatization projects. He will apply the experience of other countries to the specific problems faced by the requesting Mission. Missions in Honduras, Indonesia, Jamaica, Mauritania, the Philippines, R/DOC, and Thailand are among those that have received assistance. PPC assistance was discussed in 1985 STATE 224591. For additional information, please contact L. Gray Cowan, PPC/PDPR.

PPC also has several studies on privatization and divestment available for distribution to Missions upon request. These include "Divestment and Privatization of the Public Sector, Case Studies of Five Countries" L. Gray Cowan (December 1983), "The Private Provision of Public Services and Infrastructure" by Steven H. Hanke (May 1984), and "Privatization of Municipal Services in Sub-Saharan Africa" by Dr. Ian Marceau (October 1985).

Shorter studies are also available to Missions on specific aspects of the privatization and rationalization process such as management contracting, business analysis, problems faced by LDC governments in privatization planning and the contract plan, as well as case studies of individual country plans (such as Tunisia, Malaysia, Thailand, and the Philippines).

PPC is having prepared a technical assessment on privatization and divestment techniques which will be completed later this year.

B. Agency-wide Resources - PRE. PRE is currently contracting for assistance to Missions in policy dialogue with host governments, strategy development for divestiture and privatization, and technical assistance for the beginning stages of privatizing specific organizations. The PRE contract with Analysis Group, Inc. and its Center for Privatization will provide assistance over a two year period primarily through short-term consultancies in a wide range of specialties. This contract is discussed in 1985 STATE 386291. For additional information, please contact Paul Haire, PRE/PPR.

That PRE contract is designed to provide assistance in developing and implementing strategies and projects for the divestiture and privatization of state-controlled enterprises. This assistance may include sector or industry specific analyses in the agricultural, industrial, and financial sectors or in service industries. Enterprise specific analyses including organization, production processes, finance, audit, marketing, personnel, and restructuring may also be provided, as can general analyses of the policy, legal or regulatory environment. Help with policy dialogue on utilizing private sector alternatives to state ownership and strategy development for divestiture and privatization plans can be supplied.

PRE will also manage the Agency's Privatization Fund, which is currently being developed. Additional information on the Fund will be made available when its operating guidelines are established.

C. Agency-wide Resources - S&T. S&T has available a variety of technical resources that can be used to assist Missions in developing different aspects of their privatization plans. A few of these are summarized below. Please contact Mike Farbman, S&T/RD/EED, for additional information.

The Employment and Enterprise Policy Analysis project (Harvard, Michigan State Univ. and Development Alternatives, Inc., contractors) has a buy-in provision under which short- and long-term TA is available to analyze sectoral and macro-policies that may affect privatization efforts.

An S&T/RD cooperator, the Industry Council for Development, has substantial experience working with USAIDs in designing action plans, assisting in political and interest group consensus-building, and assisting directly the process of privatization/commercialization of LDC seed industries.

S&T/RD supports RSSAs and PASAs with the U.S. Department of Labor (DOL) through which assistance in analyzing labor markets and/or strengthening labor market institutions may be obtained. The array of labor redundancy, ESOP, retraining, and similar employment issues that accompany some privatization efforts may be addressed through DOL assistance.

The Local Revenue Administration Project (LRAP) has supported national tax reform programs aimed at improving the environment for the private sector in several countries over the past four years. It has a buy-in mechanism under which Mission funds can be used to support tax reform programs and carry out applied research through September 1987. (Please contact Ken Kornher, S&T/RD, for more information on this project.)

A new FY 1987 activity will provide mission support and applied research in government reforms to foster private sector development. S&T/RD is especially interested in working with missions on feasibility and implementation of "contracting out" of construction, maintenance, or other public services to increase the role of the private sector and improve economic efficiency. Pending an FY 87 RFP, S&T/RD can accommodate some mission-funded TA requirements under an existing project (Performance Management).

D. Additional Resources for Africa Missions. In addition to accessing agency-wide sources of assistance, Missions in Africa have available several sources to obtain technical and financial support for privatization. A major source for East Africa Missions is the IQC set up in 1985 by REDSO/East with a group of companies led by Coopers and Lybrand in Nairobi. Others in the IQC group are Morgan Grenfell Bank, Arthur D. Little, and Technoserve. There

is a very limited amount of funding in this IQC so Missions will need to utilize their own funding.

In addition, the Africa Bureau Private Enterprise Fund, managed by AFR/PRE, can provide limited funding for short-term business consultant services. Consultants are obtained through existing umbrella contracts with two consulting firms (one of which, Equator Bank, offers specialized banking services) should they be required. This same contract also has a buy-in provision which allows Missions to acquire services using their own funding.

E. Private Sector Resources. Although Missions are encouraged to avail themselves of the privatization services offered by AID/W, there are myriad resources available for privatization in the U.S. and LDC private sector. Many management consulting firms, accounting firms, investment banking firms, and other private enterprises offer assistance in the various aspects of privatization. These firms maintain specialists in the areas noted in Section 8A of the PD. Business, trade, and membership organizations are also sources of information. Missions should utilize these resources as well.

M. Peter McPherson

June 16, 1986
Date

III. CROSS-SECTORAL POLICIES

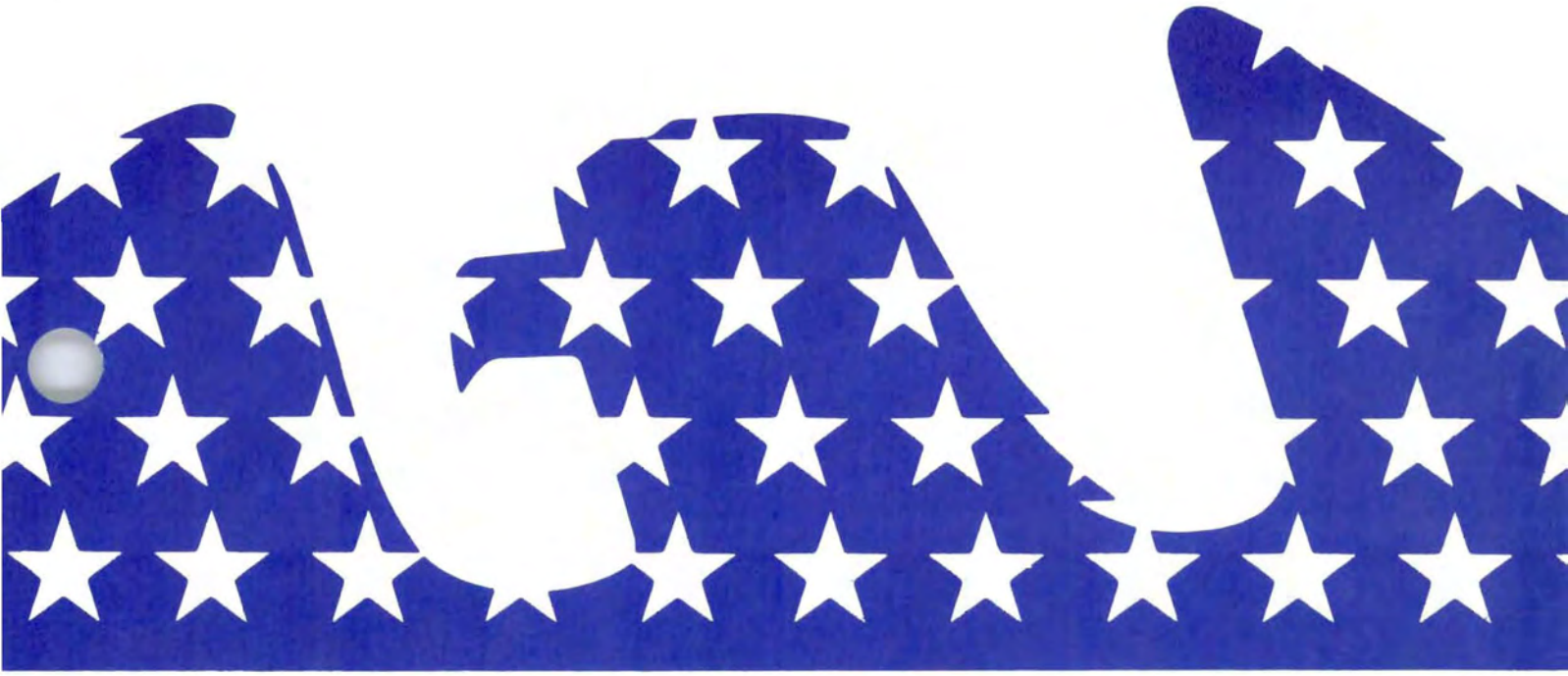
B. Socio-Economic Issues

POLICY DETERMINATION
Agency for International Development

PD – 12

September 26, 1984

HUMAN RIGHTS



HUMAN RIGHTS POLICY DETERMINATION

Advocacy of human rights was an important theme during the creation of the United States of America. The American colonists' quest for liberty was founded on human rights principles expressed to the world in the Declaration of Independence. Human rights were further defined and given legal standing in our constitution and its first ten amendments - the Bill of Rights.

A central aim of U.S. foreign policy is increasing respect for human rights throughout the world. A.I.D. is strongly committed to supporting this policy and that commitment is unequivocal.

I. Introduction

Legislative provisions in the Foreign Assistance Act of 1961, as amended, (FAA) are the legal foundation for A.I.D. policy and programs concerning human rights. A.I.D. implementation of the human rights legislation is an integral part of A.I.D.'s own work and of the United States' overall human rights policy. A principal goal of U.S. foreign policy as set forth by Section 502B(a)(1) of the FAA calls for the increased observance of internationally recognized human rights by all countries. Under Section 101(a)(3) of the FAA, A.I.D. is instructed to emphasize the encouragement of development processes in which individual civil and economic rights are respected and enhanced. The security assistance program is directed by Section 502B(a)(3) of the FAA to be formulated and conducted in a manner which will promote and advance human rights and to avoid identification of the United States with governments which deny to their people internationally recognized human rights and fundamental freedoms in violation of international law.

The means to accomplish these goals are also primarily determined by legislation. Section 116 applies to all assistance under Part I of the FAA; Section 502B covers Economic Support Fund (ESF); and Section 112 of PL 480 applies to Title I and Title III agreements.

Section 116 restricts A.I.D. activities in countries that are found to be consistent gross violators of human rights to assistance that directly benefits needy people. Section 502B does not include the needy people proviso, but permits aid to gross violator countries in extraordinary circumstances. Section 112 of PL 480 requires that in countries that are consistent gross violators the commodities or the proceeds from their sale can only be used for specific projects or programs that directly benefit needy people.

In contrast to these prohibitions, Section 116(e) provides for a positive approach to human rights by encouraging the increased promotion of civil and political rights. A.I.D. is particularly interested in supporting this human rights mandate, which is the second, or positive track, of U.S. human rights policy.

A guide detailing the procedures to be followed by bureaus and offices involved in implementing the human rights policy may be obtained from the Bureau of Program and Policy Coordination (PPC).

II. Scope

Human rights can be grouped into two broad categories:

> First, the right to be free from governmental violations of the integrity of the person--violations such as killing, torture, cruel, inhuman or degrading treatment or punishment, arbitrary arrest or imprisonment, abduction and clandestine detention and the like.
>
> Second, the right to enjoy civil and political liberties, including freedom of speech, press, religion, and assembly, the right of citizens to participate in governing themselves, the right to travel freely within and outside one's country, and the right of citizens to associate together with others in political, economic, and religious activities.

A.I.D.'s governing law recognizes human rights within these two broad categories in Sections 116(a) and 502B of the Foreign Assistance Act and Title I of the Food for Peace Act which prohibits assistance to any government which "engages in a consistent pattern of gross violations of internationally recognized human rights" subject to certain exceptions. These prohibitory provisions make manifest the repugnance which the U.S. Government has for such activities.

Section 116(e) directs A.I.D. to carry out programs and activities which will enhance adherence to civil and political rights. Such activities are appropriate for a developmental organization because the United States recognizes that the engine of economic growth is personal liberty. Throughout the world, societies which protect civil and political rights are far more likely to experience economic development than societies which do not. The extent to which man is free and his human rights respected is directly proportionate to the extent to which his energies are directed to productive and developmental activities.

III. Human Rights Violations

A. General

This section sets forth the policies and procedures governing the denial of assistance to governments based on human rights violations.

Section 116(a) provides that assistance shall not be provided to the government of any country which engages

> "in a consistent pattern of gross violations of internationally recognized human rights, including torture or cruel, inhuman, or degrading treatment or punishment, prolonged detention without charges, causing the disappearance of persons by the abduction and clandestine detention of those persons, or other flagrant denial of the right to life, liberty, and the security of person...."

For development assistance, the determination of whether the statutory provisions will apply to a country is made by the A.I.D. Administrator in consultation with the Assistant Secretary for Human Rights and Humanitarian Affairs. For ESF the determination is made by the Secretary of State. For PL 480, A.I.D. with the Department of State (HA), principally the Bureau for Human Rights and Humanitarian Affairs, make the determination. An Inter-Agency Working Group on Human Rights and Foreign Assistance examines the above issues and makes recommendations to the appropriate offices.

In determining the degree of violations and whether violations form a "consistent pattern", A.I.D. and the Department of State take into account, among other considerations, the extent of cooperation of such government in permitting an unimpeded investigation of alleged violations by appropriate international organizations, such as the International Committee of the Red Cross, specific actions which have been taken by the President or Congress relating to multilateral or security assistance because of human rights practices and the relevant findings of appropriate international organizations.

A.I.D. will also consider improving or deteriorating trends in the status of human rights conditions in a country. It is A.I.D.'s policy to encourage improving trends in human rights conditions.

B. Coverage under Section 116(a) and Food for Peace

A.I.D. will apply Section 116(a) to all of the following categories of assistance under its jurisdiction: development

assistance, American Schools and Hospitals Abroad, housing guaranty programs, and other activities and assistance under Part I of the FAA. Pursuant to Section 112 of P.L. 480, the same test will apply to assistance under Titles I and III of that Act.

Section 116(a) contains a single exception to the rule prohibiting assistance to governments which engage in a consistent pattern of gross violations of human rights. That exception permits aid where "such assistance will directly benefit the needy people in such country." Where Section 116(a) is in effect, any project will be reviewed for its impact on needy people before being approved. Under A.I.D. policy, "needy people" are defined by one or more of these criteria:

> (1) Food Consumption Requirement: Households that expend 80% or more of their total income (cash and in kind) on food; (2) Health Indicators: For any population subgroup, life expectancy at birth of below 60 years, infant mortality rate of over 50 per thousand live births, birth rates over 25 per thousand population, or any population subgroup in which 80% or more of the population does not have reasonable access to effective health care services; and (3) Education Indicators: Any individual who by age 15 has not received at least 4 years of formal schooling or otherwise developed the skills of literacy and numeracy. For any population subgroup, less than 50% are completing at least four years of formal schooling by age 15 and/or less than 30% of those 15 or older are literate and numerate. In addition, where there are significant differences in the pattern of grade completion between rural and urban, between male and female, and between income groups, those on the lowest end are considered poor.

For a full description of A.I.D.'s definition of needy or poor people, please see Supplement A8 of A.I.D. Handbook 2 and State telegram 30417 dated February 1, 1984.

In ensuring that Development Assistance will directly benefit the needy, particular attention will be paid to demonstrating that the <u>primary purpose</u> of an activity is to help the needy people and that it is reasonable to believe that they will benefit from the project. Regular project documentation, if it contains adequate economic and social analyses, should be sufficient to demonstrate that needy people are the primary beneficiaries. If not, additional information will be required since the A.I.D. Administrator may be required by Congress to explain in writing how a project directly benefits the needy.

If a country has serious human rights problems and, in addition, the government is characterized by widespread corruption or repression against the poor and their organizations, then special care is required to assure that the needy do benefit from the A.I.D. project.

In cases where the assistance (1) is to a private organization or individuals not connected in any way with the government, (2) does not relieve the government of a responsibility or demand it would otherwise have to deal with, and (3) is not viewed as part of a government program or an expression of American support for the government, then the assistance need not necessarily be directed at the poor, but must promote the general cause of human rights.

A.I.D. works with the Department of State, principally the Bureau for Human Rights and Humanitarian Affairs, to determine which Food for Peace programs will embody the special requirement that the programs directly benefit the needy.

C. Economic Support Funds

Economic Support Funds and other forms of security assistance provided under Part II are subject to Section 502B. When the Secretary of State determines that Section 502B will apply to a country, then ESF will not be provided unless the President certifies in writing to the Speaker of the House of Representatives and the Chairman of the Committee on Foreign Relations of the Senate "that extraordinary circumstances exist warranting provision of such assistance."

To the greatest extent possible and consistent with security, political and economic problems that ESF addresses, A.I.D. will design ESF projects in countries with serious human rights concerns so that they directly benefit the needy.

IV. Countries of Concern

It is A.I.D. policy that the statutory limitations for Development Assistance, Economic Support Funds and Food for Peace are applied whenever the Bureau of Human Rights and Humanitarian Affairs in consultation with A.I.D. finds that there is a serious question about the recipient's human rights status, even if the government has not been found to be a consistent gross violator. In making this determination, improving or deteriorating trends in the status of human rights conditions in a country are of major importance. The policy is to encourage improving trends in human rights conditions. The Department of State's Annual Country

Human Rights Reports, submitted to the Congress every January, should be consulted for an overall view of a country's human rights status.

V. Promotion of Civil and Political Rights

Section 116(e) authorizes the use of not less than $3 million for each fiscal year "for studies to identify, and for openly carrying out, programs and activities which will encourage or promote increased adherence to civil and political rights...." No such funds may be used directly or indirectly to influence the outcome of any election in any country.

This positive or developmental side of human rights activities of A.I.D. is an express recognition of the U.S. understanding that civil and political rights cannot be separated from economic policies and economic development. Under this section, A.I.D. supports specific projects which cover one or more of the following seven themes. The themes, not listed in priority order, encourage:

1. research and discussion of civil and political rights.
2. the awareness of civil and political rights.
3. adherence to the rule of law through a legal framework conducive to civil and political rights.
4. free and democratic electoral systems.
5. development of democratic principles and institutions that promote human rights.
6. development of human rights organizations.
7. increased access of women and ethnic groups to the judicial system and to the political processes.

Guidelines intended to help identify projects eligible for A.I.D. funding under Section 116(e) are annexed to this Policy Determination.

In addition to specific projects funded under Section 116(e), A.I.D. attempts to integrate its concern for civil and political rights in its other programs and projects. A.I.D. has an active private sector program which attempts to stimulate the activity of the indigenous private sector, through economic activities, cooperative, and indigenous private and voluntary organizations, in the recognition that the development of a strong, non-governmental sector is critical for the long-term preservation of civil and political rights in a society. These principles are implemented by A.I.D. in its normal project design and review process.

VI. Implementation

A.I.D. coordinates with other agencies to assure compliance

with the legislative provisions of Section 116(a) and 502B through its activities on the Inter-Agency Working Group on Human Rights and Foreign Assistance. PPC represents A.I.D. on that working group. PPC is responsible for assuring that procedures agreed to for review of the A.I.D. program are followed and are integrated into the project review process.

A.I.D.'s Bureau for Food for Peace and Voluntary Assistance in collaboration with regional bureaus is responsible for ensuring that the Food for Peace statutory provisions are implemented in countries where they are to be applied. The A.I.D. Office of the General Counsel advises whether specific projects satisfy the statutory requirement.

The Department of State Bureau of Human Rights and Humanitarian Affairs is provided an opportunity to comment on and participate in the CDSS, ABS, and other budget reviews as a means to factor human rights concerns in concrete terms into A.I.D. programs and projects. Where desired by the Bureau of Human Rights and Humanitarian Affairs or where identified by A.I.D., HA makes recommendations on specific proposals, based on human rights concerns.

Finally, in designing programs and projects under Section 116(e), A.I.D. works closely with HA which advises A.I.D. on the selection and implementation of such projects. A.I.D. believes that close coordination and consultation with the Bureau will assure effective and consistent implementation of U.S. policy.

M. Peter McPherson

M. Peter McPherson
Administrator

26 SEP 1984
Date

ANNEX

A.I.D. POLICY GUIDELINES FOR THE PROMOTION OF CIVIL AND POLITICAL RIGHTS

A.I.D. is strongly committed to implementing Section 116(e) which provides funding to encourage increased adherence to civil and political rights in countries eligible for U.S. bilateral assistance. The legislation establishes a target of $3 million for such projects, a target A.I.D. views as a minimum, not a ceiling. "Civil and political rights" is a broad term, including but not limited to the legal structure and the electoral process. Also included are such areas as freedom of the press, the right of association (trade unions, and social groups, as well as political parties) and the like.

The overall approach to the program contains the following elements:

-New initiatives are encouraged. We are looking for innovative approaches to a broad range of civil and political rights concerns.

-Projects should encourage the building of institutions that promote human rights and uphold democratic principles. This approach recognizes that in the long term democracies are the best guarantee of civil and political rights. It is not necessary to confine projects to societies that already respect human rights and democratic principles. Experience has shown that even in repressive societies there are opportunities to encourage increased adherence to civil and political rights. These opportunities should be identified and supported.

-Projects should emphasize activities that will have a positive, rather than adversarial, influence on governmental human rights policies. A.I.D. supports projects that will increase the understanding and enhance the role of civil and political rights, or that will incrementally improve performance in one or another area of rights.

-To the greatest extent possible, projects should emphasize activities that originate in developing countries themselves, and that directly involve the people of those countries.

-Projects from private groups and individuals are encouraged.

-Regional Bureaus and A.I.D. Missions should be actively engaged in identifying and helping to develop projects and activities that will promote wider observance of human rights. Funding needs for such activities should be anticipated and provided for in the regular budget cycle.

In order that A.I.D. may meet the legislative target, each Regional Bureau is responsible for providing a proportional share of funding for human rights activities.

The human rights programs A.I.D. is encouraged to support cover the seven broad themes listed below. Included are some illustrative examples of the types of activities and programs we wish to promote:

1. Encourage research on and discussion of civil and political rights.
Programs that will expand the philosophical understanding of human rights in developing countries; developing and improving the teaching of civil and political rights; studies or research on the relationship between civil and political rights and development.

2. Encourage the awareness of civil and political rights.
Studies, seminars and educational programs for developing country personnel on the full range of fundamental rights; the distribution of human rights materials; programs designed to educate the citizenry of a country to know and understand the rights and protections offered under their legal system, as well as their political rights and responsibilities; formulating, producing, translating and disseminating publications which address the establishment of principles of civil and political rights and the legal and institutional mechanisms through which they are protected and promoted.

3. Encourage adherence to the rule of law through a legal framework conducive to civil and political rights.
Included are projects assisting a government to strengthen its legal system, focusing such efforts on establishing or preserving the fundamental principles of law. A strong legal system should include such essential elements as the rule of law, due process, and an educated and independent judiciary. The legal system should encourage fairness and equal protection for all. Some of the general areas covered are the development of democratic constitutions; improvements in the administration of justice; legal education and professional development of lawyers and judicial personnel; improved informational resources on legal theory and practice; reform and implementation of civil and criminal codes; and publication and distribution of court opinions.

4. Encourage free and democratic electoral systems.
The right to vote, the right to a secret ballot, the right to a fair and accurate count of the votes, and the assurance that those fairly elected will enter into office are fundamental to the establishment and perpetuation of

free elections. Programs of local or international organizations that educate citizens on their right and responsibility to vote, provide advice in designing and implementing an electoral system, or provide for the presence of independent election observers, are examples of activities appropriate for A.I.D. support.

5. Encourage development of democratic principles and institutions that promote human rights.
Activities include programs to increase public understanding of democracy; improved functioning of democratic institutions, such as the legislature and the press; the study of democratic principles; the development and support of private indigenous groups that are pluralistic and democratic; and assistance to programs designed to help a country develop, or return to, civilian democratic rule.

6. Encourage the development of human rights organizations.
Activities should develop and support indigenous, regional and international human rights institutions that are independent of individual countries or governments; assisting groups in their efforts to develop and make available information on human rights; and develop and build contacts and institutional relationships among human rights groups.

7. Encourage the increased access of women and ethnic groups to the judicial system and to political processes.
Activities that redress violations or discriminatory laws or practices against members of a particular group; outreach programs that broaden knowledge and awareness of civil and political rights among these groups.

While the program emphasizes the above seven themes, A.I.D. is receptive to areas not listed above if a strong justification can be demonstrated showing how the proposed activity improves or promotes adherence to civil and political rights.

The legislation prohibits funds to be used directly or indirectly to influence the outcome of any election in any country. All legislative restrictions relating to Development Assistance and Economic Support Funds in the Foreign Assistance Act, including Section 660 which prohibits assistance to police, prisons, and law enforcement forces, apply to Section 116(e) activities.

The Bureau for Program and Policy Coordination (PPC) oversees the human rights program in A.I.D. A.I.D. administers the program in coordination and consultation with the Department of State's Bureau of Human Rights and Humanitarian Affairs (HA), from which A.I.D. receives policy guidance on this subject.

III.B2 (TM 1:34)
11/9/84

A.I.D. Policy Paper

WOMEN IN DEVELOPMENT

U.S. Agency for International Development
Washington, D.C. 20523
October 1982

III.B2 (TM 1:34)
11/9/84

A.I.D. Policy Paper

Women in Development

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

October 1982

Preface

This policy paper demonstrates how LDC women's concerns are to be integrated into AID's program. Other policy papers recognize various roles LDC women play. For example, the Food and Agriculture paper highlights women as agricultural producers, farm laborers and family food providers, and recommends an expansion of their opportunities in the food-related and agriculture fields. The Water and Sanitation paper recognizes women's stake in the provision of clean water and sanitation for the community. The Nutrition paper points out that since women's income is most likely to go toward food for her family, improving nutrition through increased income generation should focus on women. The Private Enterprise paper establishes four priorities for AID's investment (agriculture, agribusiness, small scale industries and private sector service enterprises), all of which are important areas for women's involvement. But, unlike most of AID's policy statements, the Women in Development Policy is cross-sectoral; it is meant to provide the policy framework and overall practical guidance for each sector and for the Agency as a whole in its efforts to incorporate women into the total development process.

I. Summary of AID Women in Development Policy

(1) AID will take into account the actual and potential roles of LDC women in carrying out its development assistance program. This will be done in all AID's country strategies and projects in order to ensure achievement of development goals, through:

a. overall country programs and individual project designs which reflect the distinct roles and functions of LDC women as they relate to project implementation;

b. strategies for explicitly benefiting women and girls in all sectors within countries, and in all projects within sectors which are developed and implemented as an integral part of AID's work;

c. sex-disaggregated data collection, gender-specific social-soundness analysis and economic analysis, monitoring and evaluation.

(2) AID will also, under appropriate conditions, support LDC women's institutions and programs where special efforts are required to reach women because of cultural conditions, where separate programs and facilities are deemed necessary, or where women's groups provide a particularly advantageous vehicle for addressing women's needs.

(3) AID recognizes that the productivity of women is important to personal, family and national well-being. Women's increased productivity depends on their improved access to resources, e.g. land, improved farming techniques, information, employment; therefore,

a. where lack of education and training constrain women's effective access to more productive work, AID will seek to increase relevant knowledge and skills among women and girls;

b. where inefficient technologies reduce women's overall productivity, AID will support the development of labor-saving and time-saving technologies which are acceptable and accessible to women;

c. where systematic bias exists against females in the labor force, or in certain segments of the labor force, AID will support efforts to alleviate the bias, through policy reform and/or experimental programs which demonstrate ways in which women can enter non-traditional types of work.

(4) AID acknowledges that largely because of their traditional responsibilities for child care and family welfare, women in developing countries have special needs for adequate human resource development programs in the areas of health care, family planning, potable water, nutrition and education. AID will support investments in human resource development which have particular implications for females in society. Effective strategies to secure women's inclusion in such programs will ultimately result in the critical national benefit of a healthy, well-trained, productive workforce.

(5) AID will support the development of institutions and transfer of technology which ensure: (a) the appropriateness and access of improved technology to women (as well as men); and (b) the existence of institutions which include women and effectively reach women (as well as men) and which permit the dissemination of benefits and information to both sexes.

(6) AID acknowledges that there is still much to know about the implications for development of gender differences among target populations. Such knowledge gaps severely reduce the effectiveness of development program planning. Therefore AID will support research in areas where adequate knowledge of gender-roles in relation to development planning is lacking. Such research will include (but not be limited) to:

a. studies of *intra-household* dynamics regarding division of labor, distribution of resources and decision-making;

b. income needs and income sources for males and females;

c. women's contribution to agriculture;

d. fuel and water needs and sources;

e. incidence of households which are actually or *de-facto* female-headed.

(7) AID recognizes that most LDC's have endorsed the goal of further integrating women and girls

into the development process through support of international efforts such as those undertaken by the various UN entities (e.g., UN Decade for Women, FAO's WCAARD Plan of Action), and that most countries have established their own programs and plans to address the concern of women in development. Therefore, AID will support reforms which are consistent with these national positions.

(8) AID seeks to increase the knowledge and skills of its staff in planning projects which effectively engage women in the development process and its benefits. The Office of Women in Development and the women in development officers will continue to *support* the Agency's personnel in their efforts to implement the women-in-development policy. However, *the overall responsibility for implementation of this policy rests with all of AID's offices and bureaus, in all AID programs and projects*.

II. Introduction

Nearly a decade has passed since Congress first introduced the subject of women in development into AID's program. The 1973 "Percy Amendment" to the Foreign Assistance Act required that the U.S. bilateral assistance programs:

"be administered so as to give particular attention to those programs, projects and activities which tend to integrate women into the national economies of foreign countries, *thus improving their status and assisting the total development effort*." (emphasis added)

This legislative mandate and the extensive women in development literature make two basic points. The first point (". . . thus improving their status . . .") raises the social or equity issues which derive from women's status relative to men in many countries. It stresses the need for development planners to be sensitive to the ways in which modernization may negatively affect females in society. This approach casts females as beneficiaries of development, and focuses on the need for planners to guard against negative effects of their projects on women.

The second point (". . . and assisting the *total* development effort"), the economic or efficiency issue, focuses on women as active contributors to and agents of economic development, and actively seeks to enhance women's participation in the process. This approach emphasizes women's economic roles. It stresses the need to enhance their productivity, raise their incomes and promote their access to economically productive resources as a means to achieving overall national economic growth. While both arguments are important and both serve to guide AID's interpretation of the women in development policy, AID's primary concern is to fully comprehend that the *pace of development and the quality of its outcome* is greatly dependent on the degree to which women and girls fulfill their potential contribution and share in society's gains.

Of course the primary responsibility for ensuring the participation of both women and men in development rests with LDC governments and the people themselves. But it is clear that foreign donors such as AID can play a part in the process. AID must now move beyond its initial activities, and provide leadership in ensuring that women have access to the opportunities and benefits of economic development.

The major challenge for economic development is the need to make more efficient use of scarce resources. Women and girls are resources for development whose contribution to development is already substantial. Yet their contribution would be dramatically enhanced if they were better educated, in better health, and had better access to training, services and jobs. Therefore, to pursue a development planning strategy *without* a women in development focus would be wasteful and self-defeating—wasteful, because of the potential loss of the contribution of vital human resources and self-defeating because development which does not bring its benefits to the whole society has failed. The underlying premise of this paper is that, for AID to undertake an effective strategy that promotes balanced economic development, a focus on the economic participation of women in development is essential.

III. Rationale for Women in Development Policy

One of the premises of AID's women in development policy is that gender-roles constitute a key variable in the socio-economic condition of any country—one that can be decisive in the success or failure of development plans. Research from the last decade portrays a fairly consistent pattern of findings that in most developing countries, females differ from men in their:

- access to and control over productive resources;
- stakes in development outcomes;
- responses to incentives introduced to encourage development

Briefly stated, the constraints which women face in the task of self- and therefore national-development are often different constraints than those men face. The particular ways in which females are constrained function as limitations to the overall development process itself. Some constraints relate to cultural norms of physical mobility, while others derive from the predominant sexual division of labor and the consequent segregation of women in the economy. Time can also act as a constraint when women must fulfill

child care, home production, and market responsibilities.

The implications of these differences for development planners are substantial. The experience of the past ten years tells us that the key issue underlying the women in development concept is ultimately an economic one: *misunderstanding of gender differences, leading to inadequate planning and designing of projects, results in diminished returns on investment*. Gender, therefore, is a critical category of analysis in AID's work, one which has not received sufficient attention to date.

A. Access to and Control Over Resources: Gender Differences

Although there are regional variations, in most countries and within most ethnic groups it is much more difficult for women to: own land; obtain credit; receive training and information; and obtain new technologies. If these constraints are not overcome women's productivity will decrease and their economic independence will decline. Attempts to raise overall output and to achieve national self-sufficiency will be thwarted.

For example, even though there is now sufficient evidence to prove women's substantial contribution to agriculture in many of the countries of the world, there is equal proof that these women are often farming without benefit of the improved inputs and services required for a more productive and renumerative agriculture. The paradox is most obvious in the African setting, where it is estimated females do 60-80 percent of all agricultural work. Yet these same females are rarely systematically targeted for: training, extension, research, technology, or improved inputs. It is predictable, then, that efforts to improve access to resources and thereby to increase productivity in the agriculture sector will need to be better directed to the female population, if goals for growth are to be achieved.

B. Stakes and Incentives Related to Productivity: Gender Differences

There are also important gender-role differences affecting the way members of the society respond to incentives introduced to encourage development and the degree to which they perceive a stake in the outcome of a development intervention. Gender-roles are strongly associated in most regions with such tasks for daily survival as water-bearing and fuel provision. For example,

- in the numerous areas where water-carrying is traditionally women's work, it is crucial to understand the greater stake women may have in a project designed to improve water availability;
- certain types of environmental degradation (deforestation, soil erosion) also may bear more heavily on the lives of women and girls if, for example, their traditional responsibilities for providing fuelwood are affected. Where females supply the household with fuel women, not men, may be largely contributory to the fuelwood/deforestation crisis—and at the same time women and girls may have the greatest stake in finding a solution to the problem.

Knowledge of these gender-role patterns will assist project planners to maximize the chance of project success. Introducing incentives for change which are specifically adapted to gender-roles, and are therefore based on a proper assessment of the stake the population feels in the outcome of project, are critical to success.

For this reason, the accuracy and utility of descriptive terms which AID uses to describe target populations are questionable without gender distinctions. Employing aggregated terminology such as "family labor," "hired labor," "farmers," "youth," "children," and others, may mask key sex-linked aspects or social and economic behavior and may contribute to incorrect assumptions about the population in the conceptualization and implementation of projects.

Reliance on the *family* as the level of analysis in social data collection for instance, also contains inherent risks of misinformation. Often *intra-family* dynamics related to distribution of resources and division of labor by sex and age will be overlooked; these intra-household dynamics have critical implications for the successful implementation of projects.

An example is useful here. There is a predominant misperception about disposition of income within poor families which has persisted and given rise to critical miscalculations in project planning. This is the assumption that household incomes are:

- dominated by the contribution of a male "breadwinner,"
- pooled with other supplementary income earners (women and children), and
- redistributed within the family according to need.

This has led project planners to establish such objectives as to "raise family incomes," "improve family living standards," and "increase family resources."

However research findings for Sub-Saharan Africa, the Caribbean and South and Southeast Asia, indicate that the prevailing pattern of household economics is quite different. In fact there is a pattern of separate and distinct income streams and expenditures, where males and females meet financial responsibilities to the family individually with little or no access to each other's cash or other resources. Furthermore, studies indicate that it is often from *women's income*, not men's, that the basic survival needs of the family (food, health care, education,

maintenance of property) are met.

In some cases this type of family dynamic is a carry-over from tradition, one which has been misperceived and misunderstood by generations of outsiders. In others it is a relatively new pattern resulting from socially dislocating factors like migration, leaving women for at least part of the year as heads of households. In either event, income needs and income sources within the family require analysis which goes beyond preconceived and often erroneous assumptions about household behavior. A thorough understanding of the gender-related dynamics of: decision-making, resource allocation, and financial responsibility within the household is imperative if a Women in Development Policy is truly to be implemented by AID. Miscalculations derived from ethnocentric assumptions about women and imprecise social analysis will have negative consequences for project design and implementation.

IV. Women in Development Policy Issues

A. Agricultural Development

Women are the majority of the Third World's rural population. The small farmer producing food in Third World countries is, increasingly, a woman. The worldwide demographic and social changes which have occurred in tandem with Third World development have worked to push women *into* the agricultural sector, rather than out of it as was the case historically in many of the developed countries.

In the Andean region, women engage in agricultural field work, especially planting and weeding, processing of agricultural products, feeding, grazing, milking and shearing of animals and to a great degree in marketing (Deere & Leon de Leal, Bourque & Warren).

In Cameroon, the existence of women's farming systems, separate and distinct from those of their husbands' and fathers', and women's crops, has been described and analyzed (Guyer; Jones).

In Kenya, the productivity of women farmers compares favorably to that of men who receive equivalent farm services (Staudt).

In India, the participation of women in reforestation programs and in milk production schemes has been shown to be an important source of household income, particularly for those with limited resources (Dixon; Jain).

Therefore, steps must be taken to ensure that the new technologies and resources which are part of development assistance in the agriculture sector actually reach women. There has been little evidence in the past decade of "trickle-across;" in fact resources allocated to "the farm household" typically reach men rather than women. Male agricultural extension agents provide information to groups of male farmers; women farmers get the knowledge of improved technologies second-hand, if at all. Credit is given to those who own land; women in most countries, however, till land which is owned by their husbands, fathers, and brothers. Furthermore, steps must be taken to ensure that control which women may have over resources is not threatened or eliminated by reallocation of such resources to others. Finally, women's participation in agriculture must not be defined solely in terms of their labor; the benefits of that labor should also flow to women.

It is especially important, in the transition from subsistence to commercial agricultural systems, that the traditional concept of reward for labor be retained. In Cameroon, for example, men were allocated the resources (land, water, seeds, information) to enable them to produce rice for sale. Women were expected to carry out the tasks of transplanting and harvesting this rice and, at the same time, to continue their traditional cultivation of sorghum for their family's subsistence. Unavailability of women's labor became an unanticipated constraint to the expansion of commercial rice production and therefore to the desired improvement in standards of living in the area (Jones). Better pre-project analysis as well as implementation monitoring systems which enable women to communicate directly to project management, can help to prevent repetition of such cases. Farming systems approaches to agricultural research—*where researchers get directly in touch with rural women*—offer another avenue for seeking women's inputs into the definition of agricultural problems and possibilities. It should be noted however that experience has shown that this access to women farmers often requires special efforts; these must be planned for in the research design.

Other areas of agricultural and rural development activity which primarily involve women are those of food storage, processing and, often, trade. Women perform storage and processing tasks as part of their household maintenance duties as well as for cash incomes. Women engage in the trade of both processed and unprocessed agricultural commodities (both food and fiber) for profit. For example, Caribbean women higglers and hucksters are the mainstay of inter- and intra-island food trade.

In efforts to reduce postharvest food losses and to increase the amount of private sector activity in the rural areas, it is important to keep the role of women in these activities in mind. Addressing the problem of information transfer in methods of improved storage and processing technology will be part of the solution; training of women extension agents will help in this process. And developing techniques and technologies of postharvest food preservation and storage which are accessible to

women, and which can be maintained by them are equally important.

As efforts get underway in many developing countries to reduce the role of public agencies in food marketing, it is essential that women be given opportunities for greater roles in these markets. Their participation should be especially encouraged where they can provide marketing services efficiently and effectively at low capital costs.

To summarize, the key elements of AID's policy concerning women in agricultural development are that:

1. The sex- and age-linked division of labor by crop and ethnic group must be fully comprehended as a basis for all project planning.

2. Male and female differentials in access to and control over key productive resources must be understood and planned for in projects. These resources include:

land • capital • labor • credit • information • seeds • tools • fertilizers • water • fuel

3. The specific farming responsibilities which are uniquely and particularly assigned to female members of the household/society must receive an appropriate share of attention in project identification, design and implementation. These may include:

"women's animals" • "women's crops" • weeding • transporting • marketing • preserving • processing • storage

4. Explicit strategies to address gender-role aspects of farming must be built into all projects where outreach to farmers is attempted (extension, training, research, etc.). In particular, integrated services to address females' multiple responsibilities in farm households are required. These would include:

human nutrition/health • animal nutrition/health • farm management • family resource management • time/labor saving technologies

B. Employment and Income Generation

In the past decade, development activities that have targeted women as beneficiaries have been primarily focused on women's reproductive, health and nurturing roles. Projects aimed at directly increasing women's income have typically been small in scale with little attention paid to effective marketing or long-term viability. Such small-scale income generation programs, which effectively stand outside the mainstream of development planning, do little to address the long-term economic needs of low-income women. Furthermore, large-scale development programs often have not accounted for the actual economic roles women play or attempted to enhance these roles. The consequences have been to keep women in the unproductive sectors of the economy, underutilizing their capacity, and contributing to the failure of programs.

Poor women in developing countries bear major economic responsibilities, yet they are generally less well educated than men and have less access than men to modern productive resources. Thus they often fill jobs which require little skilled work and are among the lowest paying. General trends in Third World countries show that the percentage of women, although low in the formal labor force as a whole, is disproportionately high when one looks at the service sector. In all regions except Africa, where women tend to concentrate in agriculture, more than a third of working women are confined to service occupations. The data from Latin America show quite dramatically how the ranks of women in the labor force are swollen by their entry into service sector, where they fill the menial jobs, primarily as domestics.

Informal labor markets have always existed in developing countries but the increased population and the inability of the formal sector to accomodate the expanding labor force has pushed more people, especially women, into seeking employment in the informal sector. The size of the informal sectors in cities such as Bombay, Djakarta, and Lima varies from 53 percent to 69 percent of the working population of those cities. Female workers are disproportionately represented. In India, between 41 percent and 49 percent of the female labor force participates in the informal sector, while only 15 percent to 17 percent of the male labor force does so. (Mazumdar 1976, ICSSR 1975).

Therefore, in the *formal sector*, AID must encourage attempts to break the pattern of women's relegation to low-productivity occupations with no growth potential. AID can accomplish this by designing into projects the expansion of employment opportunities in sectors where women have not traditionally worked, and in those relatively new sectors of the economy where gender-specific work roles are not yet entrenched. In addition, AID can support and fund occupational training programs for women at two basic levels:

- Technical and industrial skills programs should be used to prepare younger women for entry into profitable employment sectors where there are shortages of skilled workers.
- Management skills programs should be used to prepare women for entry into white collar occupations which require knowledge of basic accounting, and administrative skills.

For the *informal sector*, a variety of programs for small entrepreneurs and micro-enterprises have been successful, and AID can adapt them for women. AID's decision to focus on technical assistance and/or provision of credit through financial intermediaries must depend on the par-

ticular situation. However, in many countries there are substantial numbers of self-employed women, particularly in micro and small industries, who will gain from enhanced managerial, administrative and financial skills, as well as from the formation of cooperative institutions.

Other factors which are relevant to AID's approach to women's employment and income generation are:

1. *Measurement of Women's Economic Activities*

Current information on women's productive activities in their national economies not only masks the contribution women make, it also masks the division of labor and the roles women play. These data collection practices are disadvantageous to women because:

- they exclude activities connected with household production of goods and services which are not actually sold on the market, and
- because women are more likely to be misclassified as economically inactive since the reference period or time frame in which women perform work often does not conform to the standard reference period used in data collection; women's work is more often than men's, home based, seasonal, and therefore elusive to categorize;
- for status reasons both men and women often deny that women "work".

AID's reliance on standard statistical measures of female economic activity must be tempered with knowledge of the substantial limitations of these data. Wherever possible, efforts to supplement national census data with more recent and microlevel surveys and other research data should be undertaken.

2. *Migration*

For several decades increasing population pressure, rural poverty and, more recently, the high wages offered in countries with labor shortages have caused men to emigrate from rural areas in search of wage labor in the city or in another country. As a result, women's roles are changing rapidly in rural areas. Rural women are being called upon to increase their work loads, to take over important decision-making roles, to organize cultivation, and to ensure that the decisions they make in economic matters are implemented. AID's investments in rural areas must be made with full knowledge of these effects of migration and the concomitamt increase in number of households which are female-headed.

Though men still predominate among migrants to urban areas, the number of women migrating is increasing, especially in Latin America and a few African and Asian countries. As compared to the men, the women immigrants have a lower educational level and face a very limited labor market. In Latin America they usually become street vendors or domestics. Whereas long-term male migrants are more likely to achieve upward mobility, the female either remains at the same level or her situation worsens. Special programs of non-formal education and vocational training must be provided to help these women develop skills for employment in the formal sector and increased income earning opportunities in the informal sector.

3. *Displacement of Female Workers by Technology*

The introduction of labor-saving technologies in many developing countries has resulted in the displacement of large numbers of unskilled rural and urban female laborers (e.g., rice milling, grain grinding, food processing, and the mass production of handmade items). In cases where mechanization has resulted in a decline in traditional sources of income for females or in reductions in female employment, mechanization can provide new employment for women only when they are trained and encouraged to enter the industry. The choice of mechanization in the agriculture sector, for example, should be made selectively, where economically justified and where the selected technologies are appropriate to the setting.

4. *Women's Organizations*

Typically, organizations selected to undertake income generating activities for women have had little technical expertise and yet have been selected because they are organizations exclusively of women. The objectives of these programs tend to be welfare-oriented and ill-defined; their activities often fail to provide women with real opportunities for generating income over the long-term. AID should support the upgrading and development of implementing institutions based on their *technical capability* or *potential technical expertise*. AID will support the funding of women-specific organizations only to the extent that they meet this criterion.

C. Human Resource and Institutional Development

1. *Education*

The education of women and girls has been called by the World Bank "one of the best investments a country can make in its future growth and welfare" for the following reasons:

- The better educated the mother, the less likely the child is to die in infancy. The children of educated mothers are better nourished and healthier.
- The children of educated mothers are more likely to succeed in school, more so than if only the father is educated. Their daughters are more likely

to attend school, do well and graduate.

- Educated women are more receptive to family planning and tend to have later marriages and fewer children.
- Primary education opens the way to further education or vocational training in agriculture, health services, etc. and, thereby, increases the opportunities to find remunerated employment.

All these facts are increasingly recognized, yet the number of female illiterates grows at a pace faster than males. Two out of three of the world's illiterates today are women. The following table presents literacy rates for selected countries in which AID works; only in Latin America is the skew less severe.

Number of Literates in the Population Over 15 Years (by Percent)*

Country	Year	Male	Female	Total
Africa				
Kenya	1980	64.3	35.1	49.6
Liberia	1980	42.2	9.3	25.4
Somalia	1980	10.0	0.5	5.2
Zaire	1980	77.2	39.4	57.9
Asia				
Bangladesh	1974	37.3	13.2	25.8
India	1971	46.8	18.9	33.4
Nepal	1975	33.4	5.0	19.2
Pakistan	1972	29.6	10.3	20.7
Latin America				
Ecuador	1974	78.2	70.4	74.2
Guatemala	1973	53.9	38.5	46.1
Honduras	1974	58.9	55.1	56.9
Near East				
Egypt	1974	53.6	22.4	38.2

*Source: UNESCO Statistical Handbook 1981.

Third World countries increasingly accept the importance of education for their populations. Yet girls are still impeded in their access to education by:

- competing household and child care tasks and responsibilities. In poor families both boys and girls must work, but girls have the added responsibility of caring for younger siblings.
- parents' negative attitudes toward educating daughters. There is the fear that education will make girls less compliant and, therefore, less marriageable. Educating daughters often is considered a poor investment by the family.
- shortage of schools. In countries where schools are segregated by sex, there are disproportionately fewer girls' schools.
- distance from schools, especially upper-primary schools. Many village schools are incomplete, offering only the first three or four grades.
- shortage of female teachers who can encourage girl students and provide role models. Housing for female teacher-trainees and teachers is often inadequate in rural areas.
- earlier marriage age for girls keeps them out of school or forces them to leave school at a younger age.
- lack of provision for girls to re-enter school once they have dropped out.

A variety of direct and indirect programs have been established in some countries to overcome obstacles, such as programs to improve attitudes towards female education. Financial rewards and other incentives can be provided to schools and teachers with high female enrollment in their classes. Women must be recruited for teacher training programs and encouraged to teach in rural areas. Alternate child care arrangements will release young girls so they can attend school. However, no significant progress in either raising the levels of education in society as a whole or in increasing upward mobility for women is possible without a major increase in the number of girls successfully completing primary and entering academic secondary schools.

2. *Population, Health and Nutrition*

Among the most important goals of development are better health, improved nutrition and reduced fertility. In their multiple roles, women play a central part in strategies to improve health, raise nutritional levels and reduce population growth. Investments in these areas and in education are the basis for the development of human capital.

It is not possible to achieve the necessary changes in nutrition, health and population growth without understanding and addressing the roles of women. In places where the norms prescribe for a woman the role of child bearer as the primary means of attaining status, where female children find their educational prospects limited, where early marriage is the rule rather than the exception, daughters are typically condemned to the same conditions which circumscribed their mothers' lives. If fertility is to be reduced through the use of voluntary family planning services, it is necessary to address, through other development efforts, those factors which may militate against women's understanding of and ability to utilize family planning. Of the factors bearing on women's reproductive behavior, their education and their access to and control over resources and income are particularly significant.

3. *Institutions*

Viable self-sustaining institutions at the local, regional and national levels (both public and private) are critical elements in development. Unions, cooperatives, credit and lending associations, and markets are examples of institutions that greatly benefit from women's active participation, while at the same time benefitting women. To the degree all LDC institutions include and represent women as well as men they will succeed in providing access to key resources and ensuring the full development of human capital.

Women who combine the skills provided by modern education with an understanding of the traditional values and local realities affecting women contribute a great deal to successful development programming. Thus AID must take measures to provide access for women to training programs and higher education, especially in the management and administration of the sectors, to prepare them for positions from which they can influence policy formation.

Additionally, since most countries today have governmental agencies assigned to address the needs of women, AID should regard these entities as channels for both obtaining and disseminating information about women as well as potential vehicles for carrying out projects to enhance women's economic productivity. In countries where, women's issues can *only* be addressed in a segregated context, these women's bureaus can also provide an appropriate institutional contact to inform and advise AID in its women in development efforts. AID recognizes, however, that in most countries it is the functional ministries that bear primary responsibility for integrating women into their programs—and for ensuring the relevance of their programs to the particular needs of women and girls—in order to ensure the success of their overall activities.

D. Energy and Natural Resource Conservation

In the villages of the Third World, women are important providers and consumers of energy. Traditionally, animal and human energy have been used to plant, harvest and prepare food, and to obtain fuel for warmth and cooking. It is usually women and girls who collect the wood, dung and crop residue used for these purposes. In effect these women are caught in a kind of vicious circle. In order to obtain fuel for the household they must expend their own energy. As fuelwood shortages increase their situation is aggravated. More and more human energy is required to travel greater distances to collect fuel or to generate cash income to pay for fuel. In effect, human energy is substituted for another form: woman's labor must increase in proportion to the ever-decreasing supplies of fuel while women's available energy for labor is increasingly being taxed.

If women are to participate effectively in the development process, the energy they expend for such activities as obtaining fuel must be reduced by access to more convenient fuel sources; this frees energy for other productive activities. Any development project which proposes to add to women's workload without commensurate energy savings can be expected to fail.

Women, therefore, have a large stake in the success of AID's reforestation projects which can provide not only fuel, but food, fodder and medicines, as well as a cash return. Rural women have been shown to be very knowledgeable about the attributes of both familiar forest products and new rapid-growing trees for forest plantations. Women, however, cannot be expected to care for the seedlings and young trees if the primary benefits will accrue to others. Only if women share the control of forest product distribution will they have the incentive to participate in reforestation.

Several other cautions are in order. The adaptation of fuel conserving stoves and other energy- and labor-saving technologies to village life has proven to be extremely complex.

- Fuel conserving stoves have been slow to be adopted for a variety of reasons. For example, though the smoke of the old stoves is considered deleterious to the family's and particularly the women's health, it also keeps the insects away.
- Solar cookers are of use only in the heat of the day when many women may prefer not to cook or need to be working away from the house.
- Biogas digesters have proven adaptive for pig-raising since pigs can be penned and fed fairly easily. In a cattle-raising society, however, either fodder for the cattle must be collected or the dung must be collected if they graze. Either activity adds time to a woman's already long day.
- Labor saving technologies have displaced poor women from some of their traditional means of livelihood. The spread of mechanized rice mills in most of Asia, though a boon to the overworked women on the medium and large farms, has left many poor women destitute. Traditionally these poor women derived some income from hand processing rice, but it is now predominately men who own and work the mills.

In one Asian country, Bangladesh, a few rice mills have been set up under the management of women's cooperatives with cooperative members employed to run the mills. And in Egypt, some women in one village have organized to bake bread for the rest of the community using solar ovens which, though very economic in terms of fuel costs, are too time-consuming for individual households. Therefore these new technologies can provide the basis for small-scale enterprises with

long-term viability and economic return for village women when appropriately conceived and implemented.

E. **Water and Health**

AID recognizes that success of water and sanitation programs depends in large measure on the ability and commitment of people to use, operate and maintain the systems properly. What is not clearly understood by project planners is that the relation between water and health is primarily a women's concern.

As mothers, women are the traditional family health guardians and teachers of hygiene, disease prevention and sanitation. And as mothers they are largely responsible for the care and raising of children. Thus the high prevalence of waterborne and parasitic diseases, health problems due to contaminated water, and consequent high infant mortality rates are critical concerns to women. Women, therefore, have a strong stake in the establishment of water and sanitation systems and an equally strong incentive to make sure the systems are adequately and continuously maintained.

1. *Water Use*

Women as primary users and haulers of water can and should play a significant role in promoting community acceptance of improved water supply and sanitation programs. As primary water users the question of access is usually of more importance to women than to men. Will the location of the water source mean an increase or decrease in the time spent fetching and hauling it? Furthermore, numerous social and religious restrictions exist in many regions which may dictate restrictions (as in the case of installation of latrines) which will virtually prohibit men and women, or men and children from using the same facilities. Or the facilities may be situated too far from the home so that women will not or cannot use them. A lack of awareness of these sorts of traditional attitudes can lead to the failure of water and sanitation projects.

2. *Water Management*

Once a water supply system is brought to a village, a number of questions arise regarding its use. Will it be used primarily for agricultural and irrigation purposes? The need for sufficient available water for domestic use and for women's use in their small home gardens, where much of family's food needs are met, should not be overlooked. Women and men must not be put into competition with each other over limited available water. Involving local women in early management and water-use decisions, in regard to both domestic and agricultural uses, is critical and ultimately will be beneficial to the entire community. Wherever feasible water and sanitation projects should include a plan to train community workers—women as well as men—in the actual construction, operation and long-term maintenance of systems. Teaching women to maintain the water source can lead to long term cost savings.

3. *Time Allocation*

The time saved from water collection is especially important to women and to the community. Frequently women use this saved time in expanding or initiating more economically productive activities—like income-generation. AID Impact Evaluation Report Number 32 states that with the installation of piped water systems women in one village in Panama actually *doubled* their monthly ouptut of small home-produced goods.

V. Implementation of the Women in Development Policy

The responsibility for implementing AID's Women in Development Policy rests with all of AID's offices and programs, at all levels of decision-making. Implementation of this policy must be understood to be an important qualitative aspect of AID's overall program, one which is crucial to the achievement of the Agency's goals. It is not a concern which can adequately be addressed in any one sector alone, or by any single office or officer.

Several factors may constrain AID's implementation of the Women in Development Policy. These are:

- inadequate data on women's actual economic roles and a lack of experience in targeting women for other than welfare-type assistance;
- imputed or real sensitivities on the part of some host governments to interventions which explicitly address gender differences in the population;
- the cross-cutting nature of the Agency's women in development policy which precludes convenient compartmentalization of the issue.

In light of these contstraints, AID's Women in Development Policy should be implemented through the following approaches:

1. **Women in Development Activities in AID's Projects**

Effective implementation of AID's Women in Development Policy depends on the policy being reflected throughout AID's portfolio. This shall be done by:

a. introducing gender distinctions in the terminology employed in all of AID's program and project documents in order to define more precisely the social context and impact of AID's work.

b. disaggregating by sex data collected for AID's country strategy formulation, project identification, project design and throughout the life of projects. This prepares the way for soundness of pro-

ject implementation and provides a basis for measuring success/failure in gender-related terms.

c. relying on sex-disaggregated social soundness analysis to *inform* (not merely justify) the project development process.

d. requiring AID's country strategy, project identification and planning documents (CDSS's, PID's, PP's) to *explicitly* describe strategies to involve women, benefits and impediments to women and benchmarks to measure women's participation; providing substantive analysis of these statements during the process of their review.

e. requiring AID's consultants to address women in development issues by introducing this requirement in their scopes of work.

f. increasing the number of LDC women involved in AID's participant training programs.

g. evaluating and assessing the impact of AID's programs and projects according to gender differentials—both in relative and absolute terms—with regard to improvements in access to and control over resources and predicted benefits and returns.

WID projects and WID components of projects will continue to constitute a mechanism for the Agency to reach women, in circumstances where:

a. access to females in an integrated setting is constrained by cultural conditions;

b. where segregated institutions or facilities are the norm;

c. where experimental or model activities are being introduced and a controlled sex-specific environment offers the best hope of success.

For definitional purposes in AID, separate "women-only" projects or components of projects which are exclusively designed to directly benefit women *economically*—are differentiated from projects which provide *services* to women such as maternal-child-health, family planning services, etc. The former meet the criteria for a "WID project" in reporting Agency funding levels in women in development. The latter, services to women, do not.

2. AID's Women in Development Office and Women in Development Officers

AID's Office of Women in Development, in the Bureau for Program and Policy Coordination, will continue to serve as the Agency's focal point for disseminating relevant information, providing technical advice on specific women in development issues, granting supplementary funds to missions and outside groups to support women in development projects, components of projects, and data collection and analysis.

a. The Office will offer technical support to AID missions and bureaus to enhance their capacity to implement the Agency's women in development policy by participating in CDSS, PID and PP reviews; by consulting with mission and project staff during TDY's, and by contributing a women in development perspective to the Agency's overall policy development and evaluation efforts.

b. The Office will grant additional funds to AID's missions and outside groups primarily to support field projects where women in development concerns are addressed. Additionally, these funds will be used to support new and/or experimental initiatives where direct economic benefit will be achieved.

c. The Office will, together with other PPC offices, fulfill the coordinating function for AID with the other donors, UN agencies and nongovernmental organizations which are implementing their own women in development programs.

d. The Office will commission, compile and disseminate written resources on subjects related to women's economic and productive roles in LDC's, to inform and advise the Agency on scholarly findings and practical results from worldwide women in development activities.

e. The Office will seek to systematically collect, bank, assess and exchange experiences in implementing AID's women in development policy in projects and programs.

f. The Office will continue to work in cooperatic with Title XII and other universities, the Bureau c the Census, the Department of Agriculture and other public and private institutions to engage their expertise in implementing AID's policy on women in development through activities which provide information exchange, research, training and technical assistance to missions and private groups involved in development.

AID's women in development officers in bureaus and missions will inform and advise Agency staff and others on effective ways to implement the Agency's policy.

a. WID officers will be selected based on their knowledge of the subject of women in development in the setting to which they are assigned, their knowledge of the Agency's women in development policy, and their ability to act as resources to other staff and contractors in effectively translating the policy into operational terms.

b. WID officers will function as resources for the planning and implementation of work AID is undertaking in *every* sector. They should not be restricted to a single sector such as health, family planning or working with PVOs.

c. WID officers should seek out and make contact with groups and individuals who are actively engaged in women in development activities—including host country government of-

ficials and leaders, women leaders in the public and private sectors, scholars and researchers, project personnel and community members who have knowledge of women in development issues.

3. AID's Support for Other Donor and Host Government Women in Development Activities

The United Nations Decade for Women (1976-1985) has been instrumental in focusing international attention on women's issues as well as encouraging specific national measures for women in many countries. The sub-themes of the UN Decade for Women—employment, health and education—have important development implications and serve to guide many national governments in establishing priorities for action in women's programs.

Many LDCs now have women's bureaus within their government structures. These national machineries for the advancement of women—as they are termed by the United Nations—are important to AID in carrying out its Women in Development Policy. Whenever appropriate, women's bureaus will be encouraged to undertake activities such as collecting information on women to supplement existing macro-data sources, carry out action projects which increase women's economic self-sufficiency and encourage leadership by women leaders and scholars. AID will actively support LDC efforts to strengthen women's organizations and bureaus by granting funds and providing technical assistance as needed.

AID through its missions will support and encourage the work of regional UN organizations such as UNECA, UNESCAP and the U.N. agencies such as FAO, ILO, UNESCO in their efforts to implement their plans of action relating to the goals of the Decade for Women.

III. CROSS-SECTORAL POLICIES

C. Special Cross-Sectoral Topics

A.I.D. Policy Paper
Trade Development

U.S. Agency for International Development
Washington, D.C. 20523
July 1986

A.I.D. Policy Paper

Trade Development

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

July 1986

TRADE DEVELOPMENT POLICY PAPER

Table of Contents

Section Page

Executive Summary 1

I. Introduction 2

II. Trade and Investment in LDC Economic Growth 2

III. Obstacles to Improving LDC Trade Capabilities 3

A. Import Substitution Strategies 3
B. LDC Parastatal Policies and their Impact on Private Investment 4
C. Lack of International Marketing Information, Experience, and Networks 4
D. Trade Barriers and Market Access 4
E. Low and Unstable Prices of Primary Products 5
F. Financing Constraints and Indebtedness 5
G. Increased Use of Countertrade 5

IV. U.S. Trade Policy and Its Relevance to LDCs 5

V. A.I.D. Policy for Trade Development 6

VI. Specific Components of A.I.D.'s Policy 6

A. The Policy Environment for Trade and Investment . 7
1. The Trade Environment 7
2. The Investment Environment 8
B. Trade Diversification and Technology Transfer 9
C. Trade and Investment Promotion 10
1. Private Sector Activities 11
2. Public Sector Activities 11
3. Small Enterprises and Entrepreneurs 12
4. Government-restricted Markets 12
D. Trade Monopolies and Parastatals 13
E. U.S.-LDC Trade Promotion 14
F. Economic Infrastructure 15
G. U.S. Policy Trade Coordination 15

ANNEX A- The President's Trade Policy Action Plan, Fact Sheet, September 23, 1985 17
ANNEX B - Background Information on The General Agreement on Tariffs and Trade (GATT) 19
ANNEX C - Background Information on the U.S. Generalized System of Preferences Program (GSP) 20

Executive Summary

World trade is one of the primary keys to international economic growth and development; LDC exports are of increasing importance in achieving a level of sustained economic growth that will improve the living conditions of the poor. Because foreign assistance is a relatively less significant source of foreign exchange for LDCs, countries that seek self-sustained economic growth will have to rely principally on an expansion and diversification of trade to meet their energy needs, and finance imports of capital goods, intermediate inputs, and, in a number of cases, food. The purpose of this policy paper is to provide direction to A.I.D. in the encouragement of appropriate LDC trade policies and a framework for the design of trade-related programs and projects.

For developing countries, sound trade policies are an integral component of an effective development strategy that will stimulate growth and the productive use of natural and human resources. The opening of markets to foreign trade is an important step in accelerating economic growth. Exports play a vital role in long-term job creation and overall employment in an LDC's economy.

Despite the advantages of an outward-looking trade policy as a mechanism for achieving economic growth, there are many barriers that must be overcome before such a policy can be pursued successfully by an LDC. These barriers include import substitution strategies; LDC parastatal policies and their impact on private investment; the LDC's lack of international marketing information, experience, and networks; industrialized countries' trade barriers and market access policies; low and unstable prices of primary products; financing constraints and LDC indebtedness; and increased use of countertrade.

The U.S. view of appropriate trade policies for both developed and developing countries derives from the same basic principles to which the United States itself subscribes. A.I.D.'s policy on trade and its role in development are fully consistent with and derive from the following three fundamental principles of U.S. trade policy: (1) free and open trade benefits all nations; (2) fair trade is essential to support free trade; and (3) an effective international trading system is essential to preserve open markets and growing and fair trade. These basic principles have been the cornerstone of U.S. trade policy for over 37 years, and complement the United States' belief that only through a strengthened international trading system can effective rules governing fair trade be established, trade liberalization be negotiated, and disputes be settled.

A.I.D.'s trade development policy is designed to encourage LDCs to utilize international trade as a key instrument in the process of achieving broad based, sustained economic growth, and place a greater reliance on complementary domestic competitive markets that support more open trade policies.

A major focus of the trade development policy is on building developed country and LDC private enterprise ties on a continuing, long-term basis, consistent with the broad American objectives of trade liberalization. The formation of such ties should lead to:

- development of stronger LDC economies based on the efficiency of market-based resource allocation;
- development and strengthening of mutual economic interests between developed countries and LDCs;
- encouragement of entrepreneurship, economic institution building, and reliance on sources of private finance; and
- adoption of appropriate economic policies.

A.I.D. will focus its trade development efforts within the framework of the four pillars. Specifically, the policy directs that A.I.D. policy dialogue, programs, and projects (1) establish a policy environment that is conducive to private enterprise and expanded participation in international trade; (2) encourage the transfer of technology, skills, and information required to expand and diversify LDC agricultural and industrial bases for export production in areas with comparative advantages; (3) support trade and investment promotion efforts; (4) introduce or expand private sector competition in the export or import of essential or economically important commodities; (5) broaden the scope of export development projects to provide for greater U.S.-LDC two-way trade opportunities; and (6) encourage prudent investments in infrastructure to improve an LDC's trade

position. The guidance reflects A.I.D.'s experience with trade policy and projects, and should be applied when a Mission has made the decision to pursue trade or export development as part of its economic development strategy.

Trade Development Policy Paper

I. Introduction

World trade is one of the primary keys to international economic growth and development; LDC exports are of increasing importance in achieving a level of sustained economic growth that will improve the living conditions of the poor. Because foreign assistance is a relatively less significant source of foreign exchange for LDCs, countries that seek self-sustained economic growth will have to rely principally on an expansion and diversification of trade to meet their energy needs, and finance imports of capital goods, intermediate inputs, and, in a number of cases, food. A.I.D. will assist LDCs in improving their ability to trade because, through expanded trade, industrialized and developing countries benefit from increased economic efficiency, higher levels of income and employment, and greater access to technology. This approach is consistent with U.S. Government trade policy, which has historically promoted policies oriented towards liberalizing world markets and limiting government management of trade and investment.

The purpose of this policy paper is to provide direction to A.I.D. in the encouragement of appropriate LDC trade policies and a framework for the design of trade-related programs and projects. It is intended to be useful to Missions in thinking about and conducting their dialogue with LDCs on trade policy and in crafting A.I.D. interventions where appropriate. This policy paper builds upon A.I.D.'s experience with trade and export development and its private enterprise initiative. It supersedes "AID Policy on Trade, Investment and Development" (dated May 15, 1978).

II. Trade and Investment in LDC Economic Growth

The opening of markets to foreign trade is an important step in accelerating economic growth. Exports play a vital role in long-term job creation and overall employment in an LDC's economy. If the processes used for export production are labor-intensive, the country will realize significant employment gains in the short- and long-term.

Although foreign assistance may be needed in the early stages of development of the poorest LDCs to help provide capital and to develop export-oriented institutions, this aid becomes less important as an LDC's capacities to export are strengthened. Once their industrialization process begins, aid should be used to encourage those countries receiving assistance to graduate in a timely fashion from that assistance. For example, the economic well being and growth prospects of many emerging middle-income developing countries now depend on their ability to access international product and financial markets rather than on foreign assistance. Export earnings in many LDCs contribute a far more significant proportion of foreign exchange resources than Official Development Assistance; the LDC's export earnings of $324 billion in 1983 amounted to 10 times their inflow of resources from foreign aid. With the flow of foreign assistance unlikely to expand in the foreseeable future, reliance on trade as a means to earn foreign exchange will be of even more critical importance for most LDCs.

Recent studies have confirmed the strong relationships between export- or outward-oriented strategies, a reliance on open market trading policies, and economic growth in LDCs.* The success stories of many of the Newly Industrialized Countries (NICs) illustrate this point. Although the characteristics of individual NICs differ, four factors were very important for their success and ability to compete in world markets: (1) a reliance on export promotion and the international economy as major sources of expansion for their manufacturing and industrial sectors; (2) a commitment to achieving market-based economic growth that enabled them to alter domestic policies accordingly; (3) a sustained investment in human resources development; and (4) close cooperation between government and the private sector. Another

*See Jagdish Bhagwati, *Anatomy and Consequences of Exchange Control Regimes* and Anne O. Krueger, *Liberalization Attempts and Consequences*, National Bureau of Economic Research, New York, 1978; and Alvin Rabushka, *Free Markets and Economic Development in Postwar Developing Countries*, U.S. Agency for International Development, December 1983.

important factor contributing to this growth was the presence of a proper mix of export-oriented development policies and import substitution policies. In some cases, this meant that economic growth was spurred by, or relied in part on, a sound agricultural sector.

The NICs, who accounted for much of the impressive LDC economic growth during the 1974–1980 period, are now expanding their activities into more complex, skill-intensive, and higher wage manufacturing. As these more advanced NICs (like South Korea, Taiwan, Hong Kong, and Singapore) progress to higher technology products (such as consumer appliances, electronics and computers), there is potential for other nations to take advantage of opportunities to supply more labor-intensive manufactured goods on world markets. In fact, a second group of countries that includes Colombia, Malaysia, Thailand, and Tunisia has recently accelerated economic growth via the export of labor-intensive manufactured goods.

An LDC can maximize its benefits from freer trade to attain sustained economic growth and a reasonable approximation of full employment only if the opening of its economy to international markets is accompanied by domestic policies which foster market-based resource allocation and permit development of those activities in which it has a comparative advantage. A country that restricts trade and controls (or distorts) its internal resource allocation through administrative measures is most likely forcing some of its resources to flow into less efficient uses. Government policies and administrative efforts that ignore this fact cause some production to become more costly than the domestic market will bear. This restrictive approach could cause, in effect, a "tax" on the production in which the country may have a comparative advantage in order to "subsidize" the production in which it has no comparative advantage. These efforts to protect LDC economies from competitive world trade also result in a diversion of resources that could be applied to other development problems.

As an LDC removes import and export restrictions and controls, the market will allocate resources away from less efficient uses and toward productive activity in which they are more suited. This shift of resources to their more efficient use accounts for an initial period of increased specialization in production (as well as a genuine savings to an economy). The relaxation of import restrictions will also provide indigenous businesses with access to the financial, technological, and managerial inputs necessary to fuel economic growth. In the longer run, as a country's human resource base develops, a country may expand the number of activities in which it has a comparative advantage. Such diversification of production is important for stability and sustained growth in order to hedge cyclical or secular declines in export prices.

Increasingly, trade and investment flows are interrelated. The opening of markets to foreign direct investment also provides a way for LDCs to diversify their economies at the same time they gain access to new technology and managerial skills. Open and fair investment policies are essential to an expansion of investment and technology transfer. An open and stable investment environment will position developing countries to acquire the capital necessary for private sector development. Less government intervention in the economies of developed and developing countries with correspondingly fewer restrictions on domestic and foreign investment will greatly assist rapid development and growth in world trade.

III. Obstacles to Improving LDC Trade Capabilities

In the near term, there is some doubt about the capability of many LDCs to compete successfully in world markets or to serve as major sources of world demand. Despite the advantages of an outward looking trade policy based upon open markets, there are many barriers that must be overcome before such a policy can be implemented by an LDC. These barriers reflect problems that are both internal and external to LDCs. Although the nature of these barriers varies from country to country and generalizations may not be applicable in all LDCs, some of the more severe obstacles are common to many LDCs.

A. Import Substitution Strategies

Many LDCs have promoted import substitution strategies for economic growth and employment generation. These strategies are generally initiated by enacting temporary protection, such as high tariffs, for infant industries against foreign competi-

tion. Although these tariffs have gradually been decreased, they remain well above developed country tariffs and are used increasingly in tandem with nontariff barriers to protect these industries.

This new form of protectionism is difficult to dismantle once it has been established. In these instances, import substitution leads to increased inefficiency in the domestic market (encouraged by government policies that subsidize industries in which a country may have no comparative advantage) and keeps foreign products out of LDCs on a selective basis. It is better for an LDC to develop its economy through development of the market with increased exports leading to an appropriate percentage increase in imports than to try to do so behind barriers of import substitution.

Inward-looking development strategies utilize a variety of measures to allocate imported goods toward priority areas (as perceived by the LDC). These measures include an overhauled exchange rate, restrictive exchange controls, tariffs, and quantitative import and export restrictions. Such interventions in the market favor certain imports, but cause high prices to be charged on imported items not under official exchange rates. Moreover, productive activities in which the country has a comparative advantage may also be severely affected by the restrictions on imports of intermediate goods, the higher export price of their products, the higher transaction costs due to controls on trade, and the tax effects of cross-subsidies required to sustain the inefficient producers in other industries or sectors.

B. LDC Parastatal Policies and their Impact on Private Investment

Since inefficient sectors or industries cannot survive unless policies are in place that distort price signals, an economy that restricts trade almost always requires the use of parastatals or government-sanctioned private monopolies to provide the necessary goods and services. The existence of the parastatals or monopolies creates additional obstacles to liberalization in the future, through the creation of "vested interests" as well as the inability of such enterprises to compete against more efficient private concerns. Developing countries find themselves in the dilemma of wishing to attract private investment in a sector where a public company exists, while at the same time having to shield the less efficient public company from full competition.

In this conundrum, the private investor often loses. Existing foreign or indigenous investors often become frustrated by the favorable treatment and the unfair competitive advantage given public companies and may often see their firms forced out of business, while the LDC spends precious resources keeping the SOEs afloat. Similarly, foreign or indigenous private investors may sometimes be discouraged from entering the market altogether because of the more favorable treatment extended to the public enterprise.

C. Lack of International Marketing Information, Experience, and Networks

Many firms in LDCs find it difficult to obtain the technical skills or knowledge needed to identify products appropriate for export. The lack of information is a particular problem when new export activities require a clear technical and managerial understanding of production possibilities, a firm grasp of present and future market conditions, and international marketing skills. Among the factors contributing to this lack of market information are the (1) high cost of obtaining information; (2) lack of knowledge about new business practices; (3) insularity of many LDC businesses from market channels; and (4) costs of developing contracts and sales networks.

D. Trade Barriers and Market Access

In the wake of a global recession in the early 1980s, followed by an imbalanced recovery concentrated almost entirely in North America, many industrialized countries are intensifying and expanding protectionism for their domestic industries and agriculture against imports from LDCs. A major concern about the renewed protectionism is that it poses new obstacles against products that might form the basis of a feasible export expansion program by these LDCs. Although some analyses indicate that the new protectionism has had a modest impact on the volume of trade, the following considerations have been raised:

- the adverse effects on trade may show up later, since investment in export-oriented activities will be inhibited and since some of the measures are only recent;

• the pattern of trade may have been distorted even though total trade has not fallen; and

• in the absence of these protectionist measures, trade would have expanded much faster than gross national product, so that a shift to more export-oriented growth is being inhibited.

Widespread protectionism would lower long-term growth by reducing international trade, economic flexibility, and the productivity of capital and labor, as well as serve as a disincentive to greater foreign trade and investment in LDCs.

The United States market has been more open to LDC exports than have those of our major trading partners in recent years. In both 1982 and 1983, for example, a majority (55-60 percent) of LDC exports of manufactured goods to the industrialized countries went to the United States alone. Our more robust economic recovery, and the high value of the dollar, have drawn imports to our economy. The fact that such a large percentage of manufactures from LDCs is entering our market, despite strong protectionist pressures, is testimony that U.S. barriers to imports are relatively low.

E. Low and Unstable Prices of Primary Products

Many LDCs, especially the lowest income nations, specialize in the export production of one or a limited number of primary products. Due to technological advances in the production of substitute goods and a softening of world demand, a number of these products have experienced downward price trends.

F. Financing Constraints and Indebtedness

Much of the funds borrowed by the non-oil producing LDCs in the 1970s was invested in projects that did not produce foreign exchange earnings sufficient to cover the ensuing debt service. The debt service burden has, in turn, reduced the amount of foreign exchange available for new investments, and caused private banks to exercise more cautious lending policies than in the past. New foreign investments in LDCs have slowed as well, cutting off a valuable source of funds for economic growth and limiting indigenous investment possibilities.

G. Increased Use of Countertrade

Many LDCs resort to countertrade* arrangements because of the weakness of commodity markets and their deteriorating foreign exchange positions. Countertrade is always less efficient than normal commercial transactions—bilateral arrangements are cumbersome, costly to LDC governments, deprive LDC companies of direct marketing and financing experience, and, in some cases, intensify downward price pressures on LDC commercial exports. When LDCs deal with foreign exchange shortfalls by using countertrade as an export financing mechanism, they should take care that the comparative advantage is clear and there is minimum distortion to market allocation. Although, as a matter of policy, the U.S. Government does not oppose the participation of private enterprises in countertrade arrangements (as this may be one of the few ways that they can meet some of their import needs), it does not support government-mandated countertrade.

IV. U.S. Trade Policy and Its Relevance to LDCs

The U.S. view of appropriate trade policies for both developed and developing countries derives from the same basic principles to which the United States itself subscribes. For developing countries, sound trade policies are an integral component of an effective development strategy that will stimulate growth and the productive use of natural and human resources. A.I.D.'s policy on trade and its role in development are fully consistent with and derive from the following three fundamental principles of U.S. trade policy:

- Free and open trade benefits all nations. The United States believes that free trade and open markets permit the principles of comparative advantage to work, produces more jobs, more productive use of natural resources, more rapid innovation, increased consumer choices, a higher standard of living, and higher incomes. (Comparative advantage does not mean LDCs must continue to depend on natural resources as the

*Countertrade may be defined as transactions in which the seller provides the buyer with deliveries (such as technology or finished products) and contractually agrees to purchase goods from the buyer equal to an agreed-upon percentage of the original sales contract value. Countertrade is a term that encompasses barter, buy back, counterpurchase, offset, and compensation trade.

principle export; it means a greater opportunity for them to develop non-traditional exports.)

- **Fair trade is essential to support free trade**. The United States believes that fair trade must be based on mutually acceptable rules that give no country an unfair advantage. Trade opportunities derive from the principles of comparative advantage, not artificial advantages that create barriers or close markets. (Fair trade principles are as relevant to industrial as to developing countries since the benefits to growing world trade should not be limited to one group at the expense of another.)

- **An effective international trading system is essential to preserve open markets and growing and fair trade**. The United States believes that only through a strengthened international trading system can effective rules governing fair trade be established, trade liberalization be negotiated, and disputes be settled. The interests of developing and industrial countries can best be realized through participation of all countries in the GATT. (In particular, developing countries' active participation in trade negotiations under GATT auspices is the only effective means to assure that their trade interests are considered and respected.)

These basic principles are inherent in the General Agreements on Tariffs and Trade and, therefore, have been the cornerstone of U.S. trade policy for over 37 years. Although the basic principles of U.S. trade policy have not changed during these years, the importance of trade to the world economy and to economic development has grown.

More open trade and investment policies are particularly important for debt burdened developing countries. The major element of Treasury Secretary Baker's Program for Sustained Growth is the adoption of policy reforms that maximize the contribution that trade and investment can make to the growth and adjustment process of developing countries. For example, those developing country economies that have continued to advance during the debt crisis of the 1980s are those that have adopted outward oriented growth strategies characterized by open trade and investment policies.

V. A.I.D. Policy for Trade Development

A.I.D.'s trade development policy is designed to encourage LDCs to utilize international trade as a key instrument in the process of achieving broad based, sustained economic growth, and place a greater reliance on complementary domestic competitive markets that support more open trade policies.

A major focus of the trade development policy is on building developed country and LDC private enterprise ties on a continuing, long-term basis, consistent with the broad American objectives of trade liberalization. The formation of such ties should lead to:

- development of stronger LDC economies based on the efficiency of market-based resource allocation;
- development and strengthening of mutual economic interests between developed countries and LDCs;
- encouragement of entrepreneurship, economic institution building, and reliance on sources of private finance; and
- adoption of appropriate economic policies.

This policy is consistent with two of the principal goals set forth in the Foreign Assistance Act of 1961, as amended: (1) the promotion of conditions enabling developing countries to achieve self-sustained growth with equitable distribution of benefits; and (2) the integration of the developing countries into an open and equitable international economic system.

VI. Specific Components of A.I.D.'s Policy

A.I.D. will focus its trade development efforts within the framework of the four pillars. Specifically, the policy directs that A.I.D. policy dialogue, programs, and projects (1) establish a policy environment that is conducive to private enterprise and expanded participation in international trade; (2) encourage the transfer of technology, skills, and information required to expand and diversify LDC agricultural and industrial bases for export production in areas with comparative advantages; (3) support trade and investment promotion efforts; (4) introduce or expand private

sector competition in the export or import of essential or economically important commodities; (5) broaden the scope of export development projects to provide for greater U.S.-LDC two-way trade opportunities; and (6) encourage prudent investments in infrastructure to improve an LDC's trade position.

This guidance reflects A.I.D.'s experience with trade policy and projects, and should be applied when a Mission has made the decision to pursue trade or export development as part of its economic development strategy. Whether explicit trade development activities should be initiated by Missions depends upon several factors, including Mission priorities, staff capacity, and country strategy. It is not expected that all Missions have the staff capabilities to undertake these activities. However, even if program or project interventions may not be called for, policy dialogue activities should be considered and carried out if at all possible. Missions should look to private sector contractors and consultants; business, trade, and professional associations; and U.S. and LDC private enterprises involved in trade for assistance in designing a trade strategy. AID/W will help Missions where it can.

A. The Policy Environment for Trade and Investment

1. The Trade Environment

LDCs can most effectively enter the international trading system by pursing trade-oriented strategies that reduce import protection in favor of economic diversification, competitive markets, and technology acquisition. A.I.D.'s efforts to help strengthen the trade capabilities of LDC private enterprises can be truly effective only if they are carried out in a policy climate that encourages market-based activity and maximizes the capabilities of the private sector. **Therefore, A.I.D.'s first effort related to trade should be directed towards establishing and improving a policy environment that is conducive to private enterprise and expanded participation in international trade.** Over the long term, it will be these policies, coalescing around trade-oriented strategies, that will be the dominant influence affecting an LDC's economic growth.

Trade-oriented strategies seek to eliminate, or at least minimize, economic distortions so that the prices of exports reflect as near as possible the real opportunity costs of the items to the country. Successful export strategies usually include the following:

- the reduction or elimination of duties and quotas on imports essential to the production of exports;
- the reduction or elimination of taxes and quotas on exports;
- the simplification of licensing and other bureaucratic procedures needed to export;
- the reduction, to real levels, of transaction costs associated with the handling of exports and related imports (e.g. licensing requirements, embarkation and disembarkation processes, etc.)
- elimination of subsidies on exports; and
- exchange regimes that reflect market rates.

Missions should pursue a policy dialogue with host governments to remove existing trade restrictions and controls. Political and social resistance to reevaluating import substitution policies and adopting an export orientation may be particularly strong in countries that have an elaborate structure of import substitution supports and considerable sunk investment in non-competitive import substitution industries. It may require the reversal of many long held, politically-based policies and the decline of inefficient industries. Any change in business activities to support exports may involve resistance by those who face possible losses. Opposition may arise from owners and managers of inefficient firms that would have their markets opened to competition, from workers threatened by displacement, and from others who benefit by the status quo. Missions should explore, with LDC governments and private enterprises, alternative uses for the human and financial resources that had been devoted to these industries.

Although this is a difficult process for some LDCs, this difficulty is not infrequently exaggerated by LDC politicians. Countries that have limited their import substitution efforts, and instituted policies to keep their import substitution industries competitive with imports, are likely to be less resistant to policies that would increase trade. If restrictions can be removed and the immediate adverse impacts of removing protection are hedged or lessened, the potential

for sustained economic growth will be dramatically increased. Although this may be easier said than done, it is important to pursue our targets here.

In a number of LDCs, the enactment of those policies that support the expansion of exports and the removal of those policies that restrict trade, must be accompanied by fundamental policy changes that may have more profound consequences for the economy at large. These may include:

- open market sales of foreign exchange;
- liberalization of financial systems so that the market will determine domestic rates of interest;
- elimination of laws or conditions that reduce or eliminate competition in production and trade; and
- policies that ensure that establishment of wage and benefit packages more nearly reflect the value of labor input.

There is no single rank ordering of the issues related to improving trade that can be applied in each Mission's policy dialogue with the host country. In some LDCs, opportunities may emerge to program A.I.D.'s assistance in direct support of a comprehensive policy reform program that will have a significant impact on improving trade and moving away from import substitution policies. In other LDCs with a relatively long tradition of import substitution and central management of their economies, A.I.D. assistance may have to be programmed to help the host country overcome fundamental fears of exposing its economy to world (and domestic) market forces. In such countries, A.I.D. may need to support a learn-by-doing approach focused on the development of a country's comparative advantage in nontraditional exports. Missions should obviously be careful not to augment distortions or introduce new disincentives into an LDC economy; their actions should be consistent with or designed to reinforce market-oriented activities and to encourage predictability in LDC policies.

Critical to the success of an open trading strategy is stability in government policies affecting trade and investment in particular and economic growth in general so that exporters, importers, and investors can develop long-term linkages. Stability contributes to confidence that public policies favorable to economic growth and the development of a competitive private sector will continue (assuming that they exist in the first place), which is necessary to encourage the long-term commitment required for trade and investment.

An important policy issue that should be discussed with host governments is the use of standards. Generally accepted standards, both for product quality and for measures and weights, are crucial to the efficient functioning of markets and their growth. Standards permit the rapid and wide spread of information that, in turn, is needed for truly competitive markets. The lack of common minimum standards often frustrates achievement of the consistent quality needed for trade in large quantities or over great distances. This is especially essential to the development of agricultural trade in LDCs; it is also one of the major inhibitions to small scale manufacturers. In addition, many LDCs utilize unfair and arbitrary standards to discriminate against foreign products.

There are many vehicles available in LDCs for standards development. Government attitudes toward standards need to be improved through the policy dialogue. Trade associations can help to promote voluntary industry-wide standards. **A.I.D. should encourage LDC private and public institutions to develop and strengthen quality and other standards. A.I.D. should also work with host governments to eliminate the use of product standards, testing, and certification procedures that unfairly restrict imports.**

Missions should also consider providing aid to LDC business associations in order to involve more deeply the indigenous private sector in the policy dialogue. These groups, representing the local business community, should be a primary mechanism for keeping the host government institutions aware of private sector concerns with respect to trade and other government policies or programs that affect business.

2. The Investment Environment

Foreign direct investment offers LDCs a way to acquire new production facilities at a lower risk than financing and building their own operations. The investments bring new technology, provide employment, and transfer new managerial skills.

In order for LDCs to attract foreign investment, businesses must be confident that such countries pursue realistic economic policies and maintain a stable and open investment environment. **Missions should encourage LDCs to adopt a market-oriented investment climate so these countries will be able to attract the investment capital essential for private sector development.** The basic elements of an open investment environment include policies that:

- treat investors equally on most-favored nations principles and provide comparable treatment to foreign and domestic investment (in such areas as taxes);
- conform to internationally recognized standards for compensation in the event of expropriation;
- permit the transfer of profits and other funds associated with investments;
- do not encourage performance requirements that mandate conditions on investments regarding local content, exports, or equity;
- provide adequate and effective protection of intellectual property rights such as copyrights, patents, and trademarks; and
- provide effective means for settling disputes.

The attractiveness of a particular LDC market to potential investors depends upon the restrictions that the country imposes on such relationships. If approval and import licensing procedures are excessively lengthy, foreign equity limitations stringent, and requirements to export a portion of the production or to source local goods unreasonable (without regard to availability, price, and quality), then a foreign investor may be discouraged from pursuing LDC investments or joint ventures altogether. Even if the investor is not put off at the outset, the government approval process may require the investor to spend a great deal of money before any returns can be realized. Investors sometimes have cancelled projects if delays are too prolonged.

In addition, foreign companies should (1) not be limited to producing for small segments of the market, or to concentrate on exports, as protection for competing local concerns; (2) have access to foreign exchange to acquire needed imported inputs; and (3) be allowed to hire management talent of their choice, regardless of nationality. These obstacles to investment suggest additional agenda items for Missions' policy dialogue with host governments.

The issue of intellectual property rights, raised above, deserves special attention. Inadequate intellectual property rights protection continues to hinder foreign investment and innovation in many LDCs. If the country fails to guarantee patents and copyrights, and to license and protect trademarks, investors will be reluctant to come to that country in the first place and, in any event, will be hesitant to make the most up-to-date methods of production or formulas available to local partners. Many countries that wish to comply with internationally recognized copyright, trademark, and patent conventions, however, often lack the resources and capabilities to enforce these conventions. **A.I.D. should undertake efforts to assure LDC governments that proper enforcement of copyright, trademark, and patent conventions is essential to strategies intended to increase the transfer of technologies and expand LDC access to information.**

B. Trade Diversification and Technology Transfer

A country's comparative advantage in production for international trade is not static; new competitors emerge and old ones disappear, technology changes, essential resources become scarce, substitute products become available, and consumer preferences change. Successful participation in international trade requires the dynamic involvement of producers and governments in a process of regular adjustment of practices and policies, respectively, that responds to current market conditions and anticipates future trends. LDCs are particularly vulnerable to a loss of their comparative advantage in production because of their limited human resource base, limited access to new technology, and limited access to market information, as well as rigidities imposed by poor policy.

Where appropriate, Missions should direct program and project resources to encourage the transfer of technology, skills, and information required to overcome the limitations that threaten the comparative advantage of LDC exports or inhibit the

emergence of new areas of comparative advantage in production. In this regard, A.I.D. programs should seek ways in which the capacity of indigenous firms can be increased in order to engage in, expand, or diversify exports.

One important method of achieving this objective is through the encouragement and facilitation of cooperative business relationships or joint ventures between developed and developing country private enterprises (such as joint ownership ventures, licensing, contract manufacturing and assembly, management contracting, and supplier agreements). These types of business relationships serve as a means for promoting trade linkages between private enterprises, and are based on the mutual desire of the involved firms to improve their competitive position in the world market.

These business relationships usually result in a new source of inputs and substantial transfers of technology, managerial techniques, marketing expertise, and market information to the LDC entrepreneur; represent a way to minimize costs and share risks; and open up access to markets and channels of distribution. They also provide a conduit for information on world market conditions which is almost impossible to obtain from publications usually available within the LDC or from contacts with other indigneous firms. The LDC firm's adoption of the management and quality control standards required for success in the world market results in immediate financial gain. **Missions should encourage joint ventures (as well as other forms of cooperative business relationships) as additional sources of technical assistance for LDC private enterprises.**

Special attention should be given to the development of producers in new lines of exports. Such action is particularly suitable for nations whose export earnings are tied to a few primary products that experience wide fluctuations in world prices. In addition to diversifying an LDC's export base and market risk, nontraditional exports are less likely to compete with most U.S. producers. However, A.I.D.-supported country export development projects should not favor some individual exporters at the expense of others, as this might lead to the exclusion of potentially viable exporters and the subsidization of current exporters.

The services sector (finance, training, software, maintenance, and others) is a major and growing component of trade and an important complement to the efficient use of capital in LDCs. Developing countries frequently restrict business opportunities in these areas, assuming that these can be reserved for local entrepreneurs; however, these restrictions are often at substantial costs in terms of access to technologies and management practices. **A.I.D. should encourage LDCs to open up their economies to imports of services, and develop the local private sector institutions and technological capability to complement foreign-supplied services.**

A growing number of sophisticated manufactured imports require continued service input to keep them in operation; this input, in many cases, may not be available in the importing markets (such as user training or maintenance). A.I.D. should encourage countries to overcome the tendency to buy only the capital components of a particular technology, and to devote greater attention to the technical information and process technologies that may be embodied in more complete packages.

Finally, increasing developing country to developing country trade is another method for stimulating economic development. Food emergencies often exist in one country while its neighbors may have adequate or even abundant food supplies. A combination of poor information, inefficient (or non-existent) market channels, and the absence of transport are often as important as lack of foreign exchange or creditworthiness in keeping normal trade and market activity from quickly dissolving these emergencies. As more LDCs adopt the proper trade environment and overcome their financing constraints, indebtedness, and barriers to "national self-interest," there will be greater opportunities for inter-LDC trade.

C. Trade and Investment Promotion

Trade and investment promotion are important for promoting and diversifying exports, attracting new capital and technology, and generally improving the participation of a country in the world market. Missions are encouraged to review the variety of approaches available for export and investment promotion. In

developing export promotion projects, Missions should perform appropriate analyses to identify exportable products, determine potential markets, and make realistic determinations of the changing environment in which the potential export products must compete, as well as identify cost-effective ways to have local firms evaluate their prospects and undertake marketing initiatives.

1. Private Sector Activities

A.I.D. Missions are encouraged to support the development of private sector institutions that can help indigenous entrepreneurs improve their export capacity and capabilities, as well as attract foreign investors. Where there are existing private sector organizations providing trade and investment promotion and services, Mission projects should rely on the private sector to continue providing these services and channel assistance for this activity directly to private sector entities.*

The development of private sector institutions may consist of establishing export promotion centers and marketing offices (channels of distribution); business associations that promote the sharing of technologies and technological innovation; private financial institutions (export financing and credit facilities, industrial and agricultural banks, and other financial intermediaries); export trading companies; and other institutions. For example, in the area of export promotion, USAIDs should examine the possibility of contracting (through competitive bidding) for a promotion facility to be established within one of the local business associations or other firms, rather than establishing one within a government ministry.

Mission programs should also seek opportunities to assist current and potential LDC export industries to gain needed information and technology to enhance their competitive position. A.I.D.'s assistance could support management and technical training for LDC producers, exporters, private bankers, and lawyers; promote access to advisory and consultant services for LDC firms and industries; support the development of product and market information services; and assist firms conducting market analyses to identify new areas of comparative advantage. In providing such assistance, Missions should seek ways to work directly with the private sector through chambers of commerce, trade associations, labor organizations, and other private institutions.

*This approach is consistent with A.I.D. policies on Institutional Development and Private Enterprise Development, which emphasize reliance on the private sector rather than the public sector where there is a choice and when host country conditions make this possible.

2. Public Sector Activities

A number of LDC governments are involved in trade through incentive programs designed to promote specific export activities or attract imported capital for new commercial ventures. In some countries, particularly NICs, such programs have been quite successful. Experience in many LDCs, however, suggests that government-managed export or investment promotion schemes have not been successful and may have retarded growth and development by introducing market distortions into the economy. This has often resulted because (1) LDC investment promoters are often government officials with little business experience; (2) government promotion agencies often operate within the context of governmental bureaucratic and legal structures that often complicate otherwise simple activities;* and (3) management decisions on the targets and types of incentives were responsive to perceptions of government rather than based on market conditions, which inhibited the growth of exports or the attraction of capital.

In general, A.I.D. Missions are advised to exercise considerable caution before agreeing to support LDC government-managed export or investment promotion schemes. Assistance to LDC governments for export and investment promotion schemes should have as its objective the fostering of market-based trade between their private enterprises and foreign markets (similar to the services provided by the U.S. Foreign Commercial Service and the U.S. Foreign Agricultural Service). Support may be given when the following conditions are met:

- The proposed incentive scheme does not violate any international or U.S. laws, conventions, or agreements related to export

*SRI International, *An Assessment of Investment Promotion Activities*, Final Report prepared for the Bureau for Private Enterprise, Agency for International Development, Washington, D.C. January 1984.

subsidies, anti-dumping, or other unfair trade practices.

• The proposed incentive scheme does not target commodities that would conflict with statutory provisions (e.g. FAA Section 620(d)) and existing Agency policies proscribing activities that would result in direct competition with U.S. enterprises.

• The incentives are appropriate to specific, identified constraints on exports or investment and their duration must be terminated within a reasonable period of time (as agreed upon by the Mission and the host government).

• Decisions on general areas in which incentives will be targeted and the types of incentives provided must be made in close consultation with a broadly representative group from the LDC's private sector, and must be consistent with efficient use of the country's resources.

• It should not add unnecessarily to the host country's restrictive practices or to already excessive red tape, which would inhibit trade.

Missions should investigate providing technical assistance to host governments to help them effectively implement their trade programs and streamline their procedures. This could include, for example, consolidating the decision-making authority over export and investment licenses and other necessary permits in one centralized institution, or supporting training for LDC public sector personnel who are central to the export process (such as personnel in ministries of trade and commerce) to strengthen their effectiveness in representing their country's commercial interests overseas.

Evaluation of costs and benefits is a crucial activity if a Mission chooses to pursue a public sector approach to export promotion. These promotion programs can be subjected to cost/benefit analysis, since quantifiable costs are incurred and quantifiable benefits are achieved. Costs may include the operating budget of the promotion agency, marginal expenses of applied promotion techniques, cost of the project, and the costs associated with incentives provided. Among the benefits are the eventual economic gains derived from new investments (in the form of employment, income, foreign exchange earnings, and tax revenues).

Missions may also wish to encourage LDC governments to adopt laws that allow the establishment of free trade zones as a means of encouraging private enterprise development. In addition to the manufacturing and assembly activities derived from the import of duty- or tariff-free items into these zones, there may develop indigenous suppliers that provide backward or forward linkages to firms in these zones.

3. Small Enterprises and Entrepreneurs

Special attention should be given to exports by small and medium enterprises. The production techniques employed by these entrepreneurial firms are generally less capital- and import-intensive than those of large firms, which makes them an important economic force in areas in which the LDC develops its comparative advantage. These enterprises may be important sources of employment and can compete favorably on world markets due to the low wages that prevail in LDCs. If market forces justify small scale enterprise exports, Missions should carefully look at ways to encourage them. This may take the form of supporting directed programs in financial institutions, organizing cooperatives, or providing information and training, as well as insuring that the policy environment does not discriminate against small and medium enterprises and allows them to contribute to export expansion. Missions should look to existing LDC private and public sector institutions that deal with small enterprises rather than undertake direct support to individual firms.

4. Government-restricted Markets

Government-restricted markets will become more commonplace as LDCs increase their exports and pose market challenges to competitors in industrialized countries. Missions are aware of the growing tendency by industrialized countries to levy import quotas or other trade barriers in response to LDC exports (such as higher tariffs, tariff-rate quotas, orderly marketing arrangements, or some combination of these). Although protectionist sentiment in the United States has received considerable publicity, the United States' openness to LDC imports and President Reagan's strong stand in support of free trade should be borne in mind in discussions with host country officials.

A.I.D.-supported export projects may achieve progress only to see target market potential diminish because of unforseen restrictions. A.I.D. currently has restrictions in place for sugar, palm oil, and citrus exports to the United States (see AID Policy Determination #71: AID Financing of Palm Oil, Citrus and Sugar Projects and Related Products). The U.S. maintains quotas on textile products under bilateral agreements with certain countries. Therefore, countries not covered by such bilateral textile agreements are free to ship textile or apparel products to the U.S., but Missions should be aware that a large increase in shipments that result in market disruption in the U.S. may trigger imposition of a quota on the particular products. (Other actions can result from countervailing duty or anti-dumping investigations against particular countries' unfair trading practices.) Although an LDC's actual export production may be small in relation to these developed country markets, it could add to the displacement of manufacturers or workers in the developed countries when taken in the aggregate with other countries' exports of the same products.

In an effort to avoid the imposition of quotas or other restrictions on LDC exports to the United States, U.S. supply and demand projections for the particular product to be produced should be undertaken when planning export projects that would include the United States as a potential market. Similarly, export data from A.I.D.-supported export promotion projects and private sector trade efforts in neighboring LDCs should be included in these analyses. Among the other factors that Missions should consider are the potential injury to U.S. producers (based upon the export potential of the project), and the condition of the U.S. industry that would be affected by the LDC exports.

At present, an A.I.D.-supported export development project in one LDC may be prepared in isolation from an export development project in another LDC. The potentially negative impact that one country's export development will have on export efforts or import needs of other LDCs in the region is often not taken into account. A.I.D. should not encourage potential LDC exporters to compete with each other for restricted markets; Regional Bureaus are in a position to help guard against this problem. **Regional Bureaus should advise Missions on potential export conflicts and opportunities when reviewing CDSSs, Action Plans, and Mission project proposals in their respective regions.** Where practicable, Regional Bureaus should first look at the countries within their jurisdiction as regional sources of supply and demand. It might also be useful if Regional Bureaus shared information on their trade-related programs.

D. Trade Monopolies and Parastatals

LDC governments have become heavily involved in their country's international trade by granting special rights to import or export essential or economically important commodities (such as fuel, agricultural inputs, and food) to one or a few firms. In many cases, the firm receiving the sole right to import or export is a parastatal or state-owned enterprise (SOE).

Generally, the granting of special trade privileges results in a separation of the domestic resource allocation decisions from world market signals so that these SOEs concentrate their efforts on production in a secure and protected market, and on the manufacture of products that are below world quality standards and above world price levels.

Over time, the SOE's production or consumption generally requires substantial subsidization and may discourage private enterprise involvement in the import or export of particular commodities. In addition, the country itself becomes locked in a particular pattern of trade and technological dependency that hastens its loss of comparative advantage in key exports. State trading companies also are more likely to seek countertrading arrangements. To the extent that countertrade transactions are less efficient and introduce distortions in trading patterns, the state trading companies themselves can intensify their country's economic problems, especially if the controlled commodities constitute a large portion of a country's exports.

These particular trade restrictions and their ensuing price distortions on fundamental economic activity have profound consequences for the entire LDC economy in terms of fostering inequity and suppressing economic growth. **A.I.D. strongly encourages and supports efforts to introduce or expand private sector competition in the export or import of essential or economically important commodities.** It is recognized, of course, that many LDCs may

raise political and social objections to this approach; the dialogue in this area is of great importance.

A.I.D. resources may be programmed to assist LDCs to terminate trade monopolies and oligopolies, dismantle marketing boards, and divest parastatals.* When A.I.D. resources are used to start a policy dialogue to initiate the dismantling of a marketing board or the divestiture of an SOE when there is no initial commitment from the LDC, Missions must show that any improvement in the performance of the marketing board or SOE resulting from our assistance will contribute to increased dependence on market forces and the eventual dismantling of the marketing board or divestiture of the SOE. Clear benchmarks of substantial progress toward market-based operations and divestiture must be established and adhered to in the assistance program. **In general, if the SOE is providing unfair trade competition to private enterprises, restricting private enterprise development, or is enjoying special trade privileges or preferential treatment, these activities should be phased out before funds are provided to the parastatal in accordance with A.I.D. policy.**

E. U.S.-LDC Trade Promotion

What is good for development should not be inconsistent with what is good for the expansion of mutual economic activity between U.S. and LDC private enterprises. **A.I.D. should broaden the scope of its export development projects to provide for greater U.S.-LDC two-way trade opportunities. A.I.D., in concert with other U.S. government agencies, should also increase its efforts to make U.S. companies aware of A.I.D.'s varied activities.** Many mechanisms are available for accomplishing these linkages. These include:

- **Interagency cooperation.** Missions and AID/W should seek greater cooperation with other government agencies that are seeking greater U.S.-LDC trade and investment ties, such as the Overseas Private Investment Corporation, the Trade and Development Program, the U.S. Export-Import Bank, the U.S. Department of Commerce (the U.S. and Foreign Commercial Service, and other offices within the International Trade Administration), the U.S. Department of State (embassy economics officers, in particular), and the Office of the U.S. Trade Representative (which administers the Generalized System of Preferences).

- **Brokering.** In recent years, a small number of U.S.-based organizations have begun to offer commercially viable packages of consulting, brokering, and facilitation services designed to help LDC firms (particularly small- and medium-sized enterprises) by furthering their relationship with U.S. private enterprises. These brokering services include identifying potential U.S. and LDC firms interested in entering into joint ventures or other collaborative business relationships; providing information to the potential collaborating firms about business conditions, risks, policy, and other concerns; and assisting client firms to identify technology or other inputs needed to exploit a particular business opportunity. Similarly, the International Executive Service Corps (IESC), through its Project ABLE, looks to match emerging or existing LDC firms with U.S. suppliers and customers.

- **Joint ventures.** The benefits derived from joint ventures and other cooperative business relationships between firms in developed countries and LDCs were identified in Section VI.B. It should be noted, however, that these business relationships result in more than a one-way transfer of knowledge and experience from the developed country firm to the LDC partner. In reality, valuable skills in marketing products in LDCs and redesign suggestions to adapt products for LDC markets can be transferred from the LDC firm to the U.S. partner.

- **U.S.-LDC trade associations.** As many business associations are cooperative efforts between foreign and host country private enterprises, Missions should consider providing assistance to these associations so they can help foster trade and increase access to technology and information between indigenous and foreign private enterprises.

- **Mixed credits.** The use of mixed credits and other concessional financing programs by foreign governments presents a growing problem for effective development

*A.I.D.'s involvement in the dismantling of marketing boards and parastatal divestiture should adhere to policy as stated in A.I.D.'s Policy Paper on Private Enterprise Development (March 1985) and Policy Determination #14 on Implementing A.I.D. Privatization Objectives (June 1986).

assistance and trade development. Mixed credits do not directly promote two-way trade; however, A.I.D. recognizes that other donors are actively using mixed credits to subsidize their own exports and that this can put U.S. exporters at a serious competitive disadvantage. Therefore, until such time as an effective agreement is reached with other bilateral donors on restricting the use of mixed credits for export financing, A.I.D. will use the U.S. tied aid credit program (under ESF funding) for defensive purposes in selected countries to match the concessional credit terms offered or arranged for in support of a tender of a non-U.S. supplier in an international tender competition in which a U.S. supplier is the lowest responsive bidder. This approach is consistent with the new mixed credit program announced by President Reagan in his September 23, 1985, statement on trade policy.

It is important that A.I.D. be responsive to U.S. private sector activities in LDCs, as early participation in export sales is critical in building long-term trade and investment relationships. Many of our foreign assistance activities currently generate additional future demand for U.S. products directly through the need for replacement or spare parts, the purchase of complementary equipment, and familiarization with U.S. products. These activities are also encouraged.

F. Economic Infrastructure

LDCs have attempted to promote greater international trade through investments in economic infrastructure. Infrastructure has been built to (a) relieve transportation and communications bottlenecks; (b) ease congestion at seaports, airports, and other transfer points; and (c) attract new investment by site improvement or new site development. Infrastructure has also been built to open new areas for resource development and exportation. **Investments in infrastructure to improve an LDC's trade position can be very beneficial but should be undertaken only when (1) there are firm assurances that the expected complementary private investment in export production will occur; (2) the LDC has firm commitments from the principal investors who will use the facilities; and (3) adequate provision is made to maintain these facilities.**

Support for infrastructure should not be used as an incentive to investment in the absence of such conditions. **In addition, A.I.D. resources should support trade-related infrastructure only when the host country's policy environment is supportive of competitive trade or when A.I.D.'s investment in infrastructure is in exchange for appropriate export-oriented policies.**

For the most part, LDCs should undertake trade-related infrastructure investments (such as widening roads or improving ports) only when there is clear evidence that the capacity of current facilities will restrict trade unless the improvements are carried out in a timely manner. Furthermore, before initiating such infrastructure, LDCs should ensure that current policy and practices (particularly regarding maintenance) result in the efficient use of existing facilities.

To a considerable degree, trade-related infrastructure benefits a distinct group of entrepreneurs in an LDC. Consequently, A.I.D. should seek ways in which the capital costs of trade-related infrastructure are shared by the private firms that receive the majority of the benefits. In this regard, there is considerable room for the use of capital levies or debentures subscribed to by firms engaged in export production or other aspects of trade, or introduction of a system of user fees that provides for full cost recovery of the trade-related infrastructure. Additional guidance on the use of A.I.D. resources for infrastructure is presented in Section V.I. of the revised Private Enterprise Development Policy Paper.

G. U.S. Trade Policy Coordination

A.I.D. is also involved in the U.S. trade policy coordination process. The major U.S. government fora for consideration of most trade issues and resolution of agency disagreements on U.S. and international trade issues are the White House Economic Policy Council, chaired by Treasury Secretary, and the Trade Policy Committee (TPC), chaired by the United States Trade Representative. The TPC coordinates (1) interagency views on U.S. positions for multilateral trade negotiations, (2) recommendations for the President on certain import remedies, and (3) U.S. Government policy on international investment issues, international commodity negotiations, and other trade policy matters. A.I.D. participates in the TPC (and its staff committee and review group structures) under the auspices of the office of the Director of the

International Development Cooperation Agency.

PPC represents IDCA at the TPC and in its working groups. Some LDCs are, in particular sectors, exporting products that fall under U.S. export controls or quotas. **PPC will serve as a channel between U.S. Government trade experts and A.I.D. Missions with information on how to help LDC exporters deal with the myriad of U.S. and international trade agreements, when this information is not available through direct communications.** (Brief descriptions of the General Agreement on Tariffs and Trade (GATT) and the U.S. Generalized System of Preferences (GSP) program, two of these agreements and trade preference programs, are provided in Appendices B and C.) PPC will also provide U.S. trade policy decision-making entities with information on the impact of U.S. trade policies on LDCs, and will continue its efforts to press for open U.S. and LDC economies through the trade policy coordination process.

ANNEX A

THE WHITE HOUSE

Office of the Press Secretary

FOR RELEASE AT 11:30 A.M. EDT
MONDAY, SEPTEMBER 23, 1985

The President's Trade Policy Action Plan

FACT SHEET

The President's trade policy is based on five principles:

1. Free trade and fair trade are in the best interest of the citizens of the United States. Free trade produces more jobs, a more productive use of our nation's resources, more rapid innovation, and a higher standard of living. Free trade also advances our national security interests by strengthening the economic and political systems of our allies. Fair trade based upon mutually acceptable rules is necessary for support of free trade.

2. The United States plays the critical role in ensuring and promoting an open trading system. If the United States falters in its defense and promotion of the free worldwide trading system, the system will collapse, adversely affecting our national well-being.

3. The United States' role does not absolve our trading partners of a major obligation to support a more open trading system. This obligation includes: dismantling trade barriers, eliminating subsidies and other forms of unfair trade practices, and entering into trade liberalization negotiations in the GATT.

4. The international trading system is based upon cooperation. Since World War II, we have made significant progress in moving toward an open worldwide trading system. Protectionism threatens to undermine the system. Our trading partners must join us in working to improve the system of trade that has contributed to economic growth and security of ourselves and our allies.

5. America has never been afraid to compete. When trade follows the rules, and there is an equal opportunity to compete, American business is as competitive as any. This is fair trade and we will not impair it. When these conditions do not exist, it is unfair trade, and we will fight it.

The President has taken a number of actions to translate these principles into policy.

Making Free Trade Fair Trade

The President will vigorously pursue U.S. rights and interests in international commerce under U.S. law and the GATT, and will see that other countries live up to their obligations and trade agreements with the U.S. More specifically:

1. The President will attack foreign unfair trade practices. The President has directed the United States Trade Representative to initiate or accelerate unfair trade practice proceedings, the first time done so by a President of the United States. Other actions, when appropriate, will be taken. Proceedings accelerated or initiated so far are:

- Japanese leather and leather footwear import restrictions;
- European Community canned fruit subsidies;
- Korean insurance policy barriers;
- Brazil's import restrictions on microelectronics products; and
- Japanese tobacco restrictions.

2. To discourage our trading partners from seeking unfair advantage by using predatory credits to subsidize their exports, the President will propose that Congress approve a fund of $300 million in grants which would support up to $1 billion in tied-aid credits to maintain U.S. markets in the face of this practice.

3. The President has directed the United States Trade Representative to initiate and accelerate both bilateral and multilateral negotiations with countries where the counterfeiting or piracy of U.S. goods has occurred. The Administration will increase efforts to protect intellectual property rights (patents, copyrights, trademarks), with a view toward possible legislative or administrative initiatives.

4. The President has directed that a strike force be established among the relevant agencies of the Federal Government, with the task of identifying unfair foreign trade

practices and executing the actions necessary to counter and eliminate the unfair practices.

5. The President has directed the Secretary of State to seek time limits on the current discussions with Japan designed to open access to specific Japanese markets, at the end of which specific commitments will be evaluated and follow-up procedures begun. New sectors will be added that offer the promise of expanded U.S. exports.

Promoting Free Trade and Exports

The United States is a great trading nation. The health of our economy depends on both exports and imports. The President's goal is to preserve as free and open a trading system as possible. A free and open system will be a fair system.

1. The President seeks to engage our trading partners in multilateral negotiations in the GATT to achieve freer trade, increase access for U.S. exports, provide more effective dispute resolution, and strengthen the fabric of the international trading system.

The President wants to use the multilateral negotiating process to eliminate unfair trade practices and improve access for U.S. exports, particularly agriculture and high technology, and address newer forms of international trade problems, including intellectual property protection, services trade, and investment issues.

2. The President will also explore possible bilateral and regional trade agreements that would promote more open trade and serve U.S. economic interests.

3. The President has directed the Secretary of Commerce and the Economic Policy Council, in conjunction with the President's Export Council, to review current export promotion activities with a view toward strengthening them and increasing private sector involvement. The Commerce Department will also work with state governments interested in expanding their export promoting activities.

4. To better assist workers in adjusting to the dynamics of the world trading system, the President has directed the Secretary of Labor and the Economic Policy Council to review existing worker assistance programs to assure that they promote an effective policy that contributes to maximum capacity for change, mobility, and increased productivity.

Improving the World and Domestic Economic Environments

The trade deficit has grown because economic difficulties abroad have persisted while the U.S. has been more successful in utilizing our economic opportunities. Better balance in world economic performance must be achieved.

1. To do our share in achieving the needed balance in the world economy and lowering the value of the dollar, the United States must reduce excessive government spending. The President will hold Congress to no more than the spending levels established in the Senate budget resolution.

2. The President will press for his tax reform proposal, which is essential to strengthening the economy and making U.S. businesses more competitive in international markets.

3. The President has directed the Economic and Domestic Policy Councils to review, and if warranted, seek to amend antitrust laws that impede our international competitiveness. The President will also use the trade leverage created by domestic deregulation to seek to open foreign markets.

4. The President authorized the Secretary of the Treasury to join his counterparts from other major industrial countries yesterday to announce measures to promote stronger and more balanced growth in our economies and the strengthening of foreign currencies. This will provide better markets for U.S. producers and improve America's competitive position.

5. The United States is prepared to consider the value of hosting a high-level meeting of the major industrial countries to review, implement and build upon the Group of Ten monetary studies by considering in a cooperative fashion, the policies and performance of the major industrial countries, and how these can be improved to promote convergence toward non-inflationary growth.

6. The President has also directed the Secretary of the Treasury to use the international financial institutions to encourage debt-burdened LDCs to reduce government impediments to the functioning of markets, encourage private sector production, and substitute equity capital for debt by encouraging both domestic and foreign investment.

Legislation which would reflect the President's principles and policies would include:

1. Trade Negotiating Authority.

Authority to support trade negotiating initiatives including:

— a new round of negotiations;

— elimination of non-tariff barriers (current authority expires January 3, 1988);

— tariff reductions; and

— compensation to other countries when the U.S. increases tariffs (through Congressional action or Customs reclassification) to avoid unilateral foreign retaliation against U.S. exports.

2. Intellectual Property Rights.

Further protection of intellectual property rights (patents, copyrights or trademarks), including:

— protecting against trade in articles that infringe U.S. process patents;

— extending the patent term for agricultural chemicals to match that for pharmaceutical inventions;

— eliminating the requirement in Section 337 of injury to an efficiently and economically operated U.S. industry as a precondition for a relief where the International Trade Commission found a patent, trademark or copyright infringement;

— more liberal licensing of technology under the antitrust laws;

— better protecting "firmware" through amendments to U.S. copyright law; and

— eliminating Freedom of Information Act abuses by giving affected companies notice and an opportunity to oppose release of their business confidential information.

3. Export Promotion.

Promote U.S. exports through:

— submitting legislation authorizing and appropriating approximately $300 million in grant funds to enable the Administration to offer $1 billion in mixed credit loans to targeted buyers. This program is designed to enable U.S. exports to compete effectively in third country markets until we can eliminate predatory mixed credit competition through negotiations;

— clarifying the accounting provisions and liabilities of foreign agents under the Foreign Corrupt Practices Act of 1977 to reduce disincentives to export; and

— allowing U.S. companies to export new drugs and biologicals not yet approved by the Food and Drug Administration to countries where they can be sold lawfully.

4. Existing Trade Laws

Strengthen the antidumping and countervailing duty laws with a predictable pricing test for non-market economies, place deadlines on Section 301 dispute settlement, and establish Section 201 fast track procedure for perishable items.

ANNEX B

Background Information on the General Agreement on Tariffs and Trade (GATT)

The General Agreement on Tariffs and Trade (GATT) is a multilateral agreement subscribed to by 90 governments that together account for more than four-fifths of world trade. Its basic aim is to liberalize world trade and place it on a secure basis, thereby contributing to international economic growth and development. GATT is the only multilateral instrument that sets rules for international trade; these rules govern the trade of its member countries and the conduct of their trade relations with one another.

The substantial reduction of tariffs and other barriers to trade is a principal aim of the GATT. During the negotiations held in GATT's first 25 years, the tariff rates for thousands of items entering into world commerce were reduced or bound against increase. The concessions agreed upon in these negotiations have affected a high proportion of the total trade of contracting parties and have indirectly affected the trade of many nonmembers as well, as many tariff concessions have been extended to all trading partners under the most-favored-nation (MFN) principle. Under this principle, countries agree to extend automatically to other trading partners the same treatment as that given to the "most favored" trading partner.

GATT's original Articles of Agreement incorporate several basic principles which all signatories agree to follow. Two of these are discussed below. The first and most basic is to conduct trade on a nondiscriminatory basis. Under the "most-favored-nation" clause, a GATT nation must treat all other signatories as favorably as any other nation when administering and applying its tariff charges. GATT gives no nation special advantages, except in certain important cases. For example, LDCs may receive preferred tariff treatment as in the Generalized System of Preferences (GSP).

A second basic principle is the concept of national treatment. Not only must a nation treat all foreign countries equally, but it also must not discriminate between foreign and domestic goods once foreign goods enter its local market. Its goal is to prevent internal domestic taxes or other regulations from replacing any tariffs removed as trade barriers.

Much of the attention of the latest round of multilateral trade negotiations (The Tokyo Round), which took place between 1973 and 1979, was designed to shape the multilateral trade system and international trade relations into the 1980s and beyond. The Tokyo Round resulted in the further lowering of many tariffs. A major new focus of that round was liberalization of nontariff measures that restricted or distorted trade, in constrast to earlier rounds of trade negotiations where tariff reduction was the primary objective. However, the negotiations revealed that many apparently unfair NTBs were actually domestic policies with various goals, some legitimate and some unfairly restricting trade.

It also defined special rules for developing countries' participation in the world trading system. Under the concept of "special and differential treatment," developing countries asked to be treated more leniently as to the degree of concessions they were expected to give in trade negotiations. They also asked the developed countries to extend the legal basis under which developing countries receive preferential treatment under the GSP. Developed countries accepted the principle of "special and differential treatment" of developing countries in areas of the negotiations where it was feasible and appropriate, including preferential tariff treatment, provided that the developing countries would forego such special and differential treatment as their development, financial, and trade needs permitted (the concept of "graduation").

Five codes of behavior, incorporating the "special and differential" principle, were negotiated by the Tokyo Round's conclusion. They cover subsidies and countervailing duties, goverment procurement, technical barriers to trade (standards), import licensing procedures and customs valuation.

ANNEX C

Background Information on The U.S. Generalized System of Preferences Program (GSP)

The Generalized System of Preferences (GSP) is a program of tariff preferences granted by industrialized countries to developing countries to assist them in their economic development by encouraging greater diversification and expansion of their exports. In 1968, the United States joined with other industrialized countries in supporting the concept of granting tariff preferences as a means of facilitating development through the auspices of expanded trade rather than increased aid. With the expectation that developing countries and territories could be encouraged to become more active participants in the international trading system, 19 developed countries instituted GSP programs in the early 1970s. The United States implemented its program in 1976 pursuant to the statutory authority contained in the Trade Act of 1974.

Trade with developing countries and territories has increased dramatically since the inception of the GSP program. The U.S. GSP program currently provides duty-free treatment for approximately 3,000 products from 140 developing countries and territories; however, these GSP imports represent only about 3 percent of total U.S. imports.

The GSP program is vitally important because of: (1) its recognition that trade is an effective and cost-efficient way of promoting broad-based sustained economic development; (2) the program's ability to provide greater access for U.S. exports in the markets of developing countries; and the desire to (3) promote the integration of

developing countries into the international trading system; (4) assist developing countries in generating sufficient foreign exchange to meet their international debt obligations as well as further stimulate U.S. exports to these countries; and (5) maintain the program's role as an important element of U.S. foreign policy with respect to developing countries. Many GSP beneficiary countries consider the program an important indication of the seriousness with which the United States views its policy of encouraging self-sufficient economic development.

III.C3 (TM 1:34)
11/9/84

A.I.D. Policy Paper

PRIVATE AND VOLUNTARY ORGANIZATIONS

U.S. Agency for International Development
Washington, D.C. 20523
September 1982

BEST AVAILABLE COPY

III.C3 (TM 1:34)
11/9/84

A.I.D. Policy Paper

A.I.D. Partnership in International Development with Private and Voluntary Organizations

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523
September 1982

TABLE OF CONTENTS

		Page
INTRODUCTION		1
POLICY FRAMEWORK		2
OPERATIONAL GUIDELINES		5
I.	Categories of PVOs and Other Non-Profit Organizations	5
	A. Cooperatives and Credit Unions	5
	B. AFL-CIO Labor Institutes	5
	C. Family Planning Organizations	5
	D. Non-Profit Consulting Firms	5
	E. Traditional Voluntary Organizations	5
II.	The PVO Grant Program	6
	A. Categories of Support in the PVO Grant Program	6
	1. Operational Program Grants	6
	2. Comprehensive Program Grants	6
	3. Institution Building	6
	B. The Field Support Program	6
	1. Mission Support to PVOs	7
	2. Centrally Funded Matching Grants	7
III.	Accountability	7
	A. PVO Accountability	7
	B. Agency Accountability	8
IV.	Funding Decisions	8
	A. Funding Levels	8
	B. Funding Allocations between Field Program Support and Institution Building Support	9
	C. Funding Allocations between Matching Grants and Operational Program Grants	9
V.	Information Coordination and Dissemination	10
	A. Information Dissemination	10
	B. Evaluation	10
	C. FVA's Role	10
VI.	Formulation and Implementation of PVO Policy	11
VII.	Organizational Configurations	11
	A. The FVA Bureau	11
	B. The PVO Liaison Committee	12
VIII.	Advisory Committee on Voluntary Foreign Aid	12

INTRODUCTION

United States private and voluntary organizations (PVOs) have been active in humanitarian work overseas for more than a century. In the years since World War II, however, their activities—on a variety of continents and in a range of program areas—have shown a marked upswing. In the past twenty years in particular, PVOs have moved beyond relief, disaster assistance and distribution of food and have directed their energies more intensively toward alleviating the causes of poverty and improving the quality of human life in the Third World—i.e., toward development.

Since the end of World War II, the United States Government has facilitated various aspects of PVO work in an expanding way. Selective encouragement of PVO relief and refugee activities in post-war Europe has grown into multifaceted support of PVO activity. In fiscal year 1983, the AID-administered funding for PVOs will be drawn from a wide range of accounts: each of the AID functional accounts, the International Disaster Assistance Account, the Sahel Development Program, American Schools and Hospitals Abroad, the Economic Support Fund (ESF), excess property, Food for Peace and the State Department's Refugee and Migration account. Total AID-administered resources available to the PVOs for overseas programs in FY 1983 is expected to exceed $600 million. During the previous 15-year period funding of such activities rose from $254 million in 1964 to $448 million in 1979. This significant expansion in government funding of the international programs of PVOs was accompanied by an even larger increase in privately generated resources. Figures compiled by the AID Advisory Committee on Voluntary Foreign Aid (ACVFA) indicate that for the agencies registered with AID—and there are many which are not—private outlays and commitments for development in 1979 totaled $1.1 billion, an increase from $427 million 15 years earlier.

The steadily growing cooperation with the private and voluntary agencies reflects the U.S. Government's belief that the programs of those agencies embody the traditional humanitarian ideals of the American people and support a principal objective of the foreign policy of the United States—"the encouragement and sustained support of the people of developing countries in their efforts to acquire the knowledge and resources essential to development and to build the economic, political and social institutions which will improve the quality of their lives." (Section 101, Foreign Assistance Act "FAA.")

The expanding roles and scale of PVO involvement in development processes are reflected in the legislation governing United States development cooperation policy. After a series of important individual statutory provisions in the 1950s and 1960s, the U.S. Congress since 1973 has spoken with increased regularity to PVO issues. In 1978, Congress highlighted the national interest in supplementing the financial resources of PVOs and cooperatives in order to "expand their overseas development efforts without compromising their private and independent nature." In responding to these Congressional interests, AID initiated several forms of PVO support which provided for expansion of PVO development efforts and maintenance of PVO independence from reliance on United States Government financing through increased cost-sharing relationships. In 1981, Congress for the first time specified a range of funding "based on historical trend of steadily increasing scale of PVO use of AID funds," by directing AID to make available at least twelve and up to sixteen percent of AID's development and disaster assistance funding to PVOs.

AID itself has developed a variety of forms of PVO support. These have evolved from year to year in response to the needs of PVOs and the interests of AID. However, it is widely recognized by PVOs, the U.S. Congress, and AID itself that the partnership as it has evolved has not brought with it clear AID policy governing its relations with PVOs, nor coherent and consistent ways in which AID, in its multiplicity of aspects, deals with PVOs in all their heterogeneity. Given the commitment of this Administration to facilitate the work of the private sector, the time is opportune for stating in clear terms both AID's policies as they relate to the partnership with PVOs and the institutional mechanisms through which that partnership will be made more effective.

PVOs are a heterogeneous universe—diverse in their expertise, size, bases of support and modes of operation. PVOs bring unique skills to the job of Third World development.

(a) By virtue of their links with private institutions in the Third World, PVOs can be a means for effectively engaging the rural and urban poor in their nation's development.

(b) By virtue of their support within the United States, PVOs can be a means for mobilizing among the general public not only a broader awareness of the pressing needs of developing Third World countries, but also for generating private resources for international development.

(c) As a heterogeneous group of agencies reflecting the diverse nature of American society, PVOs active in developing countries embody the basic American values of pluralism, voluntary action and concern for others.

(d) At a time when AID's own resources, both human and financial, are severely limited, PVOs can extend AID's own effectiveness, particularly with respect to matters such as community level involvement.

However, public and private objectives and programmatic interests frequently do not coincide. AID is accountable to Congress and the U.S. public; PVOs must account to their contributors.

AID, by its very nature as a government development agency, operates very differently from private and voluntary development agencies. AID, as the official arm of the U.S. Government responsible for economic development support to Third World countries, is an instrument of our total foreign policy. As a result, in determining where it will concentrate its resources for development, it must factor in a wide range of considerations. Our government's judgment about the national interest is, obviously, one of these considerations as are strategic, geopolitical and economic factors. At the same time, AID and PVOs share the fundamental objectives of:

- helping the people of the Third World to develop their skills and abilities to solve their own problems, and
- developing democratic institutions in the broadest sense which help people to achieve control over their own lives and, in the end, to take responsibility for their own development.

Experience demonstrates that it is only at the point when people are willing and able to assume the responsibility for their own future that development becomes self-sustaining. As the magnitude of Third World problems has grown—so have the ramifications of these problems for the rest of the world. It is important at this juncture that public and private development agencies work together to pursue the common goal of achieving sustained Third World development. Nevertheless, while acknowledging and valuing those areas where AID and PVO interests do overlap and where AID and PVOs can and do work together, it is important to underline that the motivations, interests and responsibilities of these development agencies are not and should not be identical. It is AID policy to minimize these differences but they still remain. Both parties in the relationship recognize that it is to be expected that each will pursue goals related to their particular concerns and objectives while working together on common priorities.

AID wishes to keep this relationship viable and productive. AID shares with PVOs the belief that [illegible] complementary characteristics of the partners provide the basis for fruitful and effective cooperation between the governmental and non-profit sectors needed to carry out the urgent task of alleviating poverty and fostering development in the Third World.

Broadly speaking, AID's partnership with PVOs has two major dimensions. AID deals with PVOs both as intermediaries in conducting AID's programs and as independent entities in their own right. AID has over the years designed—and in the current policy review reaffirms—programs which support PVOs in both capacities. AID considers support to PVOs in both capacities to be consistent with the dual interests of Congress to facilitate the activities of PVOs which are consonant with AID's mandate of meeting the basic human needs of the poor majority in developing countries and to protect and preserve the independence and voluntary nature of such organizations.

While some of the policies, programs and mechanisms dealt with in this paper are departures from past practice, that should not obscure the fact that the operative policy framework remains one in which AID views PVOs as its development partners, both as intermediaries for AID programs and as independent development agencies in their own right.

POLICY FRAMEWORK

The policy framework within which the AID-PVO partnership operates is summarized below. Programmatic and administrative mechanisms governing the partnership as elaborated in the attached operational guidelines are derived from this policy framework. The broad objectives of this policy are:

- to increase the economic development impact of PVO programs through increased program integration and focusing resources on field programs;
- to discourage dependence on U.S. Government financing of the international development programs of PVOs;
- to reduce the administrative cost to both AID and PVOs of AID funded PVO programs by simplifying management and administrative procedures to the maximum extent possible and creating a central focal point for PVO relationships with AID within the Food for Peace and Voluntary Assistance Bureau (FVA); and
- to insure that AID funds are used in [illegible] reflect AID's legislative mandate [illegible] way [illegible] capabilities [illegible]

[illegible] approach[illegible] of the [illegible]

BEST AVAILABLE COPY

knowledge of the local situation and their programming and managerial flexibility.

This Policy Paper incorporates the following principles and/or requirements for AID offices and Missions to ensure effective implementation of the above policy objectives:

1. **Increased emphasis needs to be placed on country program integration** in order to maximize the effectiveness of scarce development resources in the Third World. All AID funded programs operating in a country including those of the PVOs should address that country's development priorities and requirements whether the program is centrally funded or Mission funded. Therefore, AID should facilitate PVO participation in and contribution to AID's country programming process. Not only will AID's final product (i.e., the Country Development Strategy Statement [CDSS]) often profit from their advice, it will also provide PVOs a sense of participation and an early feel for the principal country programming parameters (e.g., sectoral, functional, and regional emphases) which will serve to guide their participation in any subsequent AID funded activities.

While Missions should do a better job of bringing PVOs resident in that country into the country programming process, the particular mode of participation should be worked out at the field level between Missions and PVOs. At the same time, the Bureau for Program and Policy Coordination (PPC) and FVA will more actively seek to ensure that PVO concerns and activities are being addressed in the CDSS and Annual Budget Submission (ABS) reviews. This will provide the necessary checkpoint for determining that conscious decisions are being made by the Agency regarding PVO participation. By the same token, the burden of ensuring that PVOs are brought into such planning discussions should not be left solely to the Missions; the responsibility for being informed and in contact with Missions is shared by the PVOs resident in that country.

Focusing AID funded PVO programs on country-specific development needs and priorities does not compromise a PVO's independence to program its activities in that country. It does not mean that, in a particular country, an AID supported PVO must always work in the same sectors and the same geographic regions that AID does in its government-to-government program. What it does mean is that PVO programs funded by AID should be viewed as integral parts of a consistent and coordinated utilization of resources to address development priorities in each country where they operate.

2. **Voluntary agencies should be given ample scope for independence in the actual design of project activities.** It is expected there will be significant interchange between voluntary agency and USAID personnel throughout the program planning process. However, if Mission staff is comfortable with the basic directions of new activities, PVOs should be free to negotiate working arrangements with host country counterparts, private or public. The Mission's offices may often be helpful in such negotiations.

3. **AID must reserve the right to reject, approve, or seek modifications in the final package which the PVOs ask us to approve.** AID is under no obligation to fund activities which it believes are inconsistent with its objectives.

4. **Funding for PVO programs should be viewed as complementary to other AID assistance** even though present practice will continue under which PVO programs compete with all other AID programs for budget priority. The increased participation of PVOs in the country development strategy process and the strengthened FVA and PPC role in the Agency's CDSS and ABS review processes will ensure responsiveness to the 12 percent Congressional earmark and 16 percent funding target.

5. **The legislated 20 percent non-USG funding requirement will be applied in determining whether a U.S. PVO qualifies for grants available under the PVO grant program.** An organization should obtain at least 20 percent of its total annual financial resources for its international programs from non-USG sources, with a preference given for private funding, in order to qualify for matching grants, operational program grants and institution building support. The purpose of the test is threefold: (1) to discourage dependence on USG financing of PVO's international programs and thereby ensure that PVOs maintain their independence of action; (2) to ensure that PVOs continue to leverage additional private financial resources for development; and (3) to build an awareness of Third World development issues and programs among the American public. AID legislation establishes January 1, 1985 as the effective date by which this requirement is to be applied. In the intervening period, the Agency encourages and will monitor a progressive phase-in towards meeting this target on the part of current PVO grantees.

6. **AID links the concepts of cost-sharing and program independence in its grant relationships with PVOs.** AID gives PVOs which cost-share greater independence to program funds. Foreign aid legislation envisions a dual role for PVOs as independent development agents with their own programs of responding to the poor and also as in-

termediaries for AID. Even when serving in an intermediary role, the PVO's relationship with AID should not result in a loss of the PVO's private and independent character since, without independence, the fundamental values associated with AID's working with PVOs are called into question. Congress' direction to AID to introduce non-USG cash funding requirements as a determinant of PVO grant eligibility is designed to address this potential problem.

Organizations which do not meet this privateness test will continue to be eligible for "intermediary" forms of support to implement AID programs but will no longer be eligible for matching grants, OPGs and institution building support, which support PVO programs and give greater programming flexibility to the PVO in recognition of its sharing of the program's expenses.

7. **Emphasis should be placed on utilization of existing U.S. PVO capacity to undertake field programs.** AID has over the years helped a number of U.S. PVOs to develop their capacity to plan and carry-out international development activities. Because that capacity now exists in a substantial number of PVOs with which AID works, building U.S. PVO institutional capacity can be done more selectively. It is recognized that there will be circumstances when institutional support is appropriate, particularly on a cost-shared basis. There may be instances, for example, when too close an adherence to operational guidelines can result in discouraging innovative programming possibilities with PVOs. Therefore, while not encouraging exceptions, a degree of programming flexibility should be preserved in this regard. At the same time, AID must continue to emphasize its overall priority for field projects and programs.

8. **The diversity of the PVO community should be taken into account by AID.** AID has traditionally spoken of PVOs as a homogeneous group. However, as a practical matter, there are a variety of distinct subgroups within the PVO "universe." These include traditional voluntary organizations (volags), cooperatives and credit unions, labor institutes, family planning organizations, and other non-profit intermediaries. New policy development, including eligibility for the PVO grant program, will explicitly take this diversity into account.

9. **The PVO administrative relationship with AID will be simplified.** The number of grant mechanisms will be reduced to the extent feasible; the management and administrative requirements of the PVO field support program will be standardized wherever possible; policy and program implementation will be monitored for consistent application; and a central point of contact in AID for PVO information coordination and dissemination will be established in the FVA Bureau.

Attachment: Operational Guidelines

Operational Guidelines

I. Categories of PVOs and Other Private Non-Profit Organizations

The heterogeneity of the private, non-profit community, as reflected in the 156 PVOs registered with the Agency for International Development (AID), is clearly a strength reflecting diverse development program capabilities. Tapping the resources of this diverse community requires recognition of the historical, structural and financial differences of these organizations. Development of a policy-effective management system and coherent decision-making structure which facilitates linkages with these organizations offers both a challenge and an opportunity.

Unless disaggregated into sub-groupings, the heterogeneity of the PVO community can serve as an impediment to the formulation of productive relationships with the community and to the effective use by PVOs of AID funds. By the same token, working in partnership with diverse PVOs in ways which respect their heterogeneity can enhance AID's own effectiveness.

Acknowledging the diversity of the private non-profit development community, AID has disaggregated organizations within the PVO rubric into a number of more homogeneous sub-groups within the following broad categories: cooperatives and credit unions, labor institutes, family planning groups, other non-profit intermediaries and traditional voluntary organizations (volags). Division of this universe into these functionally similar sub-categories should facilitate coherent decision-making and strengthen management effectiveness in implementing AID's PVO policy. The functional sub-categories are:

A. Cooperatives and Credit Unions

U.S. cooperatives were formed to provide business services and outreach in cooperative development for their U.S. membership. Their international programs were initiated largely as a result of AID urging, AID financing and Congressional mandate. These organizations support the goals of sections 102, 111, 123, and 601 of the Foreign Assistance Act of 1961, as amended ("FAA"), to increase "the participation of rural and urban poor people in their countries' development" (FAA, Sec. 111). These organizations are not charitable or fund-raising groups. They rely almost exclusively on AID institutional support grants. Policy Determination-73 (PD-73) governs the Agency's relationship with the U.S. cooperative development organizations.[1]

[1] PD-73 is under review and may be revised and reissued. In the near future an A.I.D. Policy Paper on indigenous cooperative development organizations will be issued.

B. AFL-CIO Labor Institutes

The Labor Institutes support FAA Section 102 and 601 goals of strengthening free labor unions and increasing participation of workers in the economic and social development processes of their respective countries. Like cooperatives, the Institutes established their international programs largely as a result of AID initiatives and Congressional mandate. They are trade associations, not charitable or fund-raising groups, relying almost exclusively on AID institutional support grants to operate their international programs. Policy Determination-52 (PD-52) governs the Agency's relationship with the Labor Institutes.

C. Family Planning Organizations

U.S. family planning organizations have expanded family planning service accessibility around the world, a major objective of U.S. foreign aid policy for more than decade and a half (FAA Section 104). Like the cooperatives and labor institutes, U.S. family planning organizations have entered international assistance activities largely as a result of AID initiatives and funding and Congressional mandate. They do not attract large amounts of private funding, relying heavily on AID institutional support grants to operate their international programs. The A.I.D. Policy Paper on Population Assistance (September 1982) governs the Agency's relationship with family planning organizations.

D. Nonprofit Consulting Firms

Nonprofit consulting firms have neither volunteers nor significant financial support from U.S. private sources and operate essentially like consulting firms in their relationship to donors/clients. They provide, among other services, management and planning assistance to U.S. and indigenous PVOs. As discussed elsewhere in this statement, AID funding of their services, if continued, should normally be provided under a cooperative agreement or an openly competed contract rather than a grant.

E. Traditional Voluntary Organizations (Volags)

These groups have historically been involved in international programs. Many of these organizations were established at the close of World War II to undertake European relief and rehabilitation. They rely significantly on U.S. private grants and contributions for their revenue and draw on volunteers to implement their programs. These organizations are most likely to qualify for the PVO grant program and most closely represent the kind of organization that Congress in Section 123 of the FAA, has urged AID to support in development work.

Differences are to be found within each of these groups. For example, if the extent of voluntary support were made the critical factor, a different grouping would emerge. These guidelines focus on the functional role of the organization, since the new requirements for PVO grant program eligibility will assure that a minimum standard of voluntary support is met for those PVOs which desire to participate. The first three sub-groups share the characteristics that their international programs were initiated largely at the behest of AID and Congress and operate largely with AID funding in support of specific AID programs. In this sense, they can be characterized as nonprofit intermediaries of AID. The institutional support grants that these organizations receive from AID are not a part of the PVO grant program and are, therefore, excluded from the policy decisions affecting the PVO grant program which result from this paper.

Assuming good performance, support of the first four sub-groups would be expected to continue, in accordance with Agency programming judgments and priorities, even if they no longer qualify specifically for the PVO grant program. Moreover, all five sub-groups are eligible to compete for AID contracts.

New policy development, including PVO registration requirements, cost-sharing requirements and eligibility for the PVO grant program will explicitly take the diversity of these sub-categories into account. Separate policy statements which govern AID's relationship with each sub-group will be revised as appropriate as implementation of the new PVO policy proceeds. In the meantime, this statement articulates certain broad policy concerns related to the AID partnership with private nonprofit development organizations which cut across the various sub-groups.

II. The PVO Grant Program

AID's partnership with PVOs, as noted in the Policy Framework section, involves support of PVOs both as independent development agencies and as intermediaries of AID.

The variety of types of AID support available to registered PVOs and the difficulty of drawing clear distinctions among them, has tended to impede coherent program formulation and monitoring. To reduce potential confusion surrounding centrally funded and mission funded grants and the conditions for receiving them, AID will simplify the requirements of the PVO grant program.[1] Consolidation of the funding and management of institution building support, elimination of institutional support grants and consortium grants as separate grant categories, development of the comprehensive program grant concept and simplification of the field support program should facilitate and strengthen these relationships.

A. The categories of support in the PVO grant program are as follows:

1. **Operational Program Grants (OPGs).** OPGs enable PVOs to carry out specific field projects in an individual country and occasionally regions. They are funded by Regional Bureaus and field Missions. Co-financing grants are a variant of the OPG program.

2. **Comprehensive Program Grants.** In order to consolidate multiple grant relationships, provide for better program integration, reduce redundant administrative procedures and provide maximum program flexibility, these grants are awarded to a limited number of PVOs with demonstrated development track records. The Matching Grant is at present the only type of comprehensive program grant.

3. **Institution Building.** Institutional development and management support grants are consolidated into FVA managed contracts or cooperative agreements in areas that need to be strengthened. Access for PVO personnel to training courses developed for AID staff is continued; courses and workshops for AID and PVO staff will be developed as needed. Guidance for selecting among various PVOs which apply for institution building services will be issued, including a referral system within AID to identify PVOs for the service. These services are available only to registered PVOs.

Institutional Support Grants. These grants are not a separate category in the PVO grant program. Any organization is eligible to receive institutional support from AID, including a registered PVO.

Consortia Grants. These grants are not a separate category in the PVO grant program. AID will continue support for PVO consortia as part of its development assistance program.

B. The field support program is simplified as follows:

[1] In this paper, we discuss the "PVO grant program," i.e., the type of support that is specifically reserved for registered PVOs. Currently, there are three kinds of specific support grants: operational program grants including co-financing grants, matching grants (a form of comprehensive program grant), and institution building grants; and three specialized subventions: P.L. 480 Title II, ocean freight and excess property. PVOs, whether registered or not, are also eligible for other types of AID grants or contracts that are not specifically reserved for PVOs.

We point out that institutional support grants are not now reserved for registered PVOs; any entity can receive an institutional support grant from AID. It is, therefore, inconsistent for AID to include institutional support grants in the category of AID support which is " reserved."

1. **Mission Support to PVOs.** Management and administrative requirements for Mission support to PVOs (OPGs and Co-Financing programs) will be standardized to the extent practical for all regions.

(a) OPG guidelines will be revised and be sufficiently specific that they discourage unnecessarily divergent Regional Bureau or Mission interpretation. However, such guidelines will provide latitude for PVOs to design, manage and evaluate their own projects.

(b) PVO budgeting system. Each Region will allocate annual PVO planning levels to each Mission, based on Mission demand and PVO track record in the country.

(c) PVOs will share the costs of all OPGs and co-financing projects. This requirement will be implemented by phasing in over the next three years the principle that part of the 25 percent non-AID funding requirement for such programs be a cash contribution to be obtained by the PVO from private sources. Missions will be given the authority to negotiate the cash levels appropriate to individual cases, but AID will seek compliance with this principle as a matter of policy. Operational guidelines for the phasing of the cash contribution will be developed to facilitate compliance.

(d) Key elements of the project design, implementation and evaluation process will be simplified and standardized to the extent possible.

2. **Centrally Funded Matching Grants.** More explicit criteria for the centrally funded Matching Grant (MG) program are as follows:

(a) The review procedures are strengthened to ensure the focus of MG activities is consistent with country development priorities and requirements.

(b) AID seeks to ensure that Development Assistance support is directed to AID countries, where the need is most evident. AID will only consider providing support for programs in non-AID countries on an exceptional basis where the activity is of significant benefit to activities proposed for AID countries or otherwise of interest to AID.

(c) The program is available to a limited number of PVOs of recognized standing with discrete programs in high-priority sectors. The grant selection criteria to measure track record and financial management capability are more explicit.

(d) The role of the Regional Bureaus in the MG approval process is reaffirmed by standardizing an appeal process to the Administrator or his designated representative in the event of Regional Bureau disagreement with approval of an MG by FVA; and

(e) Parallel funding of Matching Grants and OPGs to the same PVO in a country is not permitted unless specifically agreed to by a Mission.

III. Accountability

Accountability is not unique to the AID-PVO relationship. It is an element of consideration in all Agency relationships with outside parties. There are two actors in the AID-PVO relationship, each with duties and responsibilities. Accountability therefore involves:

- the duties and responsibilities of those AID offices and officials responsible for the management oversight of AID-funded PVO activities; and
- the duties and responsibilities of PVOs which receive and administer AID funds.

A. PVO Accountability

Accountability is an expectation not only of PVOs by AID, but also of AID by the U.S. Congress and the Executive Branch. It is multi-faceted in its aspects, involving various AID Bureaus and Offices and coming to bear at differing points throughout the program and project process. AID recognizes that PVOs are accountable to entities beyond the U.S.G., e.g., the individual contributor and their Board of Directors. AID's approach to accountability, however, must be governed by the standards applied to Federal funds. The duties and responsibilities of non-profit organizations receiving federal funds are set forth in OMB Circular A-110 and A-122 and AID Handbook 1, Supplement B, Chapter 24B. AID is required to implement these regulations; it does not have the authority to make them.

The scope of Federal audit work is not limited to fiscal considerations. It consists of three elements: (1) financial and compliance audits, (2) economy and efficiency audits, and (3) program result audits. Audit rights remain a topic of serious discussion within the PVO community. AID's right to audit the books and field operations of U.S. PVO grantees and sub-grantees is reserved under OMB Circular A-110. As to foreign grant recipients or sub-recipients, however, audit access can become problematic unless adequate provisions are made to clarify this element of PVO accountability and to integrate them into the grant/contract process.

Where a PVO has multiple relationships with AID, the Agency will make every effort to consolidate accountability processes and to be systematic in the exercise of its accountability functions.

As a general matter, the AID-PVO relationship must reflect the autonomy of the organizations involved while at the same time insuring fulfillment

of AID's legislative mandate as custodian of taxpayer funds. AID is accountable to the U.S. Congress for use of its funds as directed and it cannot forego that responsibility. The challenge is to arrange for AID's accountability functions to be exercised in ways which respect the integrity of AID's partner agencies.

AID will review (1) the duties and obligations of nonprofit organizations receiving federal funds as set forth in OMB Circulars A-110 and A-122, and (2) AID audit rights of foreign sub-recipients as set forth in the provisions of AID Handbook 2, Supplement B, Chapter 2, 24B in the course of its work to simplify the management and administrative relationship between AID and PVOs to ensure that adequate safeguards are built into any recommended changes.

B. Agency Accountability

With the proposed designation of the FVA Bureau as the principal Agency information center on PVO matters, that Bureau will assume primary responsibility for demonstrating that adequate management controls are in place with respect to AID's substantial and growing PVO grant portfolio. The Inspector General has been enjoined by OMB to (1) provide such assistance as may be required to ensure that adequate control systems are in place, and (2) periodically test the efficacy of AID's internal control systems through individual project or functional program audits.

1. Responsibilities for various aspects of accountability are assigned and delineated within AID as follows:

(a) FVA retains oversight responsibility for those PVO activities which it funds.[1] Missions' concerns also will be protected through the provision of more timely and consistent information on a regularized basis from FVA about PVO activities in their respective countries, as detailed in Section V.

(b) Each Mission assumes oversight responsibility for PVOs which it or the Regional Bureaus fund. Missions will supply improved information to FVA about these activities in order that FVA can better function as the Agency's focal point of PVO information and coordination, as detailed in Section V.

(c) To facilitate effective performance of the above responsibilities, each Mission will identify an officer with lead responsibility for overall knowledge about PVO activities in that country. This officer will have a "trip-wire" responsibility to inform FVA of information that comes to his/her attention relevant to AID's management oversight of PVO projects, whether the project is Mission or centrally funded. The officer also will provide a point of contact between the Mission and FVA for purposes discussed in (b) above.

2. Information detailing the scope and objectives of Mission, Regional Bureau and centrally-funded PVO activities will be more fully developed and disseminated throughout the Agency. To carry this out, it will be necessary to:

(a) Clearly identify the various registration, program and grant requirements, and the guidelines or waiver procedures for each of these requirements;

(b) Assign monitoring and management responsibility for each set of requirements to the relevant office(s) in AID;

(c) Inform responsible offices of the relevant requirements and provide them with examples, particularly where precedent is involved;

(d) Spot check for uniform interpretation and application of requirements; and

(e) Incorporate the requirements and monitoring and oversight responsibilities in relevant AID handbooks and other Agency guidance.

IV. Funding Decisions

The AID-PVO relationship involves three types of funding decisions: (A) funding levels, (B) funding allocations between field-program support and institution building support, and (C) funding allocations between the two types of PVO field-program support mechanisms: Matching Grants and Operational Program Grants.

A. Funding Levels

The question of the appropriate funding level for PVO activities needs to be viewed in the context of the steadily increasing scale of PVO use of AID funds in recent years and the 1981 Congressional direction to AID to make available at least twelve and up to sixteen percent of its Development Assistance budget to PVOs.

The Agency will maintain a substantial level of support for PVOs in our total program. AID views funding for PVO programs as *complementary* to other AID projects within each Regional and Central Bureau.

[1] In addition to the existing approval and monitoring standards regarding PVO accountability, the Missions are adequately assured of the compatability of centrally-funded PVO programs with their portfolios by three other changes made by this policy statement: (1) that Matching Grant activities respond to the development problems and priorities of the country; (2) that parallel funding of Matching Grants and OPGs to the same PVO in a country is eliminated unless specifically agreed to by the Mission; and (3) that the selection criteria to measure track record and financial management capability of Matching Grant recipients are tightened.

BEST AVAILABLE COPY

While AID views funding for PVO programs as complementary to other Regional and Central Bureau activities, PVO programs compete with all other AID Central and Regional programs for funding. Although some refinements in the current budget review process as it relates to PVOs are made below, we believe that the basic approach is sound. It provides the flexibility needed to exercise program judgments regarding the competing demands of non-PVO assistance activities as well as the absorptive capacity and developmental performance of PVOs.

1. Funding for PVO programs will remain competitive with other AID programs within each Regional and Central Bureau. An appropriate balance will be maintained between field and centrally-funded grants.

2. Consideration of the funding level for PVO activities, as well as the appropriate mix between regionally-funded and centrally-funded programs, will be built into the AID program budget process so that funding trends are consistent with Agency policy and represent conscious decisions by Agency management. Grants made to PVOs from *all* AID bureaus will be included in this decision-making process and review as follows:

(a) The PVO program will be reviewed at each stage of the CDSS review process to tie PVO policy to each country's development strategy. Each Regional Bureau and PPC will consider the strategy and reasons for using or not using PVOs in each CDSS review.

(b) Proposed PVO funding levels will be reviewed at each stage of the ABS review process to tie PVO policy to funding decisions. PPC will review the total PVO program and recommend to the Administrator any changes in the total PVO funding level and the mix between regional and central PVO funding levels.

B. Funding Allocations between Field Program Support and Institution Building Support

Budget constraints and the need for development impact in the field require that increased percentages of AID funding for PVO activities be allocated to specific PVO field programs (managed either regionally or centrally), as opposed to institution building support. Institution building support, particularly when the organization is not sharing the costs, also can create unhealthy dependency on the U.S. Government, a concern shared by both AID and the Congress.

AID's past support to a number of U.S. PVOs has significantly strengthened their abilities in the development assistance field. In recognition of the capacity that already exists in many U.S. PVOs and in order to make effective use of limited development assistance resources, funding priority is directed to PVO field programs. This emphasis also is responsive to Congressional concern that AID support direct PVO involvement in overseas development. However, the Agency's preference for field programs should not discourage the pursuit of innovative programming opportunities which may arise with certain PVOs. AID will maintain a degree of flexibility in this regard, reserving the possibility of considering institution building support on a cost-shared basis in select circumstances.

1. Increased percentages of AID funding for PVO activities will be allocated to PVO field programs as opposed to institution building (capacity-building) support.

2. Management and other institutional support services to U.S. PVOs will be provided based on the identification of a specific need under centrally-managed contracts awarded competitively, or under cooperative agreements.

3. Institution building support to U.S. PVOs, while not encouraged, may be considered on a cost-shared basis in select circumstances, particularly in those instances in which the AID support directly enhances or supports field activity.

C. Funding Allocations between Matching Grants and Operational Program Grants

The two principal mechanisms for funding PVO field activities are centrally-funded and managed Matching Grants (MGs) and regionally-funded and managed Operational Program Grants (OPGs). (Co-financing programs, for purposes of this discussion, are treated as variants of the OPG program.)

Mission-funded PVO field programs, usually OPGs, generally relate clearly to Mission CDSS priorities and normally include little AID/Washington involvement. The Mission has the sole responsibility for monitoring and evaluating OPGs. However, Missions should consult and coordinate with FVA on the overall capabilities and management strengths of a PVO prior to initiating an OPG. OPGs will normally support discrete projects rather than represent a PVO's broader presence in a given country.

PVO activities under Matching Grants must also be consistent with country development priorities identified by the various AID Missions. AID's resources are sufficiently limited that it cannot fund PVO programs which do not address the country's development priorities. This approach does not, however, mean that, in a particular country, AID-supported PVOs must work only in the same sectors and geographical regions that AID does in its program.

AID's country programs derive from an analysis of the conditions retarding development in that

country, and a purposeful focusing of resources on those constraints, or on opportunities for development where AID judges that it has a comparative advantage. Budget, personnel and technical limitations normally will not permit the AID bilateral program to address **all** of a country's priority development constraints. Thus, a PVO might well work in a region or sector where AID is absent, thus expanding the scope of AID's total development effort. For example, programs of the family planning organizations supplement AID's bilateral activities in a number of countries. Similarly, the West Bank/Gaza and South Pacific programs offer examples of PVO management or all or most AID-financed activity in a specific region. Alternatively, PVOs can augment existing AID programs in particular sectors or regions. The critical point is not the sector or regional allocation of PVO activity, but rather the need to focus limited AID resources on the development needs and priorities of a given country.

1. Most support for field programs of PVOs in LDCs will be managed and administered through project-specific grants (OPGs) by the relevant Mission or Regional Bureau. However, AID also encourages consolidation of grants by country and/or sector into centrally-funded and managed comprehensive program grants for PVOs which have a demonstrated record in international development.

2. To ensure that those PVOs receiving Matching Grants are capable of programming and implementing overseas development activities with minimum AID oversight, the criteria used in Matching Grant program selection, particularly those for judging performance and financial and managerial capabilities, have been made more explicit.

V. Information Coordination and Dissemination

Inadequate information exchange between AID and PVOs, within AID, and among PVOs hampers effective programming. PVOs have very different strengths. AID has not developed a sufficiently active two-way information system to describe and evaluate PVO characteristics or strengths, and to inform PVOs of AID technical and program experience. Nor has AID developed a sufficiently strong information system to inform PVOs of Mission priorities and country settings relevant to the operation of PVO country programs.

Better information is needed on such questions as (1) which organizations are best at doing what and where; (2) which technical approaches are most promising under what circumstances; and (3) which program packages are managerially and technically effective and staff efficient.

A. Information Dissemination

FVA will develop a more focused program of active two-way information dissemination within AID based on the overall strengths and characteristics of various organizations, and with PVOs regarding AID sectoral priorities, country strategies, and other relevant program/sectoral concerns;

B. Evaluation

Increased attention will be given by both AID and PVOs to evaluation and dissemination of the results of PVO experimentation in pilot programs. Several steps will be taken to accomplish this end. The following list is illustrative, not exhaustive:

1. Internalize Evaluation

To increase the effectiveness and replicability of PVO development projects, project evaluation capabilities must be internalized by the PVO. FVA will continue to assist PVOs in strengthening their evaluation capabilities by opening AID evaluation seminars to PVO personnel.

2. Improve Communication

PVOs typically work independently of each other even in the same country. Particularly where this is the case, PVOs could share information about what each is doing, explore areas of common interest, pool resources and exchange ideas. Such exchanges among PVOs should be facilitated and could be funded by the respective Missions.

3. Improve PVO Evaluation and Information Dissemination Inside AID

AID needs to improve its ability to evaluate systematically the **overall** performance of specific PVOs and develop an **active** information dissemination and exchange system. Information about PVO programs gathered by PVOs and AID Offices and Missions that manage PVO grants must be provided more systematically to the FVA Bureau, synthesized, and disseminated to AID program managers and PVOs. To accomplish this, Missions will provide relevant documents to FVA. FVA will periodically provide such overall evaluations of PVOs to the field.

C. FVA's Role

FVA will more actively provide:

1. Technical assistance to AID regions and Missions, at their request, to plan, design, manage and evaluate PVO programs and, if possible, to suggest new and innovative approaches to programs involving PVOs.

2. Assistance to PVOs regarding AID procedures, functional or sectoral priorities, and country

strategies. Relevant AID documents regarding AID procedures, sectoral strategies, country strategies, program and impact evaluations should be sent to registered PVOs as they inquire. Likewise, FVA will facilitate the dissemination of PVO documents relevant to the Missions and/or regions.

3. Orientation to AID Mission Directors and others in the Agency regarding PVO involvement and activities in any given country.

VI. Formulation and Implementation of PVO Policy

If an effective relationship is to be maintained with the PVO community, the Agency must formulate clear and comprehensive policy guidance. The matter of "lead policy role" is of major importance to the PVO community, as well as within AID. In addition, the roles and functions of the various Bureaus and Offices with which PVOs will be interacting must be clarified to facilitate productive AID-PVO relationships.

Although the AID Administrator has ultimate responsibility for AID policy, PPC will continue to function as the lead office in policy formulation and coordination while FVA/PVC will continue to serve as the lead office in relation to Agency-wide operations involving AID and the PVOs. This separation of the policy formulation role of PPC from the operational role of FVA is consistent with PPC's role vis-a-vis other AID Bureaus. This division of responsibilities is appropriate in maintaining PPC's position as the Administrator's "policy broker."

Within this PPC policy framework, AID recognizes that effective assistance and guidance to PPC in the area of policy formulation requires consistent and broad accessibility to the PVO community. This necessitates a working knowledge of the attributes, functions and activities of these heterogeneous organizations. The current position of Director of PVC in the FVA Bureau has these characteristics.

A. PPC is the "lead office" in PVO policy formulation and coordination:

1. PPC formulates PVO policy for the Agency. FVA's responsibility is to implement the policy. PVC's Office Director provides assistance, information and guidance to PPC in the area of policy formulation.

2. PPC reviews overall Agency PVO strategy in the CDSS process and overall Agency PVO program levels in the ABS process. FVA participates in these reviews as a resource to PPC and to provide for effective monitoring.

3. FVA chairs the intra-agency PVO Liaison Committee and assumes primary responsibility for implementing the Committee's recommendations. Policy-related issues will be directed to PPC, which can "reconvene" the Committee at the Assistant Administrator/Office Head level as appropriate.

B. Utilizing this policy statement as a basis, PPC, working with appropriate offices, will produce a series of AID policy-related documents on PVO matters as appropriate. Such documents will, **inter alia**, address such topics as:

- guidance on the workings of the CDSS and ABS processes as they apply to PVOs;
- AID support of indigenous PVOs as entities in their own right and as partners with U.S. PVOs.

VII. Organizational Configurations

The present organizational configurations for managing and administering the AID-PVO relationship require clarification concerning functions and roles. A change in emphasis on certain functions is also needed to respond to evolving PVO requirements and AID's own concerns.

A. The FVA Bureau

FVA will structure itself to be a more active resource for AID Offices and Missions as they plan specific actions or programs with PVOs. FVA's role as the information center for PVO matters is being strengthened. Such an overall communication system will both utilize and maintain AID's PVO memory and will contribute to consistent implementation of AID-PVO policy.

The FVA Bureau assumes the role of general broker between PVOs and the Regions. For example, FVA informs AID Offices of PVOs' characteristics and strengths, and of the kinds of assistance the registered organizations receive from which AID offices and countries; assists PVOs with AID procedures, functional and sectoral priorities and country strategies by holding workshops and disseminating relevant AID documents; provides technical assistance to PVOs and to AID Regions and Missions to plan, design, manage and evaluate PVO programs and to suggest, when possible, new and innovative approaches to programs involving PVOs.

In order for FVA to play this enhanced role, a revised and strengthened management and information system will be put into place to assure (1) that necessary information concerning PVO-related plans, projects and policies is provided to FVA on a regularized and timely basis and (2) that regional and other bureaus inform and solicit information from FVA prior to making PVO grant awards. FVA will take the lead in developing a

system to accomplish these objectives, in collaboration with PPC and the other concerned bureaus. Great care will be taken to avoid creation of an administrative bottleneck in PVO funding in the PVO information system.

The FVA Bureau also carries out the following functions:

1. PVO registration.

2. Maintenance of ongoing knowledge of PVO financial and managerial capabilities.

3. Development and management of the central grant program.

4. Liaison with the Advisory Committee on Voluntary Foreign Aid.

5. Implementation and monitoring of AID policy on PVOs, and with PPC, development of AID program guidance concerning PVOs.

6. Development and monitoring the application of simplified AID procedures for supporting PVO programs.

7. Coordination of the evaluation of overall PVO performance.

B. The PVO Liaison Committee

The PVO Liaison Committee—the intra-AID coordinating committee—is a forum to discuss PVO policy, program and procedural matters. The program recommendations of the Committee are implemented principally by FVA. Recommendations relating to policy are directed to AA/PPC. The Committee will meet periodically at the Assistant Administrator/Office Head level to resolve policy issues and discuss new policy directions.

VIII. Advisory Committee on Voluntary Foreign Aid

As stated in its charter, the objectives of the ACVFA are:

- to serve as a focal point for relations between the U.S.G. and U.S. PVOs active in relief, rehabilitation, and development assistance overseas; and
- to assure that the voluntary sector plays a vital and dynamic role in the formulation and execution of foreign assistance programs.

Its duties and scope of activity are outlined as follows:

- To consult with, provide information to, and advise the Agency for International Development (and other U.S. Government agencies, as appropriate), on matters and issues needing attention across a wide spectrum of development issues relating to foreign assistance in which U.S. Government and U.S. private and voluntary organizations interact.
- To provide the community of private and voluntary organizations working abroad with information, counsel, and other assistance on problems and issues of concern to them in their relations with AID and other U.S. Government agencies.
- To foster public interest in the fields of voluntary foreign aid and the activities of private and voluntary U.S. organizations.
- To provide guidance to AID concerning the standards, criteria, requirements and process for the registration of voluntary agencies.

1. ACVFA will continue to explore ways in which it can enhance its catalytic role in facilitating the AID-PVO relationship.

2. AID will continue actively to seek the Advisory Committee's advice on broad policy-related issues involving the AID-PVO relationship including, in particular, those issues of long-term importance to maintenance of an effective and mutually beneficial partnership and identification of potential areas for greater PVO involvement.

3. AID will insure that the ACVFA staff remain apprised of major issues pertaining to the AID-PVO relationship so that it can effectively carry out its mandate.

4. AID will actively seek the Committee's advice and use the ACVFA meetings as a forum to discuss proposed changes in PVO policy, programs and procedures.

III.C.6 (TM 1:35)
8/14/85

A.I.D. Policy Paper

COOPERATIVE DEVELOPMENT

U.S. Agency for International Development
Washington, D.C. 20523

April 1985

III.C.6 (TM 1:35)
8/14/85

A.I.D. Policy Paper

Cooperative Development

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

April 1985

TABLE OF CONTENTS

Page

I. Introduction 1

II. Rationale for AID Support to Cooperatives 1

III. Common Characteristics of Cooperatives 2

A. Business Purpose

B. Voluntary Membership

C. Democratic Control

D. Equity in Contributions and Benefits

IV. Assessing the Environment for Cooperatives 3

A. Government Attitudes and Policies

B. Effective Management

C. Cultural Norms

D. Test of the Market Place

V. AID Assistance to Cooperatives 3

I. Introduction

This policy paper on cooperative development makes the following points:

1. **Definition.** Cooperatives are voluntary, independent business enterprises formed to meet specific needs of their members through a common venture.

- As private sector organizations, their development effectiveness is measured by the same standards as other private organizations.
- In order for the members to realize the benefits from a cooperative it must first be a viable business enterprise.

2. **Rationale.** AID supports the development of cooperative organizations because cooperatives embody aspects of the principles of voluntarism, democratic choice and the economic effectiveness of private enterprise that historically have shaped our own nation's development.

- Cooperatives are able to reach and benefit sectors of the population that would not normally be served by other private sector institutions or direct government programs.
- The relatively permanent institutions created by cooperative development in the Third World provide an institutional framework through which other resources and programs can be channeled.
- The high premium placed on member participation in the operations and decision making of the cooperative promotes independence and self-reliance encouraging members to take an active role in their own development.
- Cooperatives offer an attractive alternative to public sector programs. The paternalistic approach of governments and absence of competition provide little incentive to seek efficient methods of product or service delivery. A cooperative, because it is recipient owned, has an automatic incentive to maximize benefits to the members.

3. **Environment.** To judge whether the cooperative will be successful, the local environment must be assessed to determine if it is supportive to the creation of a viable cooperative business enterprise. Some common factors influencing cooperative formation are:

- Government attitudes and policies.
- Effective management.
- Cultural norms.
- Marketplace.

4. **AID Assistance.** AID will encourage the development and use of cooperatives where they can be effective instruments for program and project implementation.

- Institutional support to U.S. cooperatives will be centrally funded.
- Cooperative activities under bilateral programs will be funded by the regional bureau and/or the country AID program concerned.
- Missions desiring assistance in assessing the local environment for cooperative development or in designing and planning cooperative activities should direct requests to the relevant AID/W geographic bureau which will coordinate with other concerned offices.

A detailed examination of certain issues raised in this policy paper as well as a comprehensive analysis of factors affecting cooperative projects can be found in the report, "Cooperatives in Development - A Review Based on the Experiences of U.S. Cooperative Development Organizations, Development Alternatives Inc., Washington, D.C. 1984." This publication may be requested from PRE/CSBD, Agency for International Development, Washington, D.C. 20523.

Cooperatives are one type of local organization. Further policy guidance on the role of local organizations in A.I.D.'s program and on overcoming the limitations of local organizations can be found in the A.I.D. Policy Paper, "Local Organizations in Development", March 1984, identification code PN-AAQ-157. This publication may be ordered in microfiche or paper copy from:

A.I.D. Document and Information
Handling Facility
7222 47th Street
Suite 100
Chevy Chase, MD 20815

II. Rationale for AID Support to Cooperatives

Emphasis on the private sector for development is one of the Agency's four major policy approaches. (The others are: policy dialogue, institutional development, and technology transfer.)

This policy emphasis is supported by the Foreign Assistance Act, which encourages development assistance to be carried out as much as possible through the private sector. The Act also encourages development and use of cooperatives to strengthen the participation of rural and urban poor in their country's development.

AID supports cooperatives because they fit in the mainstream of U.S. development philosophy. Cooperatives embody aspects of the principles of voluntarism, democratic choice and the economic effectiveness of private enterprise that historically have

shaped our own nation's development. They provide a means of reaching large numbers of poor people through grass roots organizations, and offer encouragement and a means for the poor to pool their resources to help themselves toward a better life. In pooling of resources (such as credit worthiness) frequently the whole is greater than the sum of its parts. One of the most attractive aspects of cooperatives is their potential for capital formation, a scarce resource in most developing countries.

III. Common Characteristics of Cooperatives

Cooperative forms of social and economic organizations exist throughout the world, engendered and molded by often quite dissimilar social, economic and political traditions. No single definition of "cooperative" would be adequate to describe the diverse activities that have been labeled "cooperative." But it is possible to identify certain common characteristics of cooperative organizations:

Cooperatives are private, voluntary and independent associations of persons joined together to achieve a common economic objective. They are democratically-controlled, for-profit business organizations whose members make equitable contributions to capital. They are normally operated on the principle of "one member - one vote," and benefits are distributed in proportion to the contributions of individual members. Along with freedom to join and bring assets into the organization, is the freedom to leave and take assets out. In some cases restrictions may apply to asset removal, but if so, this is known and freely accepted as a condition of membership when members join.

Such a definition highlights four major principles of cooperative organization:

A. **Business Purpose.** Cooperatives are formed primarily to serve an economic function. Although social ends are often an important purpose, unless a cooperative is successful economically, no long-lasting or self-sustaining social development can be expected.

B. **Voluntary Membership.** The decision to join a cooperative must be an individual one, based on one's own assessment of needs and of various alternative ways of meeting them. Personal identification with a cooperative, for instance through exclusive purchase of inputs from a cooperative store, is often critical to the success of the organization. Joining cannot be coerced if the cooperative is to be successful. Only when individuals have free choice will the organization be certain to be responsive to the needs and wishes of the members.

C. **Democratic Control.** All members of a cooperative should have the opportunity for a voice in its affairs, no matter what amount of share capital they may have contributed, and without regard to other positions they may hold either within or outside the organization. In practice, many cooperatives, particularly the larger ones, may proceed with little input from the great majority of their members, who may have little knowledge of, or interest in, management of the enterprise. It is the capacity for input which assures that management is responsive to the members. The provision for a particular form of democratic control sets cooperatives apart from most other private firms; it is also a fundamental distinguishing characteristic between cooperatives and state enterprises.

D. **Equity in Contributions and Benefits.** Members of a cooperative should contribute share capital equitably, so that individuals or small groups cannot assume *de facto* control of the enterprise. Equitable contributions might be equal, or might be based on the economic size of members (i.e., equal assessment per acre of farmland or on a sliding scale) or anticipated use of the cooperative. A related principle is that members should benefit in proportion to the use made of the cooperatives, rather than in proportion to shareholdings. This ensures that those who through personal involvement have helped to build the organization will be rewarded on the basis of that involvement. By contrast, in private firms that are not cooperatives, both control and benefits are in proportion to degree of ownership.

Cooperatives organized under these principles can differ widely in their objectives, operations and autonomy. They can be service, production or market oriented. Cooperatives can be integrated into confederations. The credit union movement is a good example of this kind of vertical integration. Large cooperatives can begin as such or can result from merging many small primary societies (horizontal integration). They can be single or multipurpose, or begin as single-purpose and gradually add other functions. Businesses that are wholly owned subsidiaries of cooperatives also are considered within the category of cooperatives for AID purposes.

AID experience with cooperatives goes back to the Marshall Plan era. In the 1950s and 1960s cooperatives were supported extensively in Latin America, and to a lesser extent in

in other regions. This long experience has shown not only the potential of cooperatives for effective development, but also some inherent limitations. As indicated below, it is necessary to carefully evaluate the prospects for cooperative development within the local context.

IV. Assessing the Environment for Cooperatives

Local cultural traditions, government policies and practices, the political climate and other factors need to be assessed in evaluating the environment for supporting cooperative development in a particular country. Therefore, it is not practicable nor is it desirable to attempt to provide an all-encompassing prescriptive formula for support to cooperatives. The following are some of the more common factors influencing cooperative development, and can be used to judge whether the cooperative will be successful:

A. **Governmental attitudes and policies.** A government's posture influences the formation and success of all private enterprises, including cooperatives. Government support might take the form of enabling legislation, chartering services and perhaps financial assistance, fiscal and monetary policies that for example, encourage savings and open access to commodities and markets.

A danger to be avoided is too much government involvement, which becomes intervention and negates the private and voluntary nature of the cooperative (if, for instance, a commissioner for cooperatives can appoint members of the management committees of local cooperative societies for reasons not related to financial insolvency, etc.). Few cooperatives have achieved success when burdened with such degrees of government involvement.

B. **Effective management.** A competent, dedicated manager or management team often is the single most important factor for predicting success for cooperative development. The management approach and style must be compatible with the local environment. Ultimate success in institution building requires that management be subordinate to members, and be reviewed by members or their chosen representatives.

C. **Cultural norms.** Traditional societies have structures and practices, including management procedures and behavioral norms, that can have both positive and negative impacts on self-help and cooperative enterprises. It is necessary to be aware of both the positive and negative traditional values and norms that might facilitate or impede the formation and success of cooperatives. Cultural norms often are slow to change.

D. **Test of the market place.** Cooperatives should be judged by the same economic and other standards as any other type of enterprise. They should meet the tests of the market place in their operations. The economic effect of any subsidies should be carefully weighed. Barriers against market entry of competitive alternatives (an indirect subsidy in effect) should be evaluated.[1] Normally the existence of such conditions would be appropriate topics for policy dialogue.

Missions contemplating interventions employing cooperatives may call upon AID/W offices for assistance. The primary source of technical assistance and training for organization and management of overseas cooperatives is the U.S. cooperative movement. Mission questions concerning assistance should be directed to the relevant geographic bureau, which will coordinate with the Private Enterprise Bureau/Office for Cooperative and Small Business Development and other AID/W bureaus and offices as appropriate to provide the requested assistance.

V. AID Assistance to Cooperatives

Cooperatives can be a useful and effective means for capital formation, for fostering private initiative and competition, and for directing grass roots efforts toward development objectives, at the local, regional and national levels. They can be used to reach large numbers of rural and urban poor and attack problems of basic human needs. All of these are important aspects of AID's development assistance strategy. For this reason, AID will encourage the development and use of cooperatives where they can be effective instruments for project and program implementation.

This support will be provided under two categories. First, AID will continue to encourage U.S. cooperatives in their direct relationships with cooperatives in developing countries. Appropriate institutional support to U.S. cooperative organizations and funds to support independent cooperative-to-cooperative programs will be centrally funded. This centrally funded support will be provided subject to periodic reviews and the

[1] If a cooperative has been granted a monopolistic privilege to deal in certain commodities, it will behave much like a parastatal marketing agency. Such an entity would not normally be considered eligible for AID support.

availability of funds, and in a manner that promotes AID's objectives. (See also PD 73, 3/30/80, "AID-U.S. Cooperative Organization Relationships.")

Second, AID considers cooperative development an integral concern of its bilateral programs and will provide support in this context, subject to the principles in this policy statement, and other usual requirements of AID's bilateral programs, such as project review and evaluation. Funding for these activities will be the responsibility of the regional bureaus and country AID programs concerned.

The following additional principles apply mostly to the use of cooperatives in bilateral programs, but in a number of cases they also are relevant for centrally funded cooperative activities as well.

In general, all AID assistance to cooperatives should have the goal of achieving, in the most effective and rapid manner, organizational self-reliance, self-financing and independent operational effectiveness to enhance their development impact. The kinds, amounts and methods of assistance can greatly influence the achievement of these goals.

AID assistance might range from technical assistance (for example, training, management/organizational structure), to financing of capital for the formation or expansion of cooperatives. Both loan and grant assistance are possible. The primary target population should be the rural and urban poor.

Proposals to support cooperatives should be evaluated on their merit in the context of local circumstances, in terms of how closely they meet the general criteria above, and their expected impact on goals and objectives being addressed by the mission's long term development strategy. Linkages with other Agency policy objectives should be carefully considered, such as supporting and furthering policy dialogue and institutional development.

Assistance that has a multiplier effect is preferred, e.g., to a federation that is assisting primary level cooperatives, or to a primary level cooperative that will serve as a model on which to build other primary level cooperatives. In other situations, it may be more productive to work at the policy and regulatory levels. Again, the choice has to be based on local circumstances and development goals.

The multipurpose cooperative offers advantages that can be achieved by vertical integration of a variety of functions leading to the final sale of a product or service to the ultimate user. For example, a chicken production credit and marketing cooperative might finance farmer production, produce and sell feed, process, package and market both wholesale and through cooperative owned retail outlets. Multipurpose cooperatives require sophisticated management, increase the costs and risks of failure, and may be beyond the experience level of available management in some countries. In many cases, it may be preferable to consider several cooperatives with more limited purposes rather than one multipurpose cooperative.

AID has assisted governments in arranging cooperative financing by providing grants, loans and loan guarantees. Host government financing can be arranged in a number of ways: loans to cooperatives through marketing boards, PL 480 generated funding, capitalization of special cooperative banks or international banks. Financing directly through the private sector is another possibility.

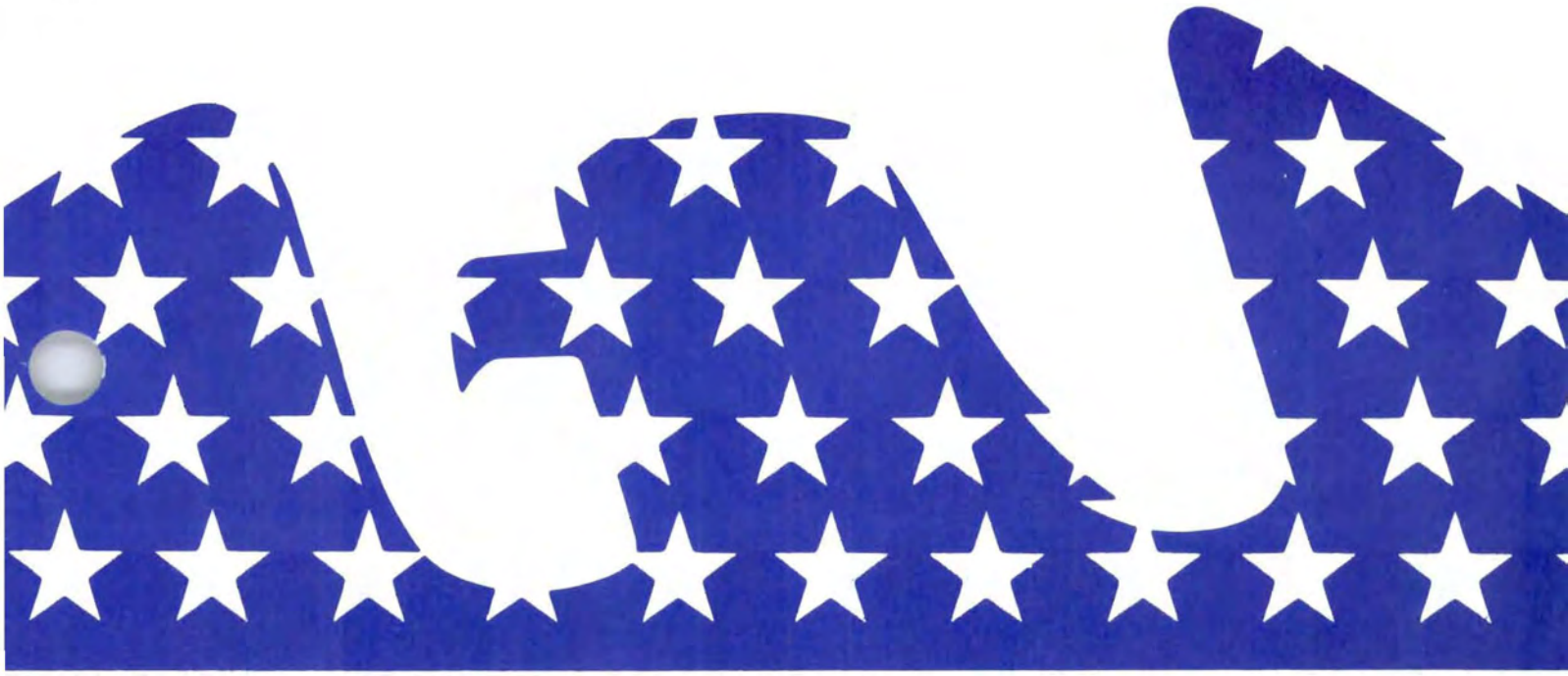
As the cooperative movement in a particular country passes from promotion and organization to operations, the need for more technically specialized assistance increases. AID's experience with overseas cooperative development has shown that this technical expertise is available from U.S. cooperative development organizations. Particular technical requirements may involve the private non-cooperative sector, and universities. This wide choice of sources gives users an opportunity to weigh various factors in addition to cost, such as broadening institutional linkages and planning for future relationships.

III.C7 (TM 1:34) 11/9/84

POLICY DETERMINATION
Agency for International Development

PD-1 August 5, 1982

Narcotics



A.I.D.

POLICY DETERMINATION

NARCOTICS

Section 126 of the Foreign Assistance Act instructs AID to "give priority consideration to programs which would help reduce illicit narcotics cultivation by stimulating broader development opportunities." Given this mandate, it is AID's policy to seek out opportunities to design projects that provide economic alternatives to farmers in narcotics growing areas. AID's projects should also reflect the interest of the host government to increase enforcement under existing bans and more generally, to affect the climate favorably for extension of government administration and services into an area. The situation is complicated by social and cultural traditions that make sustained broadly based development efforts that address economic and quality of life concerns one vehicle to facilitate the acceptance of alternative crops. We must realize that no single crop is likely to provide a viable economic alternative for traditional drug producers. Missions are encouraged to include research components for developing and testing alternative crops in programs designed to assist development efforts in narcotics growing areas. To be successful, the application of these efforts must be accompanied by parallel eradication programs designed to enforce bans on cultivation of illegal narcotic crops. Other USG agencies and not AID are responsible for funding and monitoring of these enforcement and eradication programs. AID's role is to identify, fund and implement appropriate development programs in narcotics producing areas. Obviously, both efforts require coordination in planning and implementation at the country team level and with the recipient host government. Accordingly, it is the policy of AID to develop programs and projects to help reduce illicit cultivation by providing incentives for alternative sources of income generation. AID Missions are instructed to consider seriously income substitution projects and other development assistance activities in illicit narcotics producing areas using development assistance and/or economic support fund monies. These areas must be ones in which the host government is able to provide for the safe movement of AID personnel.

Assistance must meet standard development criteria and priorities and will be funded within country levels. Standard project analysis will be followed although it is anticipated that relevant project papers will contain more analysis pertaining to the social, economic, cultural and institutional mores of producers of illicit narcotics. Projects must receive full host government support and AID Missions should encourage their inclusion into host government's overall development plan as an indication of that support. Inclusion in long term development plans also facilitates multilateral development bank and other donor financing.

Following are elements of AID policy on narcotics:

1. AID will seek out every appropriate opportunity to encourage strongly the United Nations specialized agencies, multilateral institutions and other bilateral donors to channel economic assistance to narcotics producing areas for the purpose of discouraging illicit narcotics cultivation. Independently and in cooperation with other U.S. Government agencies, U.S. representatives in multilateral forums will be encouraged to support activities and projects that further AID narcotics objectives.

2. AID will work with appropriate USG agencies to collect, analyze, disseminate and utilize information pertaining to its development activities directly related to the control of illicit narcotics through a recently revised Inter-agency Agreement For The Sharing of Information Concerning The Narcotics Producing Regions of the World. (Annex 1) AID's contribution in this area is intended to be an important component in the increased demand for quantitative and qualitative data on activities related to alternative income generating schemes that will assist in determining future project directions.

3. In order to fulfill the Inter-agency Agreement requirement, learn more about the interrelationships between narcotics and development activities and develop a realistic narcotics strategy framework, a yearly AID narcotics analysis will be conducted by affected Missions, in collaboration with State INM officials. Further guidance will be forwarded by PPC, with regional bureau input.

4. AID will support the participation of private voluntary agencies in development of alternative sources of income in narcotics producing areas, where appropriate.

5. Depending upon the type and location of project or projects undertaken, it may be both feasible and necessary to obtain an assurance from the host government, either as a part of the project agreement or in a side letter, that narcotics production will not be permitted within the area of a project(s) assisted by AID. The agreement should provide for termination of AID funding (at AID's option) if the host government does

not comply with its eradication commitment. The use of "poppy/coca clauses" would most likely be incorporated in projects which could enhance the production of illicit narcotic crops, e.g., irrigation, etc. These clauses aim at retaining AID's flexibility, raising the consciousness level of the host government to our concerns and assures that AID funded projects do not contribute to an increase in the production of illicit narcotics. It should be noted, however, that while poppy/coca clauses may be an important tool, they offer limited leverage per se in the behavior of governments. Missions, along with State officials, are encouraged to educate host governments on the scope and depth of the narcotics problem--both within their country and internationally--so that enforcement is more likely. Projects involving basic health, education, and other such activities not directly related to the cultivation of narcotics will not be affected.

6. U.S. involvement in narcotics control and enforcement programs overseas is the responsibility of the Department of State. State will provide needed assistance in this field and give guidance as AID projects are designed to ensure that host government plans and capabilities are both appropriate and adequate to meet requirements. AID recognizes that enforcement of narcotics laws is a function of the host government and looks to the State Department to monitor host government performance in the enforcement field.

7. The Department of State, through its Bureau of International Narcotics Matters will continue to plan, finance and implement programs which can have a developmental focus. These projects are generally "pilot" in nature designed to determine the feasibility of a broad program that would provide an alternative source of income for the narcotics producer and enhance the host government's ability to enforce its anti-narcotics laws in the area. The Department of Agriculture, a new signatory to the Inter-agency Agreement, will cooperate with AID in this effort by continuing research on crop substitution measures. AID Missions should monitor the progress of pilot income substitution programs to assure that positive results are taken into consideration in host government development planning and programs and, as appropriate, in AID programs and projects.

8. The responsibility for continuing the policy dialogue on narcotics and development within AID will be centralized through the Coordinator for Narcotics Affairs, located in the Bureau for Program and Policy Coordination. The regional bureaus will continue to discharge the responsibilities for project implementation and evaluation.

Attachment
Annex 1 - Interagency Agreement for the Sharing of Information Concerning The Narcotics Producing Regions of the World

M. Peter McPherson

August 5, 1982
Date

ANNEX I

INTERAGENCY AGREEMENT FOR THE SHARING OF INFORMATION CONCERNING THE NARCOTICS PRODUCING REGIONS OF THE WORLD

1. Objective

The purpose of this agreement is to improve the availability of information about narcotics growing areas of the world to those agencies and officials of the United States Government who participate in international development loans and projects. Such information will help them to channel economic development for narcotics producing areas into alternative crops and rural development, thus reducing the amount of narcotics available for non-medical drug use.

Illicit drugs have a corrosive impact on American society, especially the nation's youth. These substances also have a complex negative, domestic effect in the producing countries that, on balance, inhibits both economic and social development. It is no coincidence that the traditional narcotics-producing countries have internal drug abuse problems that are a drain on their own societies and economies.

Most of the world's illicit drugs are produced in the least developed countries and, within them, often in remote areas where governmental administrative controls, as well as services, are essentially non-existent. Economic development of these areas can serve as the first step in providing viable alternatives to illicit drug production and enhance official drug control efforts.

The United States participates on its own, through the international financial institutions and the United Nations in extensive economic assistance and loan programs throughout the world. These programs frequently involve the financing of agricultural and rural development. The signatories to this agreement believe that the economic assistance programs are one way of encouraging the substitution of alternative crops for narcotics.

In 1979 a mechanism was established to provide economic assistance and development agencies with the information required to target assistance programs so as to contribute to reducing narcotics cultivation. The purpose of this agreement is to reaffirm and enhance this mechanism so that the concerned USG agencies receive timely and accurate information on narcotics producing regions of the world and on actual or potential economic development projects in those areas.

The agreement does not require any agency to undertake new or additional responsibilities but rather, ensures that maximum potential be realized from those functions already being performed through agency cooperation in sharing essential information.

II. Responsibilities

A. Collection of Data

1. The Drug Enforcement Administration, the Department of State, and other appropriate agencies, as tasked by the Department of State, shall compile current data relating to the locations of narcotics growing regions of the primary and potential source countries. This data shall be forwarded annually to the Assistant Secretary of State for International Narcotics Matters, Department of State. The Agencies shall also identify any developmental assistance programs which may affect narcotics cultivation and report this information in a timely manner.

2. Participating agencies shall report to the Bureau of International Narcotics Matters any relevant information concerning actual or potential agricultural and rural development projects which could reduce narcotics cultivation, or conversely could encourage it; a listing of all projects and loans involving source countries; and a description of all projects in narcotics growing regions.

B. Dissemination of Data

1. The Bureau of International Narcotics Matters, Department of State, shall collect the data provided by the Drug Enforcement Administration, the Department of the Treasury, the Department of Agriculture, the Agency for International Development, other appropriate agencies, and other Bureaus within the Department of State and shall annually disseminate data to the signatory agencies and other USG officials concerning:

   a. The nature, extent and location of narcotics production in source countries;

   b. Political factors and attitudes of the source countries regarding crop substitution and narcotics eradication programs;

III.C8 (TM 1:34)
11/9/84

A.I.D. Policy Paper

LOCAL ORGANIZATIONS IN DEVELOPMENT

U.S. Agency for International Development
Washington, D.C. 20523
March 1984

III.C8 (TM 1:34)
11/9/84

A.I.D. Policy Paper

Local Organizations in Development

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

March 1984

TABLE OF CONTENTS

		Page
Executive Summary		ii
I.	Introduction	1
II.	Types of Local Organizations	1
	A. Local Administration	2
	B. Local Government	2
	C. Voluntary Associations	2
	D. Political Parties	3
	E. Private Enterprise	3
	F. Informal Indigenous Organizations	3
	G. Linkages	4
III.	The Role of Local Organizations in A.I.D.'s Program	5
	A. Planning and Decision-Making	5
	B. Implementation	6
	C. Monitoring and Evaluation	7
IV.	Overcoming Limitations of Local Organizations	7
	A. Resistance	7
	B. Subordination	8
	C. Factionalism	8
	D. Ineffectiveness	9
V.	Policy Implications	9
	A. Program Analysis	9
	B. Program Development	10

Executive Summary

Local organizations (e.g., primary cooperatives, local governments, informal associations) play important roles in the development process:

- by generating revenue to supplement investments made by donors and central governments;

- by implementing, channeling, or filtering the impact of centrally-planned interventions;

- by providing independent avenues for the expression of private development initiative; and

- by communicating to central authorities local needs, capacities, and requirements.

Hence, it is A.I.D. policy to provide direct and indirect support to a wide range of public and private local organizations. This support is meant to ensure that individual citizens are effectively and directly involved in development through local organizations that link them to national-level resources and processes; to further the democratic participation of people in assistance activities directed towards them; and to encourage the development of indigenous organizations that meet people's requirements for sustained economic and social progress.

To accomplish these policy objectives, which are aimed at generating broadly-based, self-sustaining development, A.I.D. will undertake a range of appropriate activities including but not limited to the following:

- *Policy dialogue with host country governments to define the relative roles and responsibilities of central authorities and local organizations.* A.I.D. holds that policy analysis should be directed at administrative and institutional, as well as economic, policies and that one element of policy reform should be to ensure that local organizations are free to perform their developmental roles.

- *Programmed assistance to host countries in order (a) to improve the administrative and/or economic environment within which local organizations function; (b) to strengthen intermediary organizations, such as national cooperative banks, PVOs, or women's associations, that in turn may support development-oriented local organizations; and (c) to provide direct support to local organizations through technical assistance, training, and financial and commodity assistance.* In practice this, too, will ordinarily be done through intermediaries but it is important to distinguish between assistance that strengthens intermediaries and assistance that strengthens the bottom tier of organizations.

Finally, there is a general presumption in favor of supporting pre-existing local organizations instead of creating new organizations because (a) very often a careful appraisal of rural society will reveal organizations performing precisely those tasks planners deem important; (b) existing organizations persist because they meet real needs and serve their clientele well, whereas new organizations may take years to become effective and to gain local credibility; and (c) even where existing local organizations seem deficient to planners it is unlikely that new organizations will escape whatever administrative, technical, or political pathologies are weakening the existing organizations. *Hence, A.I.D. will seek to build on or rehabilitate existing local organizations prior to considering the development of new ones.*

I. Introduction

The Foreign Assistance Act of 1961, as amended, directs A.I.D. to involve the poor effectively in development by working through "local-level" institutions (Section 102). Also, A.I.D.'s assistance in the areas of agriculture, rural development, and nutrition is to be carried out in part by "creation and strengthening of local institutions" linked to regional and national organizations (Section 103). More generally, A.I.D. is required to "encourage the development of indigenous institutions" in conjunction with all forms of assistance authorized in Chapters One and Two of the FAA (Section 281). This policy paper outlines how A.I.D. intends to carry out these legislative directives by addressing generic issues in local organization development; other policy statements on narrower topics such as indigenous cooperatives and local government will provide more specific guidance where necessary and appropriate.

A.I.D. and its predecessor agencies have a long history of activity in support of local organizations, perhaps epitomized by the cooperative development experience in Latin America. More recently, a number of Asian missions have developed programs that build on local governments and community-level water management organizations. In Africa and the Near East, decentralization programs, community-based primary health care, and other activities have brought A.I.D. into association with diverse local organizations. The literature examining the results of these experiences and other donor attempts to deliver assistance to local organizations is large and often contradictory; hence the goal of this paper is to identify some consistent lessons learned and consequently point to areas where the Agency can now build on the results of previous experience. This policy paper thus does not point the Agency in radically new directions, but rather suggests some policy guidelines based on assessments of activities in which A.I.D. has been involved for a substantial period of time.

The paper is organized in five parts. Following the Introduction, Part II defines "local organizations" in development, and discusses linkages and complementarities among them and other organizations. Part III focuses on the role of local organizations in three areas critically important to successful development: planning and decision-making, implementation, and monitoring and evaluation. Part IV discusses the limitations of local organizations, some of which are inherent, and some of which derive from the way in which these organizations interact with broader entities. Important topics include resistance, subordination, factionalism, and ineffectiveness. Guidance on addressing these limitations is presented as well. Part V, Policy and Program Implications, presents conclusions on the implications of this paper for Agency policy and program development. The primary point is that support for local organizations is not an end in itself, but rather a means to achieve A.I.D.'s broader developmental objectives in supporting development among the rural poor through institutional development, technology transfer, policy reform, and private enterprise development.

II. Types of Local Organizations

The term "local organizations" includes a broad range of enterprises, agencies, associations, and authorities that stand between the populace at large and the national level organizations that play dominating roles in the determination of development policies and the allocation of resources. Examples of local organizations include local governments (e.g., county councils), local offices of national administrative agencies (e.g., district commissioners and their staffs), primary cooperative societies, political party branches, and private businesses (including firms, intermediary support organizations such as banks, and trade unions).

In fact, none of these categories of local organization is wholly distinct from the others. Political parties are often voluntary associations also, and all the other types of local organizations will also usually have a political side to them; many voluntary associations (e.g., cooperatives), may also be viewed as private enterprises; local government may often be indistinguishable from the local private sector where, as is often the case, business leaders predominate in the elected ranks; and the lower levels of administration (chiefs, subchiefs, village agricultural agents, etc.) will also usually be very active in local voluntary associations, political parties, local government, and private business. In addition, there are usually local bodies (e.g., district development committees) in which representatives from all types of local organizations meet to set local priorities and settle disputes.

Local organizations engage in significant development efforts of their own, but they also respond to or mediate decisions made in central government; stated differently, people experience central initiatives largely through the local organizations of which they are members, clients, or constituents. In fact, the impact of virtually all national development interventions, as well as international donor assistance, is conditioned by intermediary local organizations of various types. Local organizations also constitute vehicles through which people can

make their views known, or by means of which they can lay claim to resources emanating from the center. *In giving support to policies and programs that strengthen local organizations, A.I.D. is both increasing the likelihood that resources committed at the center will have some impact on the population in general, and helping to ensure that the voice of the people will be heard in decisions regarding policy and the allocation of national resources.*

However, local organizations are in no sense a panacea for all development ills, and working with them brings up some issues that are not ordinarily confronted in dealings with national-level institutions. This paper outlines both strengths and weaknesses of various types of local organizations, the linkages among local organizations, and the linkages between local organizations and broader regional or national entities. The range of various development-related organizations and linkages among them are discussed below.[1]

A. Local Administration

Local administration includes local representatives of national administrative agencies, such as district officials responsible for agriculture and health development, representatives of executive office (e.g., district commissioners), the judiciary, and law enforcement agencies. Deconcentration, that is, the transfer of specific administrative powers from central agencies to their representatives in local offices, is perhaps the most common approach to expanding the role of local administrations in development. *A.I.D. supports the transfer of appropriate central functions to regional or district staff to improve the planning, implementation, and impact of development activities.*

B. Local Government

The character of local government organizations varies greatly across countries, and is consequently difficult to define. Specific examples include county councils and municipal authorities. Although there are exceptions, "local government" refers to public bodies:

- with specific legal authorities;
- providing a range of services;
- with some capacity to generate local revenue;
- with accountability to a geographically-based local constituency; and
- which are substantially independent of central or local administrative agencies.

Local governments are vital and powerful in some parts of the world today, and very weak in other places. The administration of essential government services (e.g., maintenance of roads and domestic water supplies), which would otherwise be the business of over-worked central bureaucracies, tend to be better handled by local government agencies when they are allowed to do so and have the necessary resources. Moreover, effective local governance can foster and expand the role of private enterprise in development through appropriate policies in the areas of land use, taxation, and the like. *A.I.D. encourages the devolution of national authority to local government as one way to overcome the inertia and wastage associated with an exclusive dependence on national public organizations,* but recognizes that successful devolution depends on strong administration and political stability in the center. Further guidance will be presented in a forthcoming policy determination on local governments.

C. Voluntary Associations

Voluntary associations are extremely common and extremely important intermediary organizations, often present in many different forms, and often very active in local development. These organizations may recruit members on the basis of residence (e.g., village development committees), economic function (e.g., a coffee marketing cooperative), age (youth associations), sex (women's groups), ethnicity (tribal unions), common property interests (water users' associations), occupation (trade unions), belief (church community development groups), and various combinations of these. Local organizations of this type, which are fundamentally action-oriented and private in nature, became increasingly important in the Agency's program during the 1970's, but remain relatively poorly understood. Incorporating them into planned programs of development generates a fundamental conflict. Such organizations are formed to serve particularistic, even parochial, purposes, and serve clienteles that are often rather narrowly defined; if they relate to central authorities at all it is to gain access to outside resources. Central

1. This section is based on material presented in two volumes prepared by Cornell University with A.I.D. support:

Esman, Milton J., and Norman T. Uphoff
1982 Local Organizations and Rural Development: The State of the Art. Rural Development Committee, Center for International Studies, Cornell University.

Uphoff, Norman T., and Milton J. Esman
1974 Local Organization for Rural Development: Analysis of Asian Experience. Rural Development Committee, Cornell University.

authorities, on the other hand (and this includes donor agencies), usually see local voluntary associations as a channel for controlling development processes in rural areas, ordinarily try to tie new resources to changes in the extent or focus of association activities, and are often reluctant to allow much in the way of independent action.[2] *A.I.D. programs that involve local voluntary associations must accommodate this fundamenial difference in perspective by ensuring that coopted voluntary associations are able to maintain a substantial degree of fiscal and administrative autonomy.*

D. Political Parties

Political parties are usually (not always) voluntary associations, but are distinguished separately here not only because they constitute a distinctly different channel through which local needs and priorities can be stated, but also because local representatives to national assemblies can have a major influence on the allocation of public resources to particular areas. Although there is relatively little that A.I.D. can or should do directly in the arena of local politics, it is important for A.I.D. to incorporate some understanding of this mode of local organization into the program development process.

E. Private Enterprise

Local private enterprise includes a wide array of small scale enterprises, including manufacturing, wholesale and retail trade, and services; and a variety of business organizations ranging from self-employed artisans to sole proprietorships, family businesses, small workshops, and cottage industries. In any particular country setting, enterprises with few workers, few and inexpensive fixed assets, and high labor intensity constitute "small scale private enterprise" as defined here. Small scale private enterprises are particularly important because they may efficiently generate needed employment; they perform essential agribusiness functions (processing, marketing, and input distribution) that stimulate agricultural growth; they contribute to the decentralization and spread of industrial development; and they are efficient users of capital.

F. Informal Indigenous Organizations

All of the local organizations discussed so far are relatively formal, insofar as their responsibilities and authorities tend to be defined in legislation, regulations, written charters, contracts, and so forth. There are other local organizations, more informal in nature, that are grounded in aspects of the social order and which play important developmental roles. These may be termed "informal indigenous organizations," and often serve as an interface between individuals and the more formal local organizations discussed above.[3]

Informal indigenous organizations include kin groups (clans, families), work groups based on festive or exchange labor, dance societies, age-grades, neighborhood associations, and other similar social units.[4] These types of groups, often unknown to outside observers, may either crosscut or provide the building blocks for more formal local organizations, and are important because they constitute the basic social context which may determine patterns of membership and activity in the broader units. For instance, many rural enterprises are family-owned and operated, a fact which strongly influences the economic behavior of these firms. Local government is often dominated by traditional lineage, caste, or hamlet loyalties, which have a profound impact on patterns of resource allocation. The work of local administration, for instance in adjudicating disputes over land and water rights, will often entail interaction with indigenous land-holding or water-managing groups. Political parties, of course, are often based on regional or ethnic identities, and the election of party delegates or parliamentary representatives is usually an occasion for intense conflict between opposed local social groups of one sort or another. In short, membership and power in local organizations of all types runs along lines determined by pre-existing social ties, and some understanding of the nature of community level social organization is required to understand the dynamics of local organizations and how they may respond to or generate development initiatives. *Thus, A.I.D. will ensure that projects involving local organizations give full consideration to the local socio-economic and political context that influences local organization performance.*

2. For a much expanded treatment of this point, see:
   Ralston, Lenore, James Anderson, and Elizabeth Colson
   1981 Voluntary Efforts in Decentralized Management. Institute of International Studies, University of California, Berkeley.

3. Actually the difference between "formal" and "informal" organizations may often be one of degree; similarly, many apparently "indigenous" organizations may be of relatively recent origin, i.e., only one or two generations old. The typology offered here for descriptive purposes should not be allowed to disguise the more complex, dynamic reality.

4. For more detailed information see:
   Cernea, Michael
   1981 Modernization and Development Potential of Traditional Grass Roots Peasant Organizations. In: Directions of Change: Modernization Theory, Research, and Realities, edited by Attir et al. Westview Press. Boulder, Colorado.

G. Linkages

Local organizations do not exist and function in isolation from one another or from central authorities. Because local leaders are ordinarily active in a variety of organizations, there may be close linkages (growing out of personal ties) between local government, local private enterprise, and various voluntary associations, including political parties. Other linkages are based not on personal but on functional relationships. For instance, local administrative offices will often regulate and provide technical and/or financial assistance to local organizations such as cooperatives, private businesses, and water users' associations. Marketing cooperatives may lease vehicles from private traders. Local government regulates and may either support or stifle local enterprise, depending on the content of policies. The Esman and Uphoff study cited earlier has shown that supportive horizontal linkages of these types increase the chances that specific local organizations will be successful. *Providing support for new organizations outside the existing network of institutional linkages may thus be ineffective. Furthermore, offering outside assistance that enables or encourages existing local organizations to withdraw from this supporting network may over the long term be counterproductive.* Finally, because of the supportive horizontal linkages, outside support for the development of local organizations may often be more effective when undertaken indirectly rather than directly. For instance, most programs to stimulate small enterprise in LDCs focus on the enterprise itself, e.g., by providing additional funds and technical assistance. But under some circumstances it may be a more effective stimulus to small enterprise to focus on reform of local government tax or land use policies. Indirect assistance of this sort may not always be possible, but it should be considered as an option.

Complementarities also tend to exist between local organizations and broader entities. Primary cooperative societies, for instance, must usually participate in regional and national federations; local enterprise requires stable links to large wholesalers or markets; and local administration needs easy two-way communication with central offices. As obvious as this may appear, the development literature is rife with examples of development projects that failed to achieve stated objectives because important linkages to essential organizations or institutions were never made. *It is for this reason that A.I.D. has determined to give explicit consideration to the strengths, weaknesses, and linkages among local organizations, as well as those between local and national organizations, before embarking on programs of development that explicitly or implicitly depend on local organizations for successful implementation.*

Five categories of developmentally-significant organizational linkages may be distinguished:[5]

- *finance linkages:* credit, savings facilities, grants, commodity support.

- *regulation and monitoring linkages:* audits, administered prices, regulated financial procedures, registration and/or certification of organizations, imposition of uniform standards, inspections, evaluations.

- *technical assistance linkages:* training, secondment of staff, managerial and technical advice.

- *service linkages:* provision of inputs, performance of complementary tasks.

- *representative linkages:* formal or informal local participation in planning, implementing, and evaluating programs, whether through patron-client networks, political parties, community development groups, or other means.

National agencies may use one or several of these linkages to strengthen or influence the performance of local organizations. Regulatory and monitoring linkages tend to be used to control local organizations, while other forms of linkages may be used to assist them without imposing controls. However, most assistance linkages can become control linkages if the superordinate national agency is determined to dominate the local organization or if the assistance is provided too long and engenders dependency. A.I.D. as a donor agency will often be in the position of supporting local organizations through intermediary superordinate organizations, and so the problem of selecting suitable national intermediaries and instituting appropriate national-local linkages is a crucial one. Missions should bear in mind the following strategic principles:

- *Commitment vs. technical capacity:* If the intermediary national organizations are to support local ones effectively, they must have both commitment to expanding the role of local organizations as well as the appropriate technical capacity. A program of community water development, for instance, might require both engineering skills and the willingness to work with local groups. The national ministry of water development might have the technical capacity but lack the commitment to work with communities, whereas the national ministry of local

5. Much of the following discussion of linkages is based on material presented in:

Leonard, David, and Dale Rogers Marshall (eds.) 1982 Institutions of Rural Development for the Poor. Institute of International Studies, University of California, Berkeley.

administration might have the commitment but lack the technical skills. Of the two, commitment is most difficult to instill. *A.I.D. should select intermediary implementing agencies primarily on the basis of commitment, recognizing that technical capacity can be built up more easily than commitment.*

• *Technical assistance linkages:* Once a national level intermediary agency has been chosen, missions should consider two alternative models according to which they may furnish advice and assistance to local organizations. One model assumes that the local organizations concerned (e.g., a cooperative, a local government) will eventually have the capacity to perform the technical or administrative function itself. Hence the technical assistance is aimed at building local capacity. An alternative approach recognizes that some organizations will never develop their own trained staff, either because the scale of the organization is too small, the required function is too specialized, or because the local-level career and lifestyle opportunities for the requisite professional staff are too limited. In these circumstances a national cadre of skilled advisers is required to furnish technical assistance on a continual basis, and the emphasis is on building national capacity rather than local capacity. *A.I.D. should try to locate reserves of national expertise in parallel, service-oriented private institutions rather than superordinate public agencies to guard against the tendency for national assistance agencies to assume excessive control over the assisted organizations.*

• *Multiple linkages:* Most programs, whether explicitly "integrated" in nature or not, are dependent upon stable performance from a system of institutions, the failure of any one of which will generate failure of the program. The solution is not necessarily to stengthen particular organizations—which may fail anyway—but rather to provide for multiple organizational linkages. For instance, rather than strengthen a central fertilizer agency (or monopoly import company), it may be more effective to encourage a multiplicity of private wholesalers. This gives farmers both public and private sources and helps to ensure availability of needed supplies. Second, rural development problems are inherently difficult to analyze, and there may be disagreement about correct solutions. It then makes sense to initiate several alternative approaches, knowing in advance that some will fail—but this strategy increases the likelihood that a viable institutional approach will emerge. *A.I.D. requires greater flexibility in forging institutional systems, and greater willingness to tolerate or even initiate multiple organizational linkages is an important part of this.*

• *Administrative simplification:* The Leonard study cited earlier offers some program maxims that appear obvious but are often neglected: single-function organizations are more likely to perform well than multi-function organizations; small agencies are less complex than large ones; compexity grows with the number of levels in a bureaucracy; the market is administratively simpler than a bureaucracy; benefits targeted for a specific subgroup (e.g., women farmers) are more difficult to administer than benefits that are more general (e.g., smallholders); and finally, complex procedures, like complex organizational structures, generate program failure and reduce the access of intended beneficiaries to planned benefits. *There is a general presumption in favor of simpler implementing structures,* but more complex programs will often be required to meet A.I.D.'s objective of equitable development and can be justified on this basis.

III. The Role of Local Organizations in A.I.D.'s Program

Local organizations may contribute to a series of critically important development activities, including (a) informed planning and decision-making; (b) flexible and adaptive implementation; and (c) low-cost, efficient monitoring and evaluation. All these tasks are key to achieving broadly-based self-sustaining development.[6]

A. Planning and Decision-Making

Development planning and decision-making in host countries and donor agencies tend to be highly centralized processes, aimed at generating a rationalized allocation of budget resources among alternative activities. Unfortunately, variable and changing social, institutional, and economic circumstances in LDCs render many such plans (at the national, program, and project level) out of date quite literally before they can be published and disseminated. Moreover, the information upon which these centralized decisions are based is often incomplete or even wrong, resulting in projects that may be either ineffective or counterproductive. While some planning functions are inevitably and appropriately the responsibility of central agencies, there is much room for lower-order organizations, including local organizations, to take part in the planning and decision-making process. A.I.D. may often accomplish much simply by getting local

6. This section draws heavily on the ideas presented in:
Uphoff, Norman T., John M. Cohen, and Arthur A. Goldsmith
1979 Feasibility and Application of Rural Development Participation: A State-of-the-Art Paper. Rural Development Committee, Cornell University.

groups "a seat at the table" when decisions affecting them are being made.

The potential planning contribution of local organizations can be seen most clearly at the stage of problem identification, when important decisions are made about priority problems and appropriate solutions. These early decisions guide the remainder of the project development process, and, if incorrect, can generate a wholly inappropriate development intervention. *Thus it is important for A.I.D. to seek the fullest possible understanding of local circumstances at the earliest possible point in project development.*

Local organizations offer ready-made mechanisms through which understanding of local circumstances can be injected into project development. Local business people and shopkeepers, for instance, are in close touch with the financial circumstances of the communities in which they live; local bankers and entrepreneurs can identify investment priorities within the local community; local government and local administrative offices can shed light on the feasibility of alternative implementation and coordination plans; farmers' groups can propose or comment on technical packages and other support programs; and the reaction of local political representatives may indicate whether and to what extent local communities will ignore, hinder, or support a planned intervention. While local views, as mediated by local organizations, should not necessarily determine the content of interventions, *A.I.D. should not commit major resources without some understanding of how particular development activities are going to be received or perceived by the local organizations and people who are to administer and utilize them.*

B. Implementation

Local organizations may play a role in program and project implementation in two principal ways: by performing administration and coordination functions, and by generating resource contributions.

1. Administration and Coordination

Active participation of local organizations in administration and coordination of project activities tends to render projects more responsive to the requirements of a varied and changing social, economic, and political environment. Unfortunately, local organizations are rarely allowed a substantive role in these matters. Local administrative offices, that is, district representatives of central line and executive agencies, often play a larger implementation role than other types of local organizations. However, even these offices are often put in the position of carrying out plans developed at higher levels, and may have relatively little independent authority to propose useful activities or to alter central efforts in ways that make them more viable in local settings. *Hence, A.I.D. should ensure that a wide range of local organizations is engaged in decision-making on the "where" and "how" of project activities.* "Where" decisions are crucial in projects that involve some type of construction: farmers' associations can advise on the location of farm-to-market roads or irrigation canals, local government can advise on siting of schools and health clinics and appropriate provisions for local maintenance, local business groups can suggest the best locations for market centers and help assess the viability of alternative fee rates, and so forth.

Local organizations may also provide important input to implementation decisions regarding project strategy, project financing, and project-related sanctions.

• *Project strategy:* If the problem is water conservation in semi-arid locations, for instance, farmers' groups can assist in the delineation of subcatchment areas and settle questions about the size, composition, and timing of local construction inputs. If the problem is road development, local government can help ensure that proposed routes serve important trade and production centers not known to central authorities, and organize local labor resources.

• *Project financing:* local leaders of various organizations are obviously well-placed to gauge what portion of an activity might be financed with local resources, and whether the contribution should be in labor, cash, materials, or some combination of these. *A.I.D. should seek their participation in decisions regarding the role to be played by local communities, so that programs we support do not result in demands that are unrealistically high, and do not fail to draw fully on potential sources of support.*

• *Project-related sanctions:* Decisions about what regulations are required to ensure compliance with project structures, and what mechanisms should be utilized in resolving disputes, should also draw upon the advice of local entities. Grazing restrictions on steep hillsides, wood harvesting regulations in reforested areas, water access and maintenance rules in agricultural and domestic water systems, and similar restrictions are often key to project success. Unless local organizations are involved in formulating and implementing them the results are likely to be less than satisfactory—because the community does not understand the

regulations, or because it cannot agree to them, or because no mechanism to resolve inevitable conflicts was ever put in place. *A.I.D. projects should be developed with the full understanding and participation of local organizations representing an appropriate range of community interests, so that conflict resolution and enforcement of necessary sanctions will proceed smoothly.*

2. *Local Resource Contributions*

Local organizations may also participate in project implementation by generating local resource contributions. Local resources may take the form of labor, cash, material goods, or information, all of which can make a significant contribution to the success of development initiatives. In has become increasingly clear that substantial and long-lasting development cannot be accomplished unless local resources are engaged not only to augment the efforts of government and donors, but also to engender interest in and commitment to a project. Unless the local people or local organizations whose resources are desired have been allowed to join in decisions about what is to be done with them, the resources are not likely to be forthcoming. While local groups may not often be able to influence the types of programs and policies directed at them, they can certainly influence the outcomes, simply by withholding their labor, their investment funds, their material resources, their willingness to participate, and their information about and understanding of local circumstances. Rarely can the resources to which local organizations have access be obtained through coercion. *Thus A.I.D. planners who wish their programs to benefit through the commitment of local resources should include appropriate local groups in substantive project decision-making.*

C. Monitoring and Evaluation

Local organizations can play a role in project management, monitoring, and evaluation, without excessively encumbering a project with expensive, time-consuming data collection and analysis efforts, Representatives of local organizations can be expected to be aware of a broad range of community responses to and perceptions of projects activities; they are likely to be aware of implementation hitches soon after they have occurred; and they often are able to propose practical solutions to emerging problems. Hence, if an appropriately wide range of local leaders is included on project advisory boards or is in some other fashion systematically included in managerial discussions, a broad array of data and experience becomes available. Managers can then monitor implementation effectiveness and other aspects of project impact by listening to the opinions of people representing local organizations. Obviously, these opinions will never reflect the views of the population in general, insofar as leaders of local organizations tend to be of the political, economic, or social elite. Nevertheless, however biased the feedback provided may be, it will be a useful supplement to more formal evaluation activities.

Finally, to the extent that political parties, voluntary associations, and other local interest groups provide strong means through which local evaluations of projects and programs may be communicated to the center, *A.I.D. can do much to improve the responsiveness of central authorities and the relevance of programs we support simply by strengthening a broad range of local organizations.*

IV. Overcoming Limitations of Local Organizations

Limitations on the performance of local organizations derive from several sources, including: (a) the resistance local organizations may generate from other elements of society; (b) the possibility that local organizations will become subordinated to other more powerful agencies; (c) the presence of socio-economic and political cleavages within local organizations; and (d) the likelihood that some local organizations will prove ineffective at accomplishing important development tasks.[7] These limitations do not pertain to local organizations alone; no organizational format is entirely free from these ills. Nevertheless, these limitations are discussed here both because (a) these criticisms often are used to justify circumventing local organizations, and (b) because donors and host country governments must understand how such problems emerge if they are to fashion remedial actions.

A. Resistance

Local organizations come into being and persist because they serve the economic, political, or other needs of their membership or clientele. As "interest groups" they are inevitably in opposition to other economic and political interests; not surprisingly, then, a program to strengthen specific local organizations, or to introduce new ones for specific purposes, may meet with considerable resistance. The main sources of resistance are local and regional elites (who may either be supported or opposed by central authorities), local and regional government administrators, national political

7. This discussion is based on the references listed in Footnote 1 above.

leaders, and perhaps even some or all of the general population in the area concerned.

For instance, established traders (sometimes reliant upon government-sanctioned trade restraints) may well oppose marketing cooperatives. Large landowners may not be enthusiastic about farmers' associations. Local administrative officials often regard local private enterprise with distrust and may express concern that proposed business associations will increase price collusion and consumer exploitation. National political leaders may fear local governments or private associations as independent political power bases. Finally, people in general may well resist the introduction of new local organizations if these are perceived as government entities, or if they appear likely to serve the needs of some groups to the exclusion of others. These types of concerns can be expected to emerge in any situation where local organizations are to be strengthened or supported.

If large segments of a population are reluctant to participate in new organizations that are proposed in conjunction with assistance programs, A.I.D. should regard this as a major problem with program objectives or modes of implementation, and should seek to understand the reasons for resistance and modify or eliminate those elements of a program that seem problematic.

B. Subordination

Local organizations, particularly voluntary associations and local government, are often weak in finances and technical skills, have poor access to legal services, and are consequently easily dominated by more powerful outside groups. In these situations local organizations do not act independently, but rather reflect the desires of central government and local elites.

Government influence inevitably grows when local organizations begin competing for and accepting government resources (loans, services, grants, credit guarantees). Along with the resources come reporting responsibilities and the requirement to conform with various regulations; eventually government may reserve the right to appoint or veto the appointment of local organizational officers. Whether and to what extent expanded control will undermine the independence and vitality of local organizations depends on any number of specific local circumstances. There is little that can be done to resist central authorities that are determined to suborn a local entity; even governments and donors wishing to strengthen the role of local organizations, for instance by providing loan or grant funds, may paradoxically weaken or subvert them at the same time. *Minimally, A.I.D. should ensure that legislation and regulatory codes spell out and protect an independent role for specific categories of local organizations.*

Local organizations can be strengthened by providing for regular, well-publicized elections, as well as mandated rotations in and out of office, but probably the best course is to ensure that the membership in general possesses the education and training needed to understand the business and procedures of the organizations, as well as legal requirements. An informed, active, and committed membership is the best defense against subordination of organizations. *Hence, in strengthening the role of local organizations in LDCs, A.I.D. will give priority to training and technical assistance in management, administration, and member education.*

C. Factionalism[8]

Local organizations are also subject to internal cleavages, reflecting differentiation that may be social in nature (castes, religion, ethnicity), economic (large farmers vs. small, traders vs. producers), or some mixture. All generate factionalism and political antagonisms, and all tend to weaken the capacity of local organizations to undertake concerted action with general community support. In other circumstances, underlying community cleavages may generate a multiplicity of local organizations, each with similar objectives but intending to serve the needs of different local groups. Fragmentation of community resources and proliferation of redundant, ineffective small-scale activities are the inevitable result. As with resistance and subordination, there are, however, some concrete steps that can be taken to check factional divisions.

Small, relatively homogeneous groups will be more resistant to factionalism than larger, diverse groups. When the primary units (e.g., primary cooperative societies) are too large and too heterogenous, collective action is discouraged and the organizations often fail. Thus, the tendency to encourage large groups so that overt administrative costs are low frequently leads to weak performance that is ultimately more costly. Another way to guard against excessive factionalism may be to stress consensual, or at least open, decision-making, so that members feel they have had a role in important decisions affecting their organization,

8. A comprehensive analysis of factionalism is offered in:
Nicholson, Norman K.
1972 The Factional Model and the Study of Politics. Comparative Political Studies, October, pp. 291-314.

Sometimes organizations that are generating demonstrable benefits are less subject to internal dissent, since all members have a stake in maintaining the organization; but at other times success itself might generate discord as groups vie for control of new resources. Plainly, some discord will always be present, and of itself ought not discourage assistance to local organizations; in fact, internal dissent is one mark of a vital, on-going organization—only moribund entities provide no criticism. *Hence A.I.D. should ensure that local organizations we support are appropriately sized, as homogeneous as circumstances will permit, and committed to open decision-making processes.*

Factionalism can also be of value, however, when formal organizations are inadequate. Factional politics allows local groups to make their views known nationally, and creates a link between politicians and the administrative officers responsible for policy implementation. *A.I.D. recognizes that factionalism, while often disruptive of immediate project goals, may also contribute to broader developmental objectives by providing the mechanism through which formal organizations may adapt to new and changing demands.*

D. Ineffectiveness

Local organizations can often be relatively ineffective at accomplishing essential development tasks, as a result of either internal or external factors. Local governments, for instance, are often weak because their independent authority to generate revenue has been usurped by central authorities, or they may be weak because of inept administrative practices. Farmers' cooperatives may be crippled by national pricing policies that mandate marketing fees at a level below the real cost, or they may suffer from poor business management. Local administrative offices may perform poorly because the incumbents are transferred frequently from post to post, never learning enough about local circumstances to identify problems and solutions clearly, or the poor performance may stem from inadequate technical abilities. Very often, it should be noted, the diagnosis of ineffectiveness differs with the perspective of the observer. If local authorities are performing poorly, for instance, officials in the center might suspect corruption; a management specialist might focus on lack of accounting skills; and the local authorities themselves might complain of inadequate revenue. The real situation will likely be a complex amalgam of all these, and so *A.I.D. must consider a wide range of problem areas and possible solutions when considering action to increase the implementation capacity of local organizations.*

Problems of ineffectiveness may be addressed in a number of ways. Sometimes (e.g., in primary cooperative societies) the need may be as simple as better bookkeeping skills; other times (e.g., weak local government) national administrative policy reform, which may have to be approached slowly and indirectly, is required. Very often local organizations may be ineffective because they have poor vertical linkages to central resources (e.g., technical advice and funds in the case of small enterprises). Surprisingly often, ineffectiveness may actually be an outcome of donor assistance, for instance when new organizations are expected to learn to accomplish a number of different tasks simultaneously. Experience has shown that single-function organizations are more successful initially than multi-function organizations; at the same time, continued success and growth is unlikely if an organization fails to expand into new areas of activity. *Hence in general A.I.D. should plan for new organizations to perform single, simple tasks, but allow for growth over time as experience and capacity increase.*

Ineffectiveness in itself is not an argument against enlisting local organizations in development initiatives; they may, in fact, be no more ineffective than alternative national organizations or ad hoc project units, although the reasons for the ineffectiveness may be different. In fact, the effectiveness of both national and local organizations may be improved by combining the complementary inputs of both levels in planned programs of development.

V. Policy Implications

Despite the limitations reviewed in Part IV, local organizations will continue to play essential roles in the process of development. Failure to understand the place of local organizations in development can undermine the most soundly-conceived initiatives. Where necessary they must be strengthened, and they can never be overlooked. *Hence, local organizations constitute an appropriate focus for A.I.D. policy with regard to both program analysis and program development.*

A. Program Analysis

Missions should address local organizations in conjuction with broader analyses of institutional development issues. It is important to (a) identify key local organizations in most or all of the five categories discussed here; (b) analyze the purposes, tasks, and clients to be served by these key local organizations; (c) discuss the problems encountered by local organizations in performing their development functions; and, where necessary, (d) present a strategy to address the issues identified.

During preparation of projects, missions should give careful consideration to the local organizations that will, implictly or explicitly, and directly or indirectly, be involved in the development intervention planned. It is important to discuss the current and planned roles for concerned local organizations, to analyze current capacity to undertake these roles, and to demonstrate that the planned program will not (a) undermine the performance of existing, well-functioning local organizations; (b) require performances that are well beyond existing capacities; or (c) result in greater unnecessary central public influence over existing local organizations.

B. Program Development

A.I.D.'s overriding concern is to assist host country governments in generating broadly-based, self-sustaining economic and social development, through continued progress in policy reform, technology transfer, private sector development, and institutional development. Because local organizations play crucial roles in all these essential areas of activity, there are four important sets of policy implications for program development.

1. *Policy Reform*

Discussions of adminsitrative policy will be an element of policy dialogue with host country couterparts. Where poor administrative policy inhibits good performance from local organizations, or where weak local organizations hinder the implementation of sound policies, missions will incorporate special interventions in their programs aimed at assisting host countries in undertaking the necessary corrective measures. Because strong, independent local organizations can help in ensuring that national policies remain reponsive to local interest, missions will support local organizations wherever appropriate, and above all will ensure they do nothing to undermine the vitality of existing local organizations. *Finally, interventions that rely on local organizations for important implementation actions, but which take place in uncongenial policy environments, will be undertaken only when provision is made for necessary adjustments in the overall national economic and administrative policy framework.*

2. *Technology Transfer*

Without effective participation by user groups and representative local organizations in the technology generation/dissemination process, there is a danger that new or improved technologies will be inappropriate, or, if appropriate, may never be effectively disseminated. *Hence programs or projects aimed at the creation, transfer, adaptation, dissemination, and use of new and improved technologies among LDC populations will analyze, build upon, and, where necessary, support the roles of appropriate intermediary local organizations.*

3. *Private Sector Development*

Local organizations encompass a broad range of private sector activities; thus support to local organizations will often contribute directly to an expansion of the role of private enterprise in development. Also, assessments of the performance of relevant local organizations (especially voluntary associations, local administration, local government, and local private enterprise) are key to sound investments in agriculture, agribusiness, and industrial development, because such initiatives are often, if not always, dependent upon actions by variety of complementary and supportive local organizations. *Thus, private sector initiatives in the realms of agricultural development, agribusiness development, and development of small- and medium-scale industries will analyze, build upon, and, where necessary, support the roles of relevant local organizations.* The capacities of intended beneficiaries must be taken into account throughout, since the type of private organization selected will determine who benefits as a result of such programs. Banks, for instance, reach a very different clientele than voluntary associations.

4. *Institutional Development*

Providing support to local organizations to improve their ability to undertake development will often entail disbursement of funds to support "capacity-building" activities in addition to delivery of specific goods and services. This approach, aimed at important institutional development objectives, requires careful attention to A.I.D.'s procedures regarding cash management, interest accrual, procurement, and project monitoring—in fact, existing procedures may well restrain missions from adopting some particularly effective approaches to institutional development through the support of local organizations. Issues such as these will continue to be resolved on a case-by-case basis by missions and A.I.D./Washington, to ensure that both program goals and legal obligations are fully satisfied. As more experience is gathered, it may be possible at some future point to issue comprehensive Agency-wide guidance on these crucial matters.

Institutional development is critical to sustained economic progress. This policy paper is meant to increase A.I.D.'s capacity to undertake institutional development, by focusing attention on the often overlooked category of local organizations. In the

last analysis, only local organizations and the people who support them can sustain and build upon the efforts of donors and central government; indeed, without the participation of strong, independent local organizations it is unlikely that the broadly-based support which is also essential to meaningful development will ever emerge. *Understanding of, and, where necessary, support for local organizations will be an element of institutional development in all country programs.* A.I.D. will not always need to work specifically with local organizations; on the other hand, A.I.D. will never be independent of them and cannot afford to take their essential contribution for granted.

A.I.D. Policy Papers and Policy Determinations

The following reports have been issued in a series. These documents with an identification code (e.g. PN-AAM-323) may be ordered in microfiche or paper copy. Please direct inquiries regarding orders to:

A.I.D. Document and Information
Handling Facility
7222 47th Street
Suite 100
Chevy Chase, MD 20815

Title—Policy Paper	Date	'Fiche #
Bureau for Private Enterprise	May 1982	PN-AAM-325
Domestic Water and Sanitation	May 1982	PN-AAM-323
Food and Agricultural Development	May 1982	PN-AAM-322
Nutrition	May 1982	PN-AAM-321
Private Enterprise Development	May 1982	PN-AAM-324
Recurrent Costs	May 1982	PN-AAM-319
Population Assistance	September 1982	PN-AAM-320
Private and Voluntary Organizations	September 1982	PN-AAM-318
Women in Development	October 1982	PN-AAL-777
Pricing, Subsidies, and Related Policies in Food and Agriculture	November 1982	PN-AAN-373
Approaches to the Policy Dialogue	December 1982	PN-AAM-431
Basic Education and Technical Training	December 1982	PN-AAM-190
Health Assistance	December 1982	PN-AAL-817
Institutional Development	March 1983	PN-AAN-108
Co-Financing	May 1983	PN-AAN-457
Local Organizations in Development	March 1984	PN-AAQ-157
Urban Development Policy	June 1984	PN-AAQ-158

Title—Policy Determination	Date	'Fiche #
PD #1—Narcotics	August 5, 1982	PN-AAM-443
PD #2—Mixed Credits	September 29, 1982	PN-AAM-444
PD #3—Voluntary Sterilization	September 1982	PN-AAM-445
PD #4—Title XII	October 5, 1982	PN-AAM-446
PD #5—Programming PL 480 Local Currency Generations	February 22, 1983	PN-AAM-591
PD #6—Environmental and Natural Resources Aspects of Development Assistance	April 26, 1983	PN-AAN-375
PD #7—Forestry Policy and Programs	May 16, 1983	PN-AAN-376
PD #8—Participant Training	July 13, 1983	PN-AAP-273
PD #9—Loan Terms Under PL 480 Title I	September 27, 1983	PN-AAN-753
PD #10—Development Communications	February 17, 1984	PN-AAP-616

POLICY DETERMINATION
Agency for International Development

PD-16

October 9, 1987

PROGRAM FINANCING ARRANGEMENTS WITH INDEPENDENT ORGANIZATIONS

PD-16
October 9, 1987

A.I.D.

POLICY DETERMINATION

Program Financing Arrangements With Independent Organizations

I. Introduction.

As a general principle, in designing and negotiating assistance activities, A.I.D. policy seeks the largest possible financial participation from an assistance recipient, United States or foreign. 1/

Appropriate financial participation by assistance recipients is desirable because it can:

-- help ensure their active involvement in and commitment to program/project activities at about planned levels or better;

-- limit A.I.D. financing for programs/projects to amounts which the recipients cannot obtain on their own or which is otherwise unavailable for such activities;

-- help mobilize additional financial resources for programs/projects;

-- enhance the likelihood that recipients will continue project activities or otherwise work towards program goals after A.I.D. support ends, thereby contributing to an institutionalization and sustainment of program goals; and

-- increase the coverage and effectiveness of A.I.D.'s limited overall budget resources.

1/ "Financial participation" as used in this policy includes in-kind contributions, in accordance with OMB Circular A-110 definition and requirements regarding valuation. See Handbook 13, Chapter 1, paragraph 1K.

II. Policy on Program Financing Arrangements With Independent Organizations

a) Basis for A.I.D. Assistance

A.I.D. provides assistance to independent organizations for two principal reasons:

-- to support or intensify the activities of independent organizations which contribute to the achievement of Foreign Assistance Act objectives; or

-- to develop the independent capacity, integrity, and quality of the recipient as an entity whose function is for the economic or social betterment of developing countries.

In general, these purposes are fully compatible with and are generally enhanced by the appropriate financial participation of a recipient independent organization in financing assistance activities.

b) A.I.D. Policy

A.I.D. policy is that assistance activities should be designed and agreements negotiated to incorporate the largest reasonable and possible financial participation of the recipient in financing a project, except where this is determined not to be appropriate in the judgment of the A.I.D. official authorizing the assistance activity. 2/

A fixed amount or percentage of financial participation for all assistance recipients is not appropriate given the diverse circumstances and conditions which may define a relationship between A.I.D. and an assistance recipient. Nonetheless, for Agency policy objectives, a useful approach is to use 25 percent financial participation as a reference point in approaching the design and negotiation of an assistance activity with an independent organization. 3/

2/ In these instances, the action memorandum signed by the Agency officer authorizing the assistance activity should describe the factors considered in reaching the judgment.

3/ The 25 percent rate in fact reflects existing policy regarding minimum grantee contributions for CRSPs, for some PVO programs, and generally is consistent with A.I.D.'s experience with grants and cooperative agreements.

Where reasonable and possible, larger participation rates should be sought; where necessary, lower rates may be justified. A financial participation less than 25 percent may be both significant, in terms of the entity's financial resources, and appropriate, in terms of A.I.D.'s objectives in joining with the entity in the assistance activity. 4/

III. Some Examples Where Financial Contributions are not Appropriate

A.I.D. programs encounter conditions and circumstances in which the financial participation of an independent organization of less than 25%, or no financial participation, may satisfy A.I.D. policy on other grounds. Among the most common of these are:

-- entities/institutions acting as intermediaries for A.I.D. in implementing programs and activities where A.I.D. chooses to have such organizational relationships for administrative or political reasons (e.g., the UNHCR in Cyprus; PVOs in the West Bank/Gaza);

-- entities/institutions established under A.I.D. programs as unique resources to provide long-term capacity to support programs and which have no substantial independent source of income (ex., JHPIEGO);

-- entities/institutions which have developed or could develop specific programs in response to FAA objectives or A.I.D. requirements but without substantial independent income to support such programs (ex., HBCUs; The Pathfinder Fund);

-- new or small nonprofit institutions without significant independent or external sources of funds (ex., NAFEO);

-- institutions working on activities and towards objectives of special importance to A.I.D. (ex., Scripps Institute and malaria vaccine development);

4/ Per Handbook 3, Chapter 4B5e(5) (a), at pp 4-6, for Operational Program Grants, a 25% financial contribution from non-A.I.D. sources to an OPG project is not simply a reference point but a requirement which must be obtained or waived.

-- institutions established in support of specific provisions of the FAA or other legislation which at their outset and for an undetermined period of time have no independent source of income (ex., ATI);

-- international institutions to which A.I.D. chooses to provide general program/organizational support;

-- contributions A.I.D. chooses to make to international organizations or multilateral funds;

The above examples are not presented as an exhaustive list. A final determination regarding whether there will be a financial contribution by an assistance recipient, and the amount, is subject to the sole discretion of the officer authorizing the activity. This consideration constitutes only one of many in determining whether to authorize assistance to an independent organization. The action memorandum signed by the Agency officer authorizing the assistance activity should describe the particular circumstances, conditions or considerations that caused the officer to conclude that a financial contribution would not be required from an independent organization under consideration as an assistance recipient.

IV. Application of Policy

This policy applies to all assistance provided by the Agency to nongovernmental organizations, in loan, grant or cooperative agreements. This guidance is consistent with but does not supersede existing guidance for OPGs (Operational Program Grants) contained in Handbook 3, Chapter 4B5e(5). This policy statement does not apply to assistance to foreign governments, which is subject to the requirements of Section 110 of the Foreign Assistance Act of 1961, as amended (cf., Handbook 3, Section A, Appendix 2G).

Jay F. Morris
Acting Administrator

10-9-87
Date

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

PD-17
October 10, 1988

THE ADMINISTRATOR

A.I.D.

POLICY DETERMINATION

MICROENTERPRISE DEVELOPMENT PROGRAM GUIDELINES

A. Statement of Objectives

Microenterprise assistance is an important element of A.I.D.'s private enterprise development strategy. It is particularly important in advancing the goal of broad-based economic growth and, specifically, increasing incomes of the poor, providing opportunities for advancement of micro-entrepreneurs, and encouraging indigenous investment. The microenterprise subsector includes the whole spectrum of productive activities ranging from rural-based agribusinesses and handicraft production to urban-based trading, service, and manufacturing enterprises, many of which are labor-intensive.

The policy guidelines described below were developed to ensure that the resources provided under A.I.D.'s microenterprise development program benefit the many and diverse business efforts of the poor.* The program's objective is to help people with limited or no access to

---

* Many A.I.D. policy guidance documents identify important issues that need to be addressed in designing A.I.D.'s assistance to lower-income groups in both the formal and informal sectors in developing countries. The policy guidelines contained herein should be applied by Missions in concert with those in the A.I.D. policy papers on Financial Markets Development (August 1988), Cooperative Development (April 1985), Private Enterprise Development (revised March 1985), Women in Development (October 1982), and Private and Voluntary Organizations (September 1982); the Guidelines on Terms of Aid; and the guidance contained in cables 1986 STATE 259310 and 259314 on the private enterprise local currency lending program contained in sections 106 and 108 of the Food Security Act of 1985. Some of these policies are summarized in the annex to this guidance.

capital achieve a level and quality of business activity that will permit increased access to formal financing and technical services and expand productive employment and incomes. Development Assistance funds, Economic Support Funds, and local currencies support programs that develop institutions that serve microenterprises and that provide microenterprises with credit, training, and technical assistance.

B. General Program Guidelines

1. Program Earmark and Funding Information. A.I.D.'s FY 1988 appropriations legislation required that A.I.D. make available not less than $50 million of the Agency's FY 1988 DA and ESF appropriations to implement a microenterprise development program. A.I.D.'s FY 1989 appropriations legislation increased the earmark to $75 million. Missions will be informed annually by AID/W of changes in the earmark level. Local currencies that result from nonproject assistance (such as cash transfers, CIPs, and PL 480 sales) may be used in lieu of dollars to achieve the objectives of the legislation. This earmark may be met through the funding of credit, technical assistance, training, or related activities directed at microenterprises. Missions should be creative in seeking funding and project approaches to implement this program.

2. Program Beneficiaries. There is no precise definition of a microenterprise. As a working definition, subject to the following exceptions, a microenterprise should have no more than approximately 10 employees and should have characteristics (assets, revenue, etc.) that fit well within the framework of objectives set forth below. Special emphasis should be placed on small-sized and individually-owned productive activities. An attempt to define or limit the size of a microenterprise too severely would exclude from the program some enterprises that Congress desired to receive the benefits of the program, i.e., enterprises made up of poor people, such as a rural, community-based firm owned and operated by 20 women or certain cooperatives. Furthermore, the objective of gradually advancing an enterprise to access formal sources of financing could be undermined with too severe a limit based upon the firm's employees.

Missions may well have to use a locally appropriate definition of microenterprise. This definition should be delineated in project or program documentation. Missions should focus on assisting new as well as existing

USAID Policy

DEMOCRACY AND GOVERNANCE

U.S. Agency for
International Development
November 1991

USAID Policy

DEMOCRACY AND GOVERNANCE

NOVEMBER 1991

Directorate for Policy
U.S. Agency for
International Development
Washington, D.C. 20523

DEMOCRACY AND GOVERNANCE

EXECUTIVE SUMMARY

The Changing International Environment. The end of the Cold War and widespread demand for democratic systems and market-oriented economies have created new opportunities for the U.S. development assistance program. It should not be expected that progress toward democracy will be linear, easily accomplished or effortlessly maintained. Nonetheless, USAID's Democracy Initiative seeks to respond to these new opportunities, building on past Agency efforts to support democracy, human rights and lawful governance.

Politics Is a Development Issue. In most developing societies, the character of social, economic and political institutions and values is a key constraint to sustained, broadly based economic growth and expanded opportunity. The effective and efficient use of resources depends fundamentally on the strengths and capacities of local institutions, including political institutions. When political systems falter, and there is violent civil conflict, military usurpation of political power, and arbitrary and unresponsive government, economic and social development cannot be sustained.

Democracy and Development. Democracy is fundamentally rooted in the proposition that the political authority is anchored in the will of the people. Enduring democratic systems are characterized by meaningful political participation and peaceful competition; protection of basic human rights; lawful governance; and strong democratic values. USAID efforts to provide direct support for democratic practices and values focus on these four broad areas.

Democracy does not guarantee successful development, but it can be highly supportive of efforts to address development problems effectively. It helps prevent abuses of power and political systems that retard broadly based economic growth and social development. Democracy is also to be valued as an end in itself because it is more likely to provide scope for the exercise of individual judgment and initiative, the fulfillment of individual potential and social justice.

The Scope of the Democracy Initiative. The objective of the Democracy Initiative is to support democratic political development, helping to establish enduring political practices, institutions and values which mobilize participation, channel competition, respect basic human rights and promote open, lawful and accountable governance. The primary areas of focus of the Democracy Initiative include:

★ *Strengthening Democratic Representation:* increase the participation of citizens in the formation and implementation of public policy; support the establishment of peaceful and stable forms of political competition;

★ *Supporting Respect for Human Rights:* help establish a framework of law and legal procedures that protects the integrity of the person and the exercise of basic human rights;

★ *Promoting Lawful Governance:* help establish formal constraints on the actions of civil servants, the military and police; support legal processes that contribute to peaceful and predictable social and economic interaction; and,

★ *Encouraging Democratic Values:* support the emergence of basic democratic values of tolerance for diverse opinions; the value of political compromise; acceptance of majority rule and respect for minority rights; supremacy of civil authority over the military; and peaceful resolution of differences.

Limitations. There are important limitations to the development and implementation of

Democracy Initiative programs. First, USAID assistance for democratic political development must be provided on a non-partisan basis. Assistance should be offered equitably to all groups committed to the democratic process, regardless of their specific platforms or programs. Second, it is essential that USAID support be open and transparent, both to the governments with which the Agency works and to the general public. Third, under Section 660 of the Foreign Assistance Act, no FAA funds or local currencies generated from these funds (aside from exceptions such as the Administration of Justice program in Latin America and the Caribbean) may be used to support training for the police or other law enforcement agencies.

Integrating Democracy into the USAID Program. In addition to direct support for democratic institutions, USAID can have a significant impact by integrating support for democracy into the full range of its programs. USAID officers are expected to take political development issues into account as they formulate strategies, plan programs, design projects and engage their host government counterparts. USAID cannot ignore the political factors which have a profound impact on the success and sustainability of its development efforts.

Democracy and Country Allocations. USAID will take progress toward democracy, respect for human rights and lawful governance into account in its allocation of funds to developing countries. Political development will be placed on a comparable footing with progress in economic reforms and the establishment of a market-oriented economy. Within the common framework established by this policy paper, regional bureaus will be asked to report on how they have implemented this component of the Democracy Initiative.

Support for Democratic Institutions. USAID recognizes that democratic political development is a long and complex process, and that it occurs in the context of broader social and economic changes. Direct support for democratic institutions requires a careful assessment of the needs and opportunities in each country. Under strategic guidance from regional bureaus, missions are expected to complete a rigorous country assessment that will establish a framework to enable USAID to determine where to begin, where to focus its attention and what priority to assign to different activities competing for limited staff and funding resources.

Three considerations should guide the development of USAID strategies to support democratic political development. First, such strategies should be country-specific, tailored to local needs and responsive to local development constraints. There is no single approach that is applicable to all countries or regions. Second, these strategies should be consistent with social and economic development strategies, taking into consideration the full range of priority development constraints and opportunities. Third, there is no standardized institutional model that underlies different country strategies. The Democracy Initiative does not seek to impose an American model on developing countries.

Rapid Response Mechanisms. The Administration is consulting with the Congress on ways to facilitate the provision of U.S. economic assistance in order to meet immediate, short-term needs of emerging democratic regimes. In addition, operations bureaus should actively explore project designs and contracting mechanisms that will establish the capacity to respond quickly to rapidly emerging opportunities.

Learning from Experience — Monitoring and Evaluation. Careful monitoring and thoughtful evaluation must be integral parts of the design, development and implementation of the Democracy Initiative. Delegation of authority to field missions is coupled with the responsibility to demonstrate that sufficient attention has been given to learning from experience and that appropriate course corrections have been made when necessary. Results should be measured not merely in terms of output, but in terms of systemic impact. Because all institutional change, including support for democratic institutions and practices, is necessarily long-term, results cannot be expected within only one or two years.

DEMOCRACY AND GOVERNANCE

TABLE OF CONTENTS

EXECUTIVE SUMMARY 1

INTRODUCTION 3

I. FOREIGN ASSISTANCE IN A CHANGING WORLD 3

II. DEVELOPMENT AND DEMOCRACY 5

III. OBJECTIVE AND SCOPE OF THE DEMOCRACY INITIATIVE 7

IV. INTEGRATING DEMOCRACY INTO THE USAID PROGRAM 10

V. DEMOCRACY AS A CRITERION FOR COUNTRY ALLOCATIONS 11

VI. SUPPORT FOR DEMOCRATIC INSTITUTIONS 13

VII. RAPID RESPONSE CAPABILITY 15

VIII. LEARNING FROM EXPERIENCE — MONITORING AND EVALUATION ... 15

DEMOCRACY AND GOVERNANCE

INTRODUCTION

In December 1990, the U.S. Agency for International Development issued a series of four initiatives to help shape its program for the critical issues of the 1990s. One of these was the Democracy Initiative, which called for USAID to focus its "experience, skills and resources explicitly to help promote and consolidate democracy."

As USAID builds on the foundation of its past work and implements the Democracy Initiative, further elaboration of the context, objectives, scope and limitations of the Democracy Initiative is required. This policy paper has been developed with two audiences in mind. The first is USAID staff, particularly in field missions, who bear the primary responsibility for conceiving, designing and managing USAID democracy programs. The second audience is the U.S. Congress and the general public. This policy paper is intended to provide a clear, coherent and concise statement of USAID's democracy program and to articulate the basic objectives, principles and limitations that will guide its implementation.

This policy paper begins with an overview of the changing international environment within which USAID works and the new opportunities to which USAID should respond. It then reviews constraints to sustained economic and social development and the reasons why politics — and more specifically, democracy — is a development issue. The third section outlines the objective and scope of the Democracy Initiative and discusses some of the limitations and parameters of its implementation. In the fourth section, opportunities to integrate political development concerns into the broader USAID portfolio are examined. Agency plans to incorporate progress toward democracy, human rights and lawful governance into the country budget allocation process are reviewed in the fifth section. The sixth section discusses appropriate USAID field mission approaches to developing a democracy program in each country. The seventh section outlines ways in which USAID seeks to develop a rapid response capability to provide appropriate short-term assistance to emerging democracies undergoing rapid political change. Finally, the paper discusses the critical importance of monitoring and evaluating programs so that the Agency and cooperating host governments can learn from the experience.

At a later date, a policy determination may be produced that can be incorporated into USAID Handbooks and become standard operating procedure for Agency personnel. In addition, more detailed technical guidance on specific operational issues (e.g., conducting country assessments) will be formulated as the Agency gains experience.

★ ★ ★ ★ ★ ★ ★ ★ ★ ★ ★

I. FOREIGN ASSISTANCE IN A CHANGING WORLD

With the waning of the Cold War, USAID's foreign assistance program must adjust to this changing reality. The world has seen the collapse of repressive governments in Central and Eastern Europe, followed by the struggle to establish democratic systems and free-market economies. In Africa, after nearly a decade of deteriorating economic and political conditions, many states are embarking, sometimes eagerly and in other cases tentatively, upon reforms to open their societies politically and to establish market economies. In Latin America, there is a resurgence of democracy as military regimes have given way to civilian, popularly elected governments. In Asia, demands for democracy and economic reforms continue, despite periods of both progress and reversal.

No doubt there will be some setbacks, or even failures, in the future. Progress toward democracy will not be linear, easily accomplished or effortlessly maintained. Nonetheless, the basic political changes of the past few years have created new opportunities for the U.S. economic assistance program. For much of the past 45 years, U.S. international relations have largely been focused on containing Soviet expansion. This was often the single most important consideration in America's dealings with other countries. Now, however, this basic organizing principle is less relevant. With this fundamental change, the United States has new opportunities to strengthen and support the global trend toward more democratic societies. Both the executive and legislative branches have emphasized that promoting and sustaining democracy are central objectives of U.S. foreign policy.

The 1990 USAID Mission Statement was developed in response to this changing world. It commits USAID to assisting "developing countries to realize their full national potential through the development of open and democratic societies and the dynamism of free markets and individual initiative."

Such support is not new to the U.S. development assistance program. Historically, the Congress has encouraged USAID's attention to democratic political development. This began with the enactment of Title IV of the Foreign Assistance Act (FAA) of 1961, which cites building democratic institutions as one goal. In 1967, Title IX was added to the FAA to emphasize "maximum participation in the task of economic development ... through the encouragement of democratic private and local governmental institutions." Throughout the 1960s, USAID supported legal assistance, legal education reform and the development of free, independent trade unions. In the 1970s, a series of amendments, including the Harkin Amendment (1974) and Section 116 (1978), highlighted human rights, both as an important element of United States Government (USG) economic aid programs and as a consideration in the provision of USG assistance. During that period, USAID also provided long-term support for decentralization programs in Latin America and Asia.

In 1984, a special congressional earmark provided funds for the Administration of Justice program in El Salvador, a first step in a larger democratic development program which now extends throughout Latin America and the Caribbean. Since the 1980s, USAID has continued to support and expand worldwide a range of projects in areas such as legislative development, administration of elections, women's legal rights, human rights and civil/military relations. In 1989, the then-Asia and Near East Bureau initiated its programs in support of open societies, followed by the Democratic Pluralism Initiative in Central and Eastern Europe in 1990 and the Asia Democracy Program early in 1991. Simultaneously, the Africa Bureau launched intensive internal debate on governance issues, expanding appropriate opportunities for USAID programs.

USAID's support for democratic systems and improved governance has achieved important results. For example, USAID's program in South Africa has been successful in supporting non-governmental grassroots organizations in the black community which are contributing to popular participation, pluralism and civil rights. For eight years, USAID has supported a Latin American organization that provides technical assistance to help ensure the fairness and integrity of the electoral system. Its activities in Guatemala in 1985, in Chile in 1988 and in Nicaragua in 1990 are now regarded as models for similar programs in other Latin American countries. In Hungary, USAID has funded technical assistance to strengthen the new parliament, and in Romania USAID helped sustain new and struggling independent media by providing newsprint and equipment at a time when the movement toward democracy was in doubt. In Nepal, USAID funded American participants in an international election observation team, and in Indonesia USAID is supporting efforts to strengthen the legislature and establish a legislative research service.

In many cases, achievements thus far are the result of USAID's strong in-country presence and familiarity with local needs and conditions. Equally important are USAID's longstanding relations with host governments, indigenous non-governmental organizations, local educational and research institutions and the private sector. These

are important assets that continue to place USAID in a unique position to develop and expand its support for democratic political development, in collaboration with other USG agencies such as the State Department and United States Information Agency (USIA).

The Democracy Initiative, launched in December 1990, therefore builds on programs and capacities already established in USAID. It extends these efforts to respond to the changed international environment and new opportunities facing the United States.

★ ★ ★ ★ ★ ★ ★ ★ ★ ★ ★

II. Development and Democracy

Constraints. In most developing societies, the character of social, economic and political institutions and values is a key constraint to sustained, broadly based economic growth and expanded opportunity. While physical resources are frequently required, their effective and efficient use depends fundamentally on the strengths and capacities of local institutions. Inappropriate, inadequate or ineffective institutional practices may be the result of a lack of technical knowledge, but they are also frequently rooted in the political process and a nation's political values.

How public issues are debated, the ways in which laws are formulated, and how they are implemented by the state — all have a direct impact on how a society addresses its development problems. For example, armed conflict, suppression of citizens groups, restrictions on the free flow of information and curtailment of public debate will distort how political issues are understood and how options for dealing with them are formulated and resolved. Intolerance of diverse views, unwillingness to accept compromise and a reluctance to accede to the wishes of the majority will exacerbate social conflict and visions. Restrictive and complicated legal and regulatory structures, and their arbitrary, corrupt or inefficient administration by the state, will divert limited physical and financial resources, constrain the development and employment of human capital and inhibit broadly based and sustained economic development. Conversely, open political systems, respect for basic human rights and an appropriate and efficiently administered legal and regulatory system based on due process of law encourage peaceful resolution of social conflict, stimulate individual initiative, by women as well as men, and thus support economic and social development.

Political development is central to sustained economic and social development. The political process is ineffective and will retard economic and social development when political development falters and there is:

★ *Violent civil conflict*, military usurpation of political power and contests for political power which threaten public order and security, frequently resulting in loss of life and property;

★ *Arbitrary government*, which ignores basic human rights of citizens and corrupts the rule of law; and,

★ *Unresponsive government,* unwilling or unable to address the basic needs of society and improve the lives of all citizens.

Democracy. Democracy is fundamentally rooted in the proposition that political sovereignty originates with citizens. The authority of the state is anchored in the will of the people, and just and legitimate government can only be based on their explicit consent. In modern democracies, this consent is mediated through representatives, chosen by means of regular, periodic free and fair elections, based on universal suffrage and a secret ballot.

Enduring democratic systems are characterized by meaningful political participation and peaceful competition; protection of basic human rights; lawful governance; and strong democratic values. Efforts to provide support for democratic practices and values, therefore, focus on these four broad areas.

Democracy in itself is not a guarantee that the problems of violent civil conflict and arbitrary, unresponsive government will be successfully overcome. There are many historical examples of ineffective and incompetent democratic governments, just as there are examples of efficient authoritarian ones. Corruption is not a monopoly of authoritarian regimes, and the establishment of a democratic political system does not ensure lawful government. The debate about the relationship

between democracy and sustained economic development is substantial, but thus far yields no firm conclusions concerning any direct, causal link between democracy and development.

Nonetheless, democratic institutions and a strong democratic political culture can be highly supportive of efforts to address development problems and establish the basis for sustained economic growth. Democratic institutions and values help prevent abuses of power and the emergence of political systems which retard broadly based economic growth and social development. Moreover, democratic systems are to be valued as an end in themselves because, more than any other system of government, they broaden and deepen individual liberty.

Political Participation and Competition. In modern democracies, effective political participation and competition are ensured through several interdependent practices which are protected and respected by the state: free and fair elections based on universal suffrage, freedom of expression and freedom of association.

Competitive elections and universal adult suffrage both mobilize popular participation and contain political competition and conflict. Although democracies encourage and promote non-violent political competition between adversaries, they also promote reconciliation when a decision is made. Citizens become engaged in political debate, but their differences are limited and channeled by the electoral process. This periodic, orderly and meaningful exercise of choice open to all adult citizens results in the selection of representatives, transfers political authority and is the basis for the legitimacy of governments.

Second, democracies help ensure the free flow of information on public issues and open debate on the alternative ways to resolve them. Access to alternative and competing sources of information is an important prerequisite for ensuring effective political competition. Without it, the formal process of elections may be scrupulously observed, but the elections will lack meaning and the foundation of the democratic system will be fundamentally eroded. The empty exercise of "free choice" in the absence of competing sources of information and open debate on different courses of action confers no legitimacy on the "elected" government.

Third, democratic societies provide for the freedom to form associations and groups of citizens which can inform and influence public debate and articulate the interests of citizens. These groups can include a wide variety of organizations, from political parties through national professional associations (such as legal, medical and business societies or societies of chartered accountants), to research institutes (universities, academies or private think tanks) and associations of citizens (neighborhood community organizations, labor unions, women's organizations or parent-teacher associations). Throughout the world, USAID has a rich experience and close relationship with many non-governmental and private voluntary organizations. These not only provide important services, but also make an important contribution to public life by articulating and channeling the views of their members, both women and men. This freedom of what is now often called "civil society" is also essential to effective and meaningful political competition.

Human Rights. Basic human rights are fundamental to all human beings, regardless of their cultural traditions and no matter what form of government they live under. The Universal Declaration of Human Rights declares that the rights of individuals should not be denied to any segment of any country's population for reasons of ethnic origin, religion, gender, race or economic class. The rights included in that document are extensive and center around three categories: integrity of the person, civil and political rights, and social and economic rights. Integrity of the person includes freedom from political killings, torture, cruel treatment or punishment, arbitrary arrest or imprisonment, denial of fair public trial or arbitrary interference in personal life. The civil and political rights mentioned include the right to take part in the government, to vote, freedom of opinion and expression, and freedom of association and assembly — rights which are essential to a functioning democracy. In addition, these rights include the freedom of movement within a country, as well as the right to leave that country, the right to a nationality and freedom of religion.

It is both U.S. law and USAID policy that USAID take into account these rights in administering U.S. foreign assistance programs. They are a basic component of the Democracy Initiative because they represent fundamental values, central to the integrity and dignity of the human condition and an integral element of U.S. foreign policy objectives. The Democracy Initiative reflects conviction that peaceful political competition, freedom of expression and freedom of association, rights which are essential to democratic systems, increase the likelihood that basic human rights will be respected over the long term.

Lawful Governance. Just and responsive judicial processes and the accountability of the executive are two key characteristics of lawful governance. This is achieved when the exercise of state power is restrained by the authority of a system of laws impartially enforced; when its actions are open to public scrutiny; when it is held publicly accountable through known procedures; and, finally, when it is responsive to the legitimate needs of all citizens. Lawful governance upholds and protects the civil and political rights of all citizens, regardless of gender, race, ethnic origin or religious affiliation.

Lawful governance is more than competent or efficient government. Basic competence and minimal efficiency are essential to the sustained legitimacy and survival of any regime, whether it is democratic or despotic. No state can assume the loyalty of its citizens and successfully exercise authority if it proves itself consistently incompetent and grossly inefficient. In some cases, it may be appropriate and important for USAID to help improve the competence and efficiency of a government, but this does not necessarily strengthen democratic representation, support respect for human rights, promote lawful governance or encourage democratic values.

Democratic institutions and values help to ensure that officials of the state act only within the mandate given to them under established laws and regulations. The effective and impartial enforcement of laws by an independent judiciary is critical to this process.

Similarly, democracy helps ensure that the actions of state officials are open to public scrutiny. Government that acts according to known rules or laws, oversight of the state bureaucracy by legislatures and independent ombudsmen, and transparency of state actions to independent associations and private groups help make the actions of public servants known to the general public. To the extent that the actions of the government are transparent to the general body of citizens, it is easier to ensure that public officials are held accountable for their official actions, and the likelihood that the state will be unresponsive to its citizens and ineffective in providing appropriate public services is reduced. Democratic processes provide a direct, legitimized and peaceful way for dissatisfied citizens to replace poor governments and seek improvement in the responsiveness and effectiveness of the state.

★ ★ ★ ★ ★ ★ ★ ★ ★ ★ ★

III. Objective and Scope of the Democracy Initiative

Objective. The objective of the Democracy Initiative is to support democratic political development, helping to establish enduring political practices, institutions and values which mobilize participation, channel competition, respect basic human rights and promote open, lawful and accountable governance. The focus of the Democracy Initiative is on *how* decisions get made: the processes, procedures and values of political systems.

The emergence of such political systems is important for two reasons. First, democratic political development is a fundamental value in itself. It permits the broadest possible freedom and opportunity to individual citizens and represents a basic value that is central to the USAID mission. Second, democratic political development can help prevent many of the recurring constraints to sustainable, broad-based economic growth. In developing countries, elite segments of society (which often include the civil service) may use the state as an instrument to pursue their own narrow interests, setting aside the legitimate needs and aspirations of the majority. Open and accountable democratic government is more likely to provide greater economic opportunity to fuel and maintain economic development. USAID recognizes,

however, that democratic political development is a long and complex process, and that it occurs in the context of broader social and economic changes. Many democracy movements in the past — in Europe, Japan, Latin America, the post-colonial states in Africa and Asia — have failed because they focused on the superficial manifestations of democratic systems and were not sustained by evolving economic and social systems or a strong democratic political culture. Where this has occurred, democracy movements have failed to take hold, losing both ideological legitimacy and popular support. Frequently these failures severely discredited democracy and gave rise to anti-democratic alternative systems.

Scope. Country programs can include support for both governmental and non-governmental agencies. There is no assumption that USAID support should be limited to one type of organization or another. The primary areas of focus of the Democracy Initiative include:

★ *Strengthening Democratic Representation:* increase the participation of all citizens, regardless of gender, ethnic or religious affiliation, in the formation and implementation of public policy; support the establishment of peaceful and stable forms of political competition.

A. Elections through universal suffrage, including activities such as:

- Strengthen electoral systems and institutions
- Observe and monitor elections
- Educate and register voters
- Improve the professionalism of political parties

B. Representative political institutions, including activities such as:

- Enhance the professionalism of legislators
- Strengthen legislative research, analysis and drafting capabilities
- Strengthen accountability of municipal/ local government

C. Civil society, including activities such as:

- Support professional associations, civic groups, labor organizations, business groups and other non-governmental advocacy groups

D. Free flow of information, including activities such as:

- Support independent policy research institutions
- Support the existence, professionalism and independence of mass media and independent journalists
- Reduce censorship, legal or regulatory constraints
- Support transparency of government decision-making
- Assist independent public opinion polling

★ *Supporting Respect for Human Rights:* help establish a framework of law and legal procedures that protect the integrity of the person and the exercise of basic rights.

E. Basic human rights, including activities such as:

- Support human rights education
- Support the rights of women, children, cultural and religious minorities
- Support institutions that monitor and advocate respect for human rights

★ *Promoting Lawful Governance:* help establish formal constraints on the actions of civil servants, the military and police; support effective legal processes which contribute to peaceful and predictable social and economic interaction.

F. Legal and judicial systems, including activities such as:

- Improve legal education
- Reform judicial systems
- Support independent judiciary
- Expand legal assistance and legal services
- Improve administration of criminal justice
- Assist public defender programs
- Support reform and simplification of the

regulatory system

G. Accountability of the executive branch, including activities such as:

- Support establishment of ombudsmen
- Improve procedures for public review of administrative decisions and actions
- Strengthen procedures for financial accountability
- Improve measures to reduce corruption
- Strengthen capacity of civil authorities to monitor and oversee military budgets and systems

★ *Encouraging Democratic Values:* Within the context of indigenous cultures, support the emergence of basic democratic values of tolerance for diverse opinions, the value of political compromise, acceptance of majority rule and respect for minority rights, supremacy of civil authority over the military, and peaceful resolution of differences.

H. Civic education, including activities such as:

- Incorporate civic education into school curricula
- Support private voluntary organization (PVO) activities to promote civic values and debate

I. Leadership training, including activities such as:

- Training programs that teach democratic values and leadership skills

There are many important activities undertaken by USAID which may indirectly support democratic institutions and values, but which lie outside the boundaries of the Democracy Initiative. For example, it can be said that citizens in a democracy must be literate if they are to participate effectively. However, basic education and literacy programs are focused primarily on achieving competence in reading and writing, rather than directly on issues of democracy, human rights or good governance. Literacy may contribute to, or even be a necessary precondition for democratic political development, but it is not the same as democratic political development.

Similarly, the efficiency and the effectiveness of the state (traditionally the concern of public administration) are critical to the survival of any regime, both democratic and non-democratic. Improving public administration may be a critical need in a given country and a legitimate focus for USAID support, but this is generally distinct from the objectives of the Democracy Initiative, except where efforts are tied directly to specific democratic reform.

An overly broad and inclusive view of "democracy activities" could lead to a re-labeling of ongoing or currently planned activities, thus conforming to a new Agency priority. The result would be no change in the focus of USAID's work and would undermine a major USAID objective. It is incumbent upon bureau and mission leadership, therefore, to look beneath the labels to determine that a proposal does not simply claim to be a democracy activity but in fact gives significant attention and emphasis to strengthening democratic representation, supporting respect for human rights, promoting lawful governance or encouraging democratic values.

This will not always be a clear or straightforward issue. For example, support for indigenous non-governmental organizations (NGOs) is an important part of the USAID program. However, not all NGO programs contribute directly to the objectives of the Democracy Initiative. It may be useful to distinguish between providing services (such as health care services, access to family planning services or basic education) and strengthening participation in public policy formulation by actively articulating and channeling the voice and interests of a particular constituency. A similar distinction may need to be made between assisting disadvantaged groups (e.g., credit programs for women microentrepreneurs) and promoting their participation in and influence over the public policy process. Some programs may be designed to meet a variety of objectives, including aspects of the Democracy Initiative, and bureaus and missions will need to consider how the overall objectives and priorities of USAID assistance can most accurately be characterized.

Program Criteria and Parameters. Although

the responsibility for program development rests primarily with USAID field staff working under Agency policy and strategic guidance from regional bureaus, and in coordination with other members of the Country Team, there are important limitations. These limitations should guide development and implementation of Democracy Initiative programs.

First, USAID assistance for democratic political development must in principle be provided to the full range of groups genuinely committed to the democratic process. Where a USAID program involves assistance for labor unions, other advocacy groups or (in rare instances) political parties, this must be provided without reference to specific policy positions taken by competing candidates or parties (so long as those positions are not themselves anti-democratic). Assistance should be offered equitably to all groups committed to the democratic process, regardless of their specific platforms or programs. In this sense, USAID assistance must be non-partisan. The focus of the Democracy Initiative is on democratic political development, not on promoting particular outcomes to political debates in recipient countries. This is true even when the domestic political debate is critical of the United States.

In any specific case, the boundary between permissible non-partisan support for the democratic process and any inappropriate activities must be clear, broad and unassailable. It is the responsibility of USAID field staff and regional bureaus to ensure that all USAID activities conform to the requirements of law and are demonstrably above accusations of inappropriate and unwarranted interference in the domestic affairs of sovereign states. Justifications based on narrow or technical reasons will not be sufficient to guard against possible abuse and to ensure that the Democracy Initiative is a legitimate development program.

For example, it is essential that USAID support for democratic systems and lawful governance be open and transparent, both to the governments with which the Agency works and to the general public. Just as transparency in government operations is one of the values the Democracy Initiative seeks to encourage, so also it is essential that USAID be transparent about the final shape of its democracy and governance programs and open in their implementation. This clear and consistent commitment to openness will help to ensure that assistance is strictly non-partisan.

Second, under Section 660 of the current Foreign Assistance Act, no FAA funds or local currencies generated by these funds (with the exception of specifically exempted programs in Latin America and the Caribbean) may be used to support training for the police or other law enforcement agencies. Even where violations of basic human rights by the police or other law enforcement authorities undermine the strength of democratic systems, support for training such forces cannot be funded except as specifically authorized by the Congress.

★ ★ ★ ★ ★ ★ ★ ★ ★ ★ ★

IV. Integrating Democracy Into the USAID Program

There are important ways in which USAID can encourage the establishment of democratic values and practices, respect for basic human rights and lawful governance across all sectors and the full range of its development programs. Over the long term, this indirect support may be more significant than specific projects which provide direct assistance to support democratic institutions.

USAID officers are expected to take democratic political development issues into account as they formulate strategies, plan programs, design projects and engage their host government counterparts. This includes but goes beyond the longstanding concern with participation of beneficiaries in the design and implementation of development projects. At issue is the broader question of the relationship between citizens and their government, how to open political life to genuine participation, channel political competition and make governments responsive and accountable to citizens.

As USAID formulates its strategies, programs and projects in all sectors, it can no longer ignore the political factors which have a profound impact on the success and sustainability of its development efforts. Political issues must be taken into account

in the same way that the current USAID process takes into account economic and social factors. For example, in developing country strategies, missions should give careful attention to examining those political constraints which have an impact on their programs and activities, as well as identifying opportunities to help support democratic practices, human rights and lawful governance.

Similarly, the USAID program development and project design process should also consciously and carefully address the extent to which democratic political development measures can be built into other USAID activities. USAID project design and implementation experiences already provide positive examples of what can be done in different sectors which might initially appear to be far removed from democracy and governance issues. For example, in Mali, USAID education programs encourage increased local control and responsibility through support for parent-teacher associations. In Nigeria and Tanzania, USAID has assisted health and road projects that decentralize budgets and decision-making from the central government to local authorities.

These same constraints and opportunities should become major elements of the mission's policy dialogue with the host government, just as economic policies are a central focal point. The management of the entire USAID portfolio is profoundly affected by host country policies with regard to democracy, human rights and governance. Programs assisted by USAID cannot be implemented effectively and projects cannot achieve their objectives where the legitimate wishes of citizens are systematically ignored, basic human rights are violated and the government is arbitrary and corrupt. Along with a growing number of other donors, USAID should not hesitate to make its fundamental concern about these issues an explicit part of the Agency's agenda.

The example set by the USAID project design and implementation process is key to demonstrating the importance USAID gives to democracy, human rights and good governance, and to building these concerns into USAID projects across the board. As USAID officers go about their design and implementation work, as well as the explicit design questions they ask, they deliver a powerful message to host governments about the opportunities to address democracy and governance issues. In contrast, reducing democracy and governance to a pro forma, routine checklist item that is only given passing attention in the design phase will send the opposite message, reinforcing the view that despite the rhetoric, USAID is only marginally interested in these issues.

★ ★ ★ ★ ★ ★ ★ ★ ★ ★ ★

V. Democracy as a Criterion for Country Allocations

The Democracy Initiative states that "within each region of the world, allocations of USAID funds to individual countries will take into account their progress toward democratization." As the Democracy Initiative says, the explicit objective is to "place democracy on a comparable footing with progress in economic reforms and the establishment of a market-oriented economy, key factors which are already used as criteria for allocating funds."

Current USG Practice. The USG already responds to progress toward democracy using a variety of instruments, including USAID programs, food aid, military assistance and training, Export-Import Bank guarantees, Overseas Private Investment Corporation and Trade and Development Program activities, trade concessions and privileges (such as Most Favored Nation status, GSP) and support for membership in multilateral financial institutions.

Generally, increased USG assistance has been triggered by some major event, such as the democratic breakthroughs in Nicaragua, the Philippines and Eastern Europe. While USG responses have been clear and unambiguous in demonstrating strong support for democracy, they have been occasioned by unique and dramatic political changes rather than slow but steady improvements over time. USAID expects that this pattern will continue and does not believe the Agency can or should seek to introduce any modifications or departures from this.

In addition, U.S. economic and military assistance programs have certain thresholds related to democracy and governance. As required by

foreign assistance appropriations enactments (Section 513 of the Fiscal Year 1991 Appropriations Act), the United States must terminate economic and military assistance to any country where a democratically elected government has been overthrown by a military coup d'etat or decree. It is also U.S. policy to reduce or terminate economic and military assistance where there is a consistent pattern of significant violations of internationally recognized human rights.

Innovations under the Democracy Initiative. The Democracy Initiative, however, goes further than this past practice. It suggests that in addition to major (but unpredictable) events, the routine annual USAID allocation process will take into account systematic and continuing assessments of progress toward democracy.

USAID believes this is important for a number of reasons. First, the Agency should try to channel its limited resources where they are most likely to be put to good use. A country that has demonstrated a commitment to political reforms generally offers greater promise than one that continues to resist political reforms. Second, continuing and systematic effort to assess progress toward democracy will strengthen USAID's policy dialogue with host countries on issues of political reform. Third, such continuing assessments will provide USAID missions with basic information and insights that will assist them in developing country strategies to support democratic institutions and integrate democracy into the broad range of USAID programs. Fourth, clear and specific steps to adjust USAID's country allocation process to recognize and reward progress toward democracy will be important to USAID's credibility and leadership on this issue within the donor community.

Revised Budget Structure. USAID will continue to work with others within the executive branch to obtain congressional approval for a new budget structure which will allow for greater flexibility in the use of economic assistance funds. As long as the present structure exists, the scope for rewarding good performance directly and visibly will remain extremely limited. In addition, severe budget constraints may so reduce the amount of discretionary funding that rewards for good performance are reduced to merely token levels.

Expanded Regional Bureau Efforts. USAID's regional bureaus already have initiated efforts to incorporate democracy and political reforms into their considerations of country allocations. Both the Africa Bureau and the Latin America and the Caribbean Bureau give specific percentages for democratic development and human rights in country performance budget allocation formulas. Also, the Asia Bureau has an explicit variable in its Performance Based Budgeting system for both democratic development and human rights.

Consistent with USAID's commitment to a performance-based budget, these bureaus are being asked to refine and further develop their systems to the extent possible. The special characteristics of the Europe and the Near East bureaus, with special authorizations and earmarks, may limit the scope for developing such approaches in these two regions. Nonetheless, these bureaus are also being encouraged to continue to look for opportunities to bring country performance to bear on country allocations.

Although different regions will approach this task in different ways, a common USAID definition of key factors or issues to be assessed in measuring "progress toward democracy" is articulated in this policy paper, including democratic representation, human rights and lawful governance. These elements should be included as appropriate in all regional bureau efforts and ensure that the Agency is speaking with one voice.

Monitoring Regional Bureau Efforts. As an integral part of USAID's emphasis on managing for results, it is essential that implementation by regional bureaus be coupled with effective monitoring and evaluation plans that will enable the Agency to reflect on its experience and improve its performance in the future. This will be achieved through annual implementation reports from the regional bureaus, which will include difficulties or weaknesses identified and how implementation in the coming year will address these problems.

Within the next several years, the experience of the various regional bureaus will be able to feed into an overall Agency review of this component of the Democracy Initiative and the determination

of appropriate steps for its continuing implementation.

Broadened Systems to Assess Progress. The results of recent USAID consultations with a panel of experts suggest that currently existing methods provide reasonably consistent information on "democracy" defined in terms of elections and civil and political rights. (The annual Freedom House report is probably the best known and most accessible.) There is no single method or system that is demonstrably superior across the board to all others. There are concerns about source or systematic bias in all existing systems.

In addition, existing systems for assessing democracy may not fully capture the Agency's additional concerns with basic human rights and lawful governance. If USAID wishes to include these dimensions in its assessment of country performance, some further work will be needed to determine whether existing systems are adequate to reflect these dimensions.

Given the prominence of the Democracy Initiative within USAID, and the leadership role the Agency is assuming both within the USG and the wider donor community, over the next several years USAID will give further attention to exploring alternative systems for assessing progress in human rights and lawful governance.

★ ★ ★ ★ ★ ★ ★ ★ ★ ★ ★

VI. Support for Democratic Institutions

Country Assessments. As with USAID support in any other sector, design of democratic political development programs requires a careful assessment of both the needs and opportunities in each country. Following Agency policy and regional bureau strategic guidance, a rigorous country assessment should establish a framework for understanding the constraints and opportunities in a country. This will also establish a basis for the development of a mission strategy and program, and coordination with other donors. The assessment's primary function is to enable USAID to determine where to begin, where to focus its attention and what priority to assign to different activities that are competing for limited staff and funding resources. It does not entail an ideal definition of "democracy" or standard template of the perfect political system which is then imposed on each country to see where it fails to conform, and therefore where USAID resources should be focused.

There may be exceptions to this general procedure of completing a country assessment prior to developing specific democracy and governance programs. In some cases, rapidly moving political events may require immediate USAID assistance in specific areas. For example, an unexpected election, and the need to strengthen the fairness and integrity of the electoral commission, have in the past generated rapid USAID assistance in the absence of a comprehensive country assessment. But this is the exception, rather than the rule. Targets of opportunity may be tempting but should not normally be the driving force behind a mission's program.

The Democracy Initiative seeks to promote sustainable democratic political development. Enduring democratic systems, like all lasting institutions, are rooted in a supportive and complementary economic, social and cultural context. Sustained political development cannot effectively be promoted in ignorance of the wider social forces creating the environment within which political systems either survive or wither. While USAID's democratic political development objectives are clear, its concern with sustainability makes it essential that these objectives be pursued in the context of other broad development challenges.

USAID has undertaken country assessments in many countries. There is as yet no standard methodology or generally accepted checklist to guide these assessments. Subsequent technical papers will outline approaches to country assessments in more comprehensive and systematic terms. However, country strategies to support the development of democratic systems should be guided by three considerations:

1. Democratic political development strategies should be country-specific. Program development must be sensitive to local historical traditions, carefully tailored to local needs and

responsive to local development constraints. The opportunities and ways of pursuing democratic political development objectives will inevitably vary between regions, from country to country within regions, and from time to time within a single country. Despite important global processes, the political, social and economic evolution of each society is unique. There is no single procedure or conceptual template that allows *a priori* judgments about the aspects of political development which are most appropriate at any given moment, or about the type of USAID assistance that is most needed, feasible and likely to be effective.

Accordingly, determination of the appropriate kind of support for democratic political development must be made at a country level and on a case-by-case basis. Working under Agency policy and regional bureau strategic guidance, and in coordination with the Country Team (State and USIA), USAID field staff have the primary responsibility for: (a) assessing the needs and opportunities in their country; (b) formulating country democratic political development assistance strategies; and (c) developing and implementing democratic political development programs taking into account broader country development objectives. The foregoing is not intended to rule out regional activities, which can often be valuable in pursuing democratic development objectives.

2. Country democratic political development strategies should be consistent with social and economic development strategies. USAID democracy programs should take into consideration the full range of development constraints and opportunities. In some cases, this may mean pressing forward with certain elements of political development, while holding back on others. For example, insisting on formal electoral processes may be counterproductive if other supporting institutions are not in place. The only organized political groups may be anti-democratic or using democratic slogans to safeguard their privileges and impede economic reforms. In such cases, efforts to strengthen civil society and promote democratic values in other sectors of the USAID portfolio may be more appropriate for sustainable political and economic development than focusing exclusively on an isolated component of democracy.

3. Strategies should acknowledge alternative approaches to democratic political development. USAID's commitment to strengthening democratic political development does not imply any standardized institutional model. Many different institutional arrangements can sustain democratic practices and values, guarantee basic human rights and encourage good governance. American institutions are one example, but there are other viable alternatives that may be more appropriate and sustainable in a specific country. The Democracy Initiative does not seek to impose the American model on developing countries.

Support for Democratic Institutions. Within the framework established by country assessments, a variety of USAID programs can help strengthen democratic institutions, values and practices. These may include, but should not be limited to, support for formal political institutions, such as legislators and staff, electoral commissions, judges and court officials.

Other institutions and organizations may also be an appropriate focus for assistance. These may include civic organizations, professional societies, women's associations, labor unions and business groups which mobilize, articulate and channel popular opinion and which help establish a counterweight to the power of the state. Such organizations can also cut across ethnic, religious or tribal cleavages and thus help diminish social divisions that may threaten to break into violent conflict. Independent think tanks can serve both to analyze social issues with some degree of objectivity and to provide a forum for wide-ranging debate. USAID support for these institutions may be possible even in countries where more direct support for independent news media, for example, would not be acceptable to the host government. Such indirect approaches, which encourage the emergence of a stronger civil society and a tradition of public debate, may in some cases have a more enduring impact than frontal assaults on the deficiencies of the formal political system.

★ ★ ★ ★ ★ ★ ★ ★ ★ ★ ★

VII. Rapid Response Capability

As of 1991, there are restrictions on the countries to which USAID can provide assistance. Generally, these include countries which have been designated as "non-free world" and those which are in violation of loan repayment requirements (for example, Brooke Amendment). With rapid political changes and the unanticipated collapse of dictatorial regimes, these often have been precisely the countries where U.S. assistance could make a significant difference. The new and struggling regimes which emerge have often been suddenly and unexpectedly thrust into power. Despite their democratic aspirations, they are faced with complex and difficult problems associated with political liberalization and economic reform. Limited but timely U.S. assistance can help them deal with immediate challenges and increase the likelihood that the momentum of the reform movement is maintained.

The Administration is consulting with the Congress on ways to facilitate the provision of U.S. economic assistance in order to help meet the immediate and short-term needs of emerging democratic regimes. This is not intended to circumvent procedures required to establish any long-term assistance relationship with the United States. Assistance would be specifically limited to clearly identified activities which could be completed in a short period of time and at a modest cost. As new procedures are agreed upon, field offices will be notified and additional guidance issued.

In the meantime, USAID can create the capacity to respond quickly to rapidly emerging opportunities in countries now eligible to receive assistance by designing project vehicles with the necessary flexibility. Regional "umbrella projects" with level-of-effort contracts, for example, allow USAID to pre-position itself to respond to new events quickly. USAID operational units should actively explore project designs and contracting mechanisms that will establish the capacity to respond quickly to rapidly emerging opportunities.

★ ★ ★ ★ ★ ★ ★ ★ ★ ★ ★

VIII. Learning From Experience — Monitoring and Evaluation

USAID recognizes that despite its previous experience in this field, the Democracy Initiative asks field missions to develop new responses to the new opportunities that are open to the Agency. There are no fixed formulae or textbook responses that guarantee success. The process will be an iterative one, with both setbacks and successes. Setbacks in themselves are not grounds for discouragement, as long as USAID can demonstrate that it has learned from the experience and incorporated the lessons into its next round of support.

Like virtually all development efforts that focus on institutional change, support for democratic institutions is necessarily long-term. Results cannot be expected within only one or two years. Nonetheless, a carefully planned monitoring and evaluation system is essential to identifying progress and achievements when they occur, as well as to making course corrections when this is required.

For this reason, assessing the effectiveness of a specific program of support is essential to the success of the Democracy Initiative. Careful monitoring and thoughtful evaluations should be integral parts of program design and development. Results should be measured not merely in terms of output (e.g., how many courthouses have been renovated or computers installed) but also in terms of systemic impact (e.g., more rapid processing of cases, decreases in reported human rights abuses). It is fundamentally important, therefore, that a mission's analysis of systemic constraints and its strategy to address them be clearly articulated during the first steps of the program or project design process. Consistent with USAID's emphasis on managing for results, delegation of authority to the missions to conceive, plan and implement democracy programs appropriate to local needs and conditions is coupled with the responsibility to demonstrate what has been achieved, what has been learned, and how this has been incorporated into the mission's future programming.

Printed on recycled paper

IV. TYPES OF ASSISTANCE & DELIVERY MECHANISMS

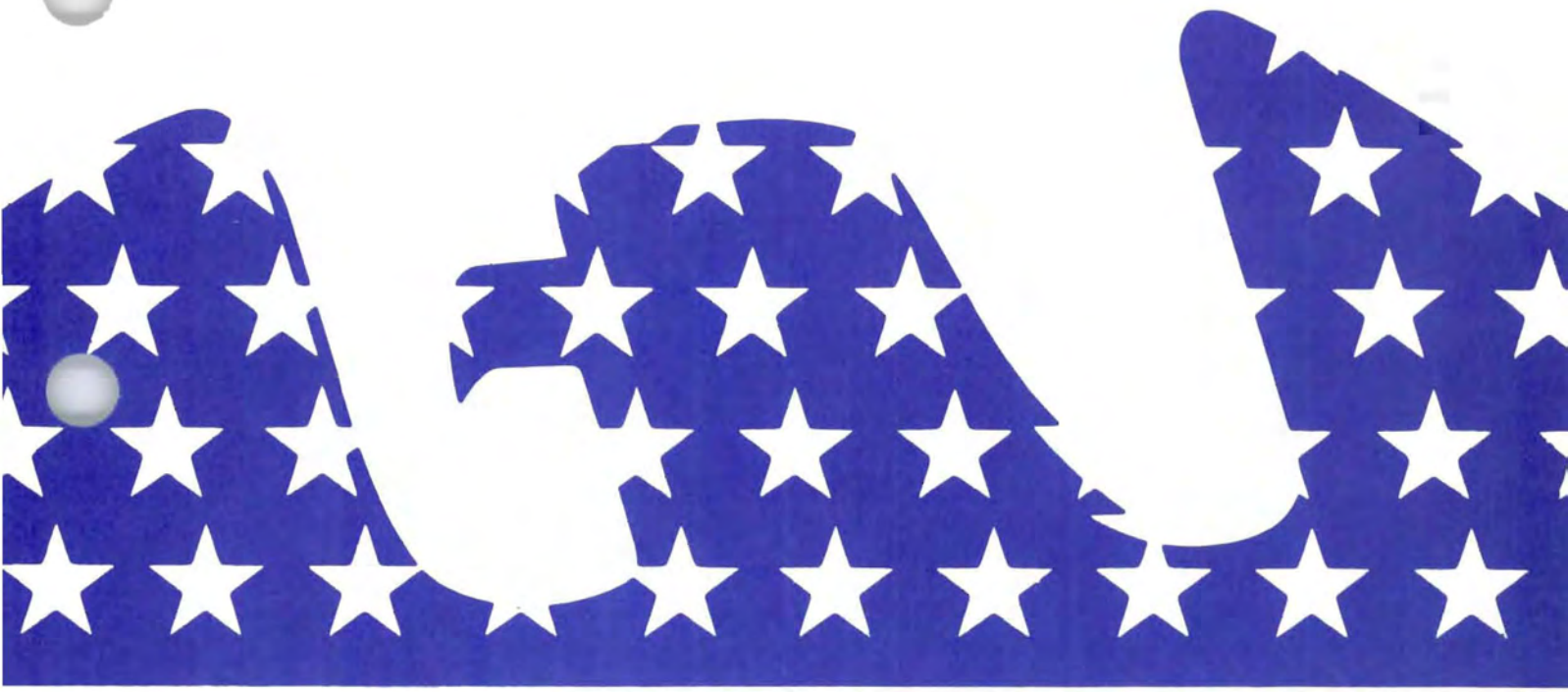
POLICY DETERMINATION

Agency for International Development

PD-18

JULY 30, 1991

LOCAL CURRENCY



AGENCY FOR INTERNATIONAL DEVELOPMENT

320 TWENTY FIRST STREET, N.W.
WASHINGTON, D.C. 20523

PD-18
July 30, 1991

A.I.D.

POLICY DETERMINATION

The Administrator

Local Currency

1.0 Summary

1.1 Important modifications in the Agency's policy governing the generation, programming, and accountability requirements associated with host country-owned local currency are described in this policy determination, which was transmitted as State 202944 (June 20, 1991). This new policy supercedes existing Agency policy[1/].

1.2 The new policy is different from existing Agency policy in three respects: (a) the new policy clarifies the circumstances under which local currency is generated and must be deposited into a separate account; (b) it explicitly permits missions to jointly program local currency to help fund a government's deficit or reduce its debt; and (c) it adopts new accountability standards for managing local currency as explained in separate operational guidance issued by FM.[2/] The policy (in contrast to the accountability standards) applies only to host country-owned local currency resulting from assistance provided under the Foreign Assistance Act (FAA); however, important provisions associated with PL 480 and Section 416(b) local currency are included as implementation guidance.

1.3 The key elements of the new policy are summarized in the attached "Local Currency Decision Tree." The decision tree depicts a logical sequence for considering: (a) options for generating and/or depositing local currency; (b) options for programming local currency that has been generated; and (c) accountability requirements linked to each programming option.

1/ Policy Determination No. 5 on "Programming PL 480 Local Currency Generations" (February 1983), and 87 State 327494 entitled "Supplemental Guidance on Programming Local Currency" (October 1987).

2/ State 204855 entitled "Supplemental Guidance on Programming and Managing Host Country-owned Local Currency" (June 21, 1991).

PHONE: (202) 647-9620 FAX: (202) 647-1770

2.0 Background

2.1 Policy Determination No. 5 (PD-5) on "Programming PL 480 Local Currency Generations" has been the Agency's basic policy statement governing the use of host country-owned local currency since February 1983. The policy was extended in 1984 to cover commodity import programs (CIPs) and cash transfers. It was supplemented in 1987 (87 State 327494) to incorporate A.I.D. monitoring, special account, and trust fund requirements.

2.2 This policy guidance supercedes both PD-5 of 1983 and the supplemental guidance of 1987. It focuses on both the generation and the programming of host country-owned local currency. Separate operational guidance (State 204855) focuses on accountability requirements and management concerns. Questions concerning the new local currency policy should be addressed to AA/PPC. Questions concerning the new accountability standards should be addressed to FM.

2.3 The policy covers host country-owned local currency generated by, or otherwise made available for joint programming as a result of: (a) Development Assistance (DA); (b) the Development Fund for Africa (DFA); (c) the Economic Support Fund (ESF); and (d) the Special Assistance Initiative (SAI).

2.4 Local currency not covered under this guidance includes: (a) U.S.-owned local currency; (b) local currency purchased with A.I.D. appropriated dollars for disbursement under project assistance; and (c) local currency generated under PL 480 and Section 416(b) agreements. However, important provisions associated with PL 480 and Section 416(b) local currency are attached as implementation guidance.

2.5 The policy covers, as a separate item in Section 7.0, local currency which is held in trust by A.I.D. and used largely, but not exclusively, to help meet mission operating expense requirements. The guidance on programming local currency (5.0) and managing local currency (6.0) is not applicable to local currency trust funds.

2.6 The new policy is effective on July 1, 1991. It applies to all local currency generated from obligations made on or after that date. However, some missions may be unable to comply with the policy on July 1, because they are in the midst of negotiating new agreements with the recipient country. Under these circumstances, geographic bureau assistant administrators (AAs) may waive the effective date of the new policy for FY 1991 obligations, as long as such waivers are not

prohibited by statute. Copies of such waivers shall be provided to AA/PPC. Waivers for FY 1992 (and subsequent) obligations will not be permitted.

3.0 Policy

3.1 The new policy, like PD-5, recognizes that A.I.D. participation in programming FAA-generated 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 set within a market-oriented macroeconomic policy framework. It also recognizes that negotiation of the external assistance agreement often constitutes the best opportunity for the U.S. to achieve its development assistance objectives, including the allocation of host country budgetary resources. As a result, joint programming of local currency should normally not be undertaken as a separate exercise additional to negotiating the agreement.

3.2 A.I.D. policy recognizes that local currency generations are not additional resources and should not be viewed and managed as such. A.I.D. also recognizes that the recipient government assumes primary responsibility for allocating its own budgetary resources. At the same time, Agency policy encourages the integration of local currency with external resources (primarily ESF, DA, and DFA resources, and PL 480 food aid) to help achieve specific program and policy objectives and to enhance the developmental impact of the external resources.

3.3 A.I.D. missions must make an initial judgement and reach agreement with the host government on: (a) whether or not the anticipated uses of the dollars disbursed under a cash transfer program or the commodities financed under a CIP will result in the generation of local currency for deposit into a separate account, as described in paragraph 4.0; (b) if not generated, whether or not local currency will still be required to be set aside and deposited into a separate account; (c) if deposited, what constitutes eligible, and ineligible, uses of the local currency; and (d) who will bear what monitoring and oversight responsibilities.

3.4 Local currency that is deposited into a separate account must be programmed consistent with Section 575(a) of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1991 (the "1991 Appropriations Act"), which sets forth eligible uses of local currency. Missions should

continue to refrain from jointly programming local currency for activities expressly prohibited by legislation governing appropriated funds. In addition, the agreement between A.I.D. and the host country government should prohibit the use of local currency generations for police training pursuant to Section 660 of the FAA, as well as the use of jointly programmed local currency for military or paramilitary purposes.

4.0 Generating Local Currency

4.1 Local currency is generated under commodity import, cash transfer, and non-project sector assistance programs in one of two ways:

(a) first, when the use of FAA dollar disbursements, as specified in the bilateral assistance agreement, results in the receipt of local currency by the recipient government. Examples of such transactions may include dollars used for private sector imports under a commodity import program (CIP) or a cash transfer program. In addition, public sector imports would generate local currency if the recipient government sold the imported commodities to the private sector or to a quasi-private entity, such as a self-financing parastatal body.

(b) second, in the absence of a local currency flow as described in (a) above, when A.I.D. requires a deposit or set aside of local currency by the recipient government as a condition or term of the assistance agreement; (this should be distinguished from the statutory 25 percent contribution requirement of Section 110 of the FAA, which is not subject to the separate account requirement.)

4.2 If generated, the local currency must be deposited into a separate account for joint programming. A.I.D. and the host government may specify in the agreement when during the life of the agreement local currency deposits shall be made and the amounts of local currency to be deposited. Such agreed upon amounts must accurately reflect projected local currency generations under the agreement (State 204855, para. 3.0).

4.3 Local currency need not be generated or deposited into a separate account in all other cases; that is, cases not covered under 4.1(a) and 4.1(b) above. This may occur when dollars are used to service external public sector debt or when commodities are imported by, and for the use of, the recipient government. Likewise, an intra-governmental transfer of the commodities would not generate local currency.

4.4 Missions can always require that the recipient government set aside an agreed upon amount of local currency as a condition of the assistance agreement -- regardless of the actual uses of the dollars. However, before missions exercise this option, they should ensure that budgetary resources are available for such a set aside; if they are not, the recipient government would need to: (a) reduce expenditures for activities that have been included in the budget; (b) increase revenues from taxation or borrowing; and/or (c) print money.

4.5 A.I.D.'s Office of the General Counsel (GC) has reviewed the legal issues associated with the generation of local currency; the key points of GC's conclusions are summarized in Annex A.

5.0 Programming Local Currency

5.1 When local currency is generated, it must be programmed to support economic development objectives as defined in current legislation [Section 575(a) of the 1991 Appropriations Act (FAA)]. Within this context, missions have four basic options. They may program local currency to support one or more of these four options, even though the local currency was generated from a single assistance source. The four options for programming host country-owned local currency are:

(a) investing in developmentally sound projects;

(b) supporting particular sectors of the government's budget;

(c) funding the government's deficit or reducing the government's domestic debt; and

(d) funding A.I.D. administrative costs.

5.2 Each programming option is associated with certain accountability requirements. These requirements are described in the operational guidelines (State 204855) as indicated below:

	Accountability Guidelines	
Programming Options	Section	Terminology
(a) projects	6.3.C. 6.4	specific sector support extra-budgetary support
(b) sectors	6.3.B.	general sector support
(c) deficit/debt	6.3.A.	deficit/debt
(d) admin. costs	8.0	OE trust funds

5.3 Jointly programmed local currency may be used to help meet the host country's contribution to A.I.D.-funded projects, including the mandatory 25 percent contribution required under Section 110 of the FAA. Local currency may also be used to support activities funded by other OECD and multilateral donors and private voluntary organizations (PVOs). The host government and A.I.D. should assure themselves that projects supported by local currency meet acceptable technical, financial, administrative, and accounting standards. Projects that are funded and monitored by other donors or undertaken by strong, highly respected host government or private sector institutions would generally meet such standards.

5.4 A.I.D. may also jointly program local currency to help meet the budgetary requirements of particular sectors or ministries of the recipient government, say, the Ministry of Agriculture. In this case, the mission must generally satisfy itself that the quality of overall sectoral activities and the technical and administrative capability of the implementing entity or entities to carry out the program are satisfactory.

5.5 Local currency may also be used to help fund the government's deficit, the effect of which is to reduce public sector borrowing from what it otherwise would be, thereby making those funds available for private sector borrowing. Similarly, local currency may be used to reduce the domestic debt owed by the government to the banking system or to another government (or parastatal) entity. Programming local currency to help fund the public sector deficit or reduce the public sector domestic debt (which is equivalent to supporting the government's overall budget) is normally appropriate only in countries implementing an IMF-sponsored stabilization program and/or a World Bank-sponsored Public Investment Program, under which the domestic money supply and credit ceilings (for both public and private sector borrowing) are firmly established. Jointly programming local currency in this way must first be approved by the Assistant Administrator (AA) of the relevant geographic bureau. This option for programming local currency would not, of course, be applicable in a country where the government was not running a deficit or had no domestic debt.

5.6 In general, jointly programmed local currency should be disbursed as quickly as is consistent with sound programming and prevailing economic conditions in the recipient country. On occasion, however, disbursement delays occur unavoidably. Therefore, A.I.D. policy favors that local currency be placed into an interest-bearing account in a deposit-taking institution, with any interest earned programmed as if it were

principal, so long as such accounts are permitted under host country law and regulation and do not undermine internationally-supported stabilization agreements and sound monetary policy.

5.7 Sterilization, or demonetization, is not permitted under the new policy. However, missions may choose to program local currency so it disburses relatively slowly by establishing, for example, an endowment, the earnings of which would be designated to support development programs of NGOs or other appropriate organizations, or a development-oriented guaranty fund.

6.0 Managing Local Currency

6.1 A.I.D. participation in programming and accounting for host country-owned local currency has changed substantially over the past 30-35 years. Prior to 1972 Agency policy and practice generally encouraged A.I.D. involvement in programming and monitoring host country-owned local currency. In 1972 the policy was changed; A.I.D. was not to participate in local currency programming. In 1976 it became obligatory for missions to consider the merits of participation in local currency programming. Beginning in 1983 A.I.D. policy required more active participation in local currency programming. By 1987 greater A.I.D. involvement had led to greater A.I.D. accountability.

6.2 In recent years, the Agency has increasingly been criticized by the Inspector General (IG), the General Accounting Office (GAO) and key Congressional subcommittees for the way in which host country-owned local currency is managed. The management problem appears to be most serious when local currency is jointly programmed as budget or sectoral support rather than as support for discrete projects where the impact of the funding is easier to document. The problem is most visible in countries where a relatively large proportion of U.S. economic assistance is in the form of program (as distinct from project) assistance. In countries where we continue our active participation, we need to handle the accountability concerns of the IG and the GAO more effectively.

6.3 Missions that generate local currency and/or require local currency set asides are required to establish separate accounts, jointly program the local currency with the host government, monitor the implementation of local currency-financed activities, provide regular reports, and permit audits to be conducted. State 204855 clarifies these accountability requirements.

6.4 This new local currency policy has been developed in cooperation with staff of key Congressional committees as well as the Office of the Inspector General (IG). Although neither the Congress nor the IG has been asked to approve the elements of the policy outlined above, both are supportive of the overall thrust of the policy.

7.0 Trust Funds

7.1 A.I.D. has authority to establish trust accounts for host country-owned local currency. If A.I.D. manages or administers local currency owned by the host government for any reason, this can be done only pursuant to a trust fund agreement. The trust fund agreement entered into between A.I.D. and the host government defines the uses to which trust funds may be put, and no other uses are permissible. Finally, the uses specified in the trust fund agreement must be consistent with specific statutory requirements which may be applicable to FAA-generated local currency.

7.2 Trust funds are primarily used by A.I.D. to help meet the administrative costs of its overseas missions. In addition, they have proven to be a useful tool when used, for example, like Project Development and Support (PD & S) funds to facilitate project design and implementation.

7.3 Trust funds utilized to finance discrete new projects or activities are generally not favored, but it is recognized that under exceptional circumstances their use for this purpose may be warranted. The use of trust funds to finance projects must be permissible under the terms of the trust fund agreement between the host government and A.I.D. When trust funds are utilized to support discrete new projects or activities, missions must develop, analyze, justify and implement the activity as if it were an A.I.D. project, including the use of a Project Paper-like authorization document. Given the significant burden on limited mission staffs associated with such trust fund projects, trust funds may be utilized for this purpose only with the approval of the highest A.I.D. official at post. Copies of each such approval shall be forwarded to the Assistant Administrator (AA) of the relevant geographic bureau and to AA/PPC.

7.4 Local currency held in trust, whether used for administrative or program purposes, is not U.S.-owned local currency, and therefore statutory restrictions that apply to appropriated funds do not as a matter of law apply to its use unless specifically applicable to local currency programming.

Since this local currency is administered by A.I.D. as a trustee and is not jointly programmed with the host government, A.I.D. must account for the local currency and report periodically to the host government on the uses of the trust funds (State 204855).

* * *

Implementation Guidance for PL 480 and Section 416(b)

1. The Food, Agriculture, Conservation, and Trade Act of 1990 (the "1990 Farm Bill") and the Agriculture Act of 1949 [Section 416(b)] permit the generation and use of local currency as a statutory end in itself, and not just a by-project of the sale of the food aid. Indeed, unlike the Foreign Assistance Act (and PL 480 Title I), the statutory objectives of monetized PL 480 Title III programs, as well as emergency PL 480 Title II and Section 416(b) assistance, would not be satisfied unless the local currency proceeds were used for their intended purposes.

2. These intended purposes are defined in the legislation: (a) PL 480 Title III [Section 306(b)] identifies 13 specific economic development purposes for which local currency proceeds may be used; (b) PL 480 Title II emergency food aid programs require that the food (if it is not distributed to needy people) may be sold, as long as the local currency is then used for emergency purposes; and (c) Section 416(b) stipulates that sales proceeds may be used either for costs incidental to moving the Section 416(b) commodities or for activities that are consistent with providing food assistance to needy people. [Note that Section 203(d) of Title II applies to the generation and use of local currency by PVOs and cooperatives under non-emergency, as distinct from emergency, programs.]

3. Local currency requirements are complicated, not only when comparing FAA provisions with PL 480 provisions, but also when distinguishing among Title II, Title III, and Section 416(b) monetization programs. Key distinguishing characteristics of local currency generated from the sale of PL 480 and Section 416(b) commodities are listed below.

(a) The 1990 Farm Bill prohibits the use of local currency derived from the sale of food commodities for abortion related activities [Section 403(k)] or to finance the production for export of agricultural commodities that would compete in the world market with similar items produced in the U.S. if such competition would cause "substantial injury" to U.S. producers.

(b) The 1990 Farm Bill requires that 10 percent of the local currency generated under Title III must be used to support indigenous non-governmental organizations (NGOs), but only if the Title III local currency is deposited into a separate account [Section 306(b)].

(c) The 1990 Farm Bill requires separate accounts for Title III programs to the extent determined appropriate by the Administrator. If local currency is generated in a food aid program, it must be deposited into a separate, interest bearing account. In the unlikely event such a deposit is prohibited by local law or regulation or would clearly be counterproductive, a waiver may be granted by the geographic bureau AA. If the requirement for a separate account is waived, A.I.D. must still be able to verify that an equivalent amount of local currency was used for specific economic development purposes [Section 304(a)].

(d) The 1990 Farm Bill requires consultations with the IMF, World Bank, and other donors to ensure that the use of PL 480 local currency for development purposes will not have a disruptive impact on the farmers or the local economy of the recipient country [Section 403(b)].

(e) Programming local currency to support developmentally sound projects is permissible under Title III agreements; to support projects that pertain to emergencies, under Title II agreements; and to support projects that pertain to food assistance to needy people, under Section 416(b) agreements.

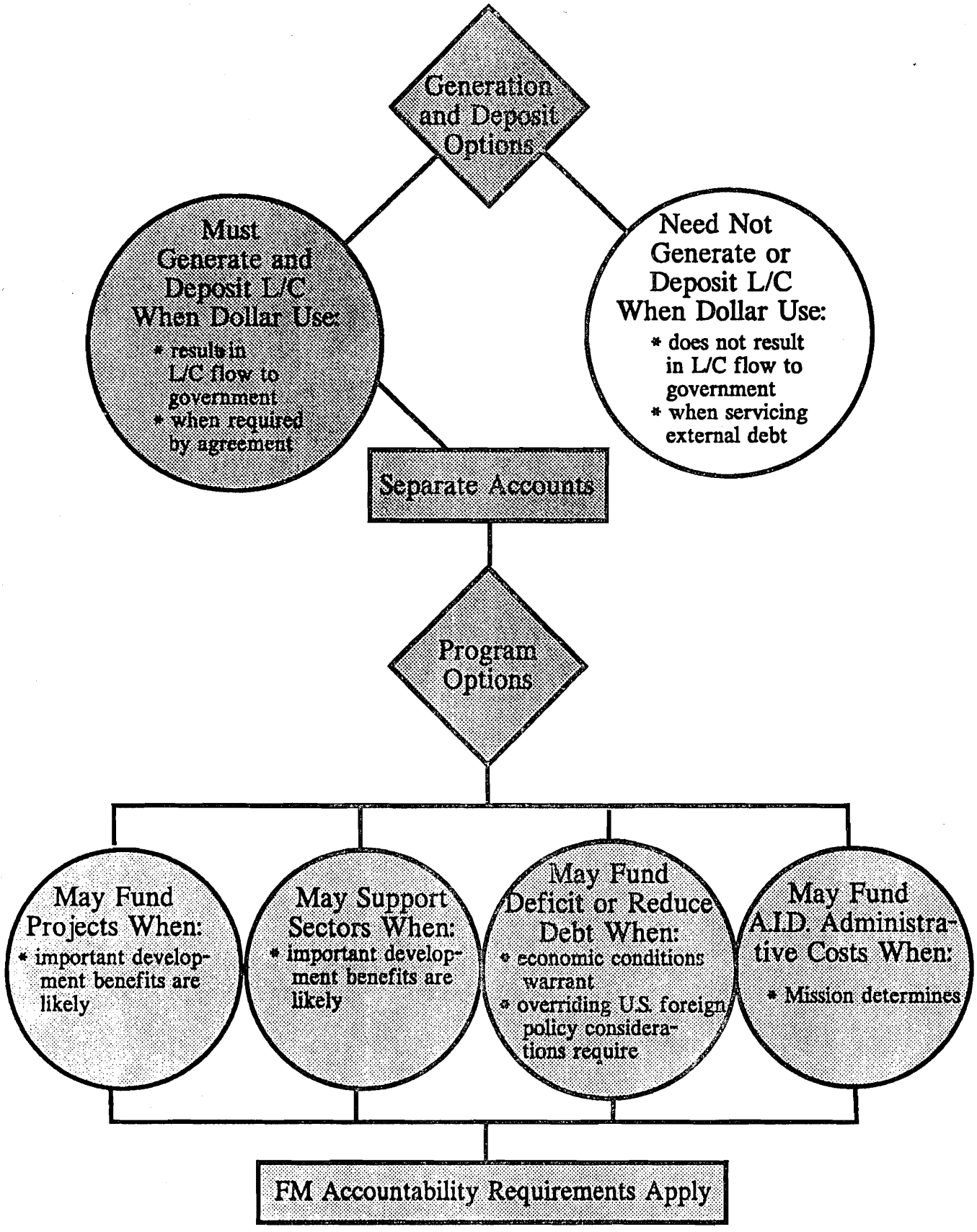
(f) Programming local currency to support particular sectors of the government's budget is permissible under Title III agreements and Title II emergency assistance; and to support the agriculture sector only, under Section 416(b) agreements.

(g) Programming local currency to reduce the government's debt may be permissible under Title III if this use can be justified under one of the specific economic development purposes described in Section 306(a) of PL 480; this use is not permissible under Title II or Section 416(b).

(h) Programming local currency to establish an endowment is permissible under Title II and Title III, but only if established by a NGO (and not by a host country); this use is not permissible under Section 416(b).

(i) Programming local currency to help fund A.I.D. operating expenses is not permitted under PL 480 or Section 416(b).

Local Currency Decision Tree (FAA)



ANNEX A

Generation of Local Currency

A.I.D.'s Office of the General Counsel (GC) has reviewed the legal issues associated with the generation of local currency in its memorandum of March 8, 1991, to AA/PPC, the key points of which are summarized below.

1. As used in section 575(a) of the FY 1991 Appropriations Act, the term "generation" encompasses a tangible flow of local currency to the host government rather than an internal account transaction. Generated local currency is considered owned by the host country rather than by the U.S. Government.

2. The direct and foreseeable use of FAA dollar disbursements determines whether and how much local currency will be generated for purposes of section 575(a) and its separate account deposit and use requirements.

3. Since planned dollar uses must be included in a Congressional Notification, the bilateral assistance agreement also should specify dollar uses. Where dollar uses cannot be specified (e.g., when dollar separate accounts are waived or otherwise not required, or disbursements are commingled) no generation results under section 575(a).

4. Where dollar uses can be specified, but do not result in a tangible flow of local currency to the host government, no generation results under section 575(a).

5. In the absence of a local currency generation (i.e., under the circumstances mentioned in paragraphs 3 and 4 above), the assistance agreement may require host governments to set aside local currency. Such local currency would then be considered a "generation" for purposes of section 575(a) and its separate account deposit and use requirements.

6. All local currency generations are subject to the deposit and use requirements of section 575(a) and assistance agreements may not require the deposit of amounts of local currency less than the amount generated.

Ronald W. Roskens

7-30-91
Date

State 259310
August 18, 1986

HB 1, Part IV
November 23, 1987
(TM 1:41)

FROM: AID/AA/FVA/FFP:JBlock

PL 480 SEC 106/108 LOCAL CURRENCY LENDING FOR PRIVATE ENTERPRISE:
FURTHER GUIDANCE IN THE FORM OF QS AND AS

1. Q: What are the advantages of Section 108 Programs for recipients when compared with current Title I agreements?

A: In real terms the balance-of-payments support is significantly greater since the recipient has no foreign exchange costs for commodities purchased with its local currency during the first ten years. Thereafter, gradually, over a 20-year period, the recipient must assure convertibility of the original commodity value, but not earnings, to dollars for repayment to the U.S. The foreign exchange cost at that time connot now be determined but it will be at the then prevailing exchange rates.

For recipients with tangible commitments to opening up the private sector, section 108 agreements clearly support those efforts. Recipients access to PVO loan financing may be more liberalized than commercial bank financing and less costly then cinancing through and from public sources.

It is likely that as access to local currency lending expands, foreigh investment may also grow to satisfy domestic import needs and/or newly developed export markets. Over the past three years experience in Kenyan and Somalia demonstrate this effect.

2. Q: What if excess bank liquidity in the recipient country, IMF Restraints, etc., make section 108 not appropriate for a country?

A: The IPG, IFIs, and the recipient country should understand the implications for section 108 given such constraints and act accordingly. Administration policy supports IMF and other agreements to rationalize recipient domestic and external monetary conditions.

3. Q: What is the IPG? Who establishes the IPG and how will it operate? How is it different from the country team?

A: The term country team does not include, for all missions, all relevant executive branch agencies having an interest in section 108 Programs: the In-country Policy Group (IPG) was created to include those agencies and/or personnel.

The IPG will be established and responsible to the Ambassador or Designee. It will include the senior staff in the mission with responsibility for commercial liaison, food assistance programming/evaluation and loan/grant negotiations.

The IPG has authority for developing selection criteria and determining eligible and participating IFIs. A.I.D. as the implementing agency is responsible for negotiating loan and grant agreements between the U.S. and IFI. OPIC will be responsible for similar loan/grant negotiations for Section 108 Programs that it develops. IFIs will implement the Section 106/108 Programs. While Section 106 calls for joint programming of funds it is expected that IFIs and potential IFIs will take that lead in forwarding proposals to recipient and IPG Officials.

4. Q: What is intended by the phrase implementing agency?

A: The implementing agency is the agency responsible for negotiating loan and grant agreements between the U.S. and IFIs for Title I, Section 106 and 108 Programs. These guidelines and forthcoming guidance on loan/grant terms will be administered by the implementing agency in conjunction with guidance for the In-country Policy Group.

The IPG will determine which IFIs participate in the program. These selection decisions will need to reflect a balance between commercial banks and PVOs.

5. Q: Is there any way that the field can ease the burden of administering this program?

A: This program has received a great deal of attention, both within the administration and on the hill. For this reason, the field has been asked to accord it the priority needed to allow it to succeed. That said, there are several ways that demands on staff and resources can be minimized.

A.I.D./PRE Officials and its contractors private bankers and financial experts and the private sector offices in A.I.D.'s Regional Bureaus can be called upon to help establish lending programs.

All or a portion of a country's program might be used by OPIC in the same fashion that OPIC handles its normal business. (See Q and A Number Nine) (Contact OPIC directly to determine lending capacity).

A portion of a country's program can be handled directly by USDA and the FAS for market development (Contact FAS directly to determine capacity).

6. Q: Who sets interest rate and loan terms on the USG loan to the IFI?

A: The interest and loan terms are negotiable. This guidance and flexible policies developed by IPGs should form the basis for negotiating loan and grant terms with IFIs.

7. Q: Who sets the interest rate and terms on IFI subloans?

A: The IFI, in accordance with its ordiniary and usual business practice.

8. Q: Are IFI subloans subject to A.I.D. or IPG approval?

A: No, except if the subloan is directed toward the production and export of agriculture commodities which compete against U.S. products in world markets. In such case USDA/FAS will give guidance.

9. Q: What is OPIC's role in section 108? How does this differ from A.I.D.'s role?

A: OPIC intends to use Section 108 funds as part of its ordinary course of business to promote specific U.S. investment in LDCS. In countries where OPIC intends to promote direct loan or guarantee activities, or where such activities are underway, OPIC will seek a commitment from the IPG for a share of the Section 108 resources. OPIC will analyze each end user activity, i.e., the local firm or enterprise, and if the project can benefit from Section 108 resources, OPIC and the proposed subborrower will find an IFI which will be a conduit for funds. The IFI will borrow the funds from the USG and relend to the project designed by OPIC.

A.I.D., in contrast, will act as a secretariat and implementing agency to the IPG in the context of loan/grant negotiations. A.I.D. will, as an IPG participant, assist in the selection of IFIs. IFIs are the only entities authorized to select subborrowers (with the exception of OPIC).

10. Q: Who negotiates the Section 106/108 Program and when is this done?

A: Section 106/108 Programs are incorporated in Title I agreements. The recipient government and the IPG representatives participate in Title I negotiations. Negotiations will be conducted by and at the time specified by mutual agreement between the recipient and the U.S., IFIs, if identified in advance, may assist informally in these government-to-government negotiations.

11. Q: Who selects the account into which the local currency is deposited? How is this done?

A: The depository bank will be a bank selected by the treasury and the account will be a treasury account. When negotiating instructions for a Title I agreement are sent, included in such instructions will be information about the depository bank.

12. Q: May the depository bank also be an IFI Borrower?

A: Yes. But the deposit and lending transactions should be handled as separate transactions.

13. Q: Must the Section 106 (country-owned) account be a separate account?

A: A separate account is preferable. But the IPG is free to conform Section 106 account procedures to other PL 480 country-owned counterpart procedures if this is necessary.

14. Q: How are disbursements to IFIs to be handled? A single bullet disbursement in advance? Disbursements only against evidence of an IFI having originated or made commitments for eligible subloans?

A: General USG disbursement policy is that disbursements should bear a relation to the needs of the project. This aspect is negotiable between IPGs and IFIs. See answer to Question No. 6.

15. Q: What are included in "Start Up" costs of PVOS and Co-ops for which grants may be given? How long is PVO or Co-op deemed to be in a "Start Up" mode?

A: Start Up costs may include operating expenses, salaries, office space, equipment and similar items. However, lendable resources are not included. The implementing agency (subject to IPG policy and DCC review) decides when and IFI in this category graduates out of the Start Up mode. There is a presumption that IPGs will not make grants for multiyear periods.

16. Q: May a PVO or Co-op in a Start Up mode qualify for lower interest rate loans if grant funds are not available or not desired?

A: It is USG policy to fund these uses on a grant basis. If grant funds are not available in the current year, highly unlikely if PVO needs are included in the "Snapshot". PVOs may have to wait for the next annual allocation cycle.

17. Q: May nonbank institutions such as e.g., finance companies, qualify for as an IFI?

A: Yes, if they otherwise meet the criteria of the guidelines.

18. Q: What if in country X (an importing country under Title I), a firm is owned 10 percent by Lebanese Nationals, 20 percent by Spanish Nationals, and 70 percent by country X Nationals? Is it eligible?

A: Yes, under Article VII, the firm is substantially owned by nationals of friendly LDCS. Spanish ownership does not disqualify the firm since theoretically Spain is eligible to receive Title I assistance.

19. Q: What is meant by program evaluation of the "Qaulity" of loans? Does this require USG review of IFI subloans?

A: It is not intended that IFI subloans be subject to the approval of the implementing agencies. Care in IFI selection should be exercised. Over time, some ideas about the "Quality" issue may emerge.

20. Q: What if an IPG cannot predict country interest in Section 106 and 108 at the time the annual "Snapshot" is taken? Does this mean a later developing program will not be considered?

A: IPGs are encouraged to press for Section106/108 programs at all times. Title I agreements signed after December 1985 may be subsequently amended to include Section 106/108 programs.

21. Q: What about joint ventures with "Substantial" host country ownership by European ownership? Are these eligible?

A: PL 480 Title I eligibility sets the standard for ownership interests of citizens. Non communist, developed countries are eligible for PL 480 Title I sales. So long as there is "Substantial" LDC ownership, i.e. majority ownership, the joint venture is eligible under Section 108. The foregoing applies where there is no government ownership or control and such ownership and control of third country participants is solely by citizens and not their governments.

22. Q: Could a subloan to a private individual qualify in the category or "Private Enterprise Support of Self-Help Measures and Project"? What is included in this term?

A: Subloans to private citizens can qualify. Some guidance on types of self help measures may be found in PL 480 Section 106. Subloans to individuals for the purchase of luxury items or for consumption as opposed to productive activities are not intended.

State 259314
August 18, 1986

HB 1, Part IV
November 23, 1987
(TM 1:41)

FROM: AID/AA/FVA/FFP:JBlock

GUIDELINES FOR SALES FOR LOCAL CURRENCIES PRIVATE ENTERPRISE PROMOTION UNDER PL 480 TITLE I

TABLE OF CONTENTS

I. INTRODUCTION AND SUMMARY

II. THE AMENDMENTS
A. General Description
B. Host Country-Owned Local Currencies (Section 106)
C. U.S.-Owned Local Currencies (Section 108)

III. HOST COUNTRY SELECTION AND SUITABILITY
A. General Policy
B. Country Allocations
C. Eligible Countries

IV. PROGRAM DEVELOPMENT, REVIEW, AND APPROVAL PROCEDURES
A. Uses of Section 106 and 108 Resources
B. Uses of Reflows Under Section 108

V. PROGRAM IMPLEMENTATION PROCEDURES
A. Agreements
B. Method for Host Country Deposits of Local Currency into the Section 108 USG-Owned Account

VI. ELIGIBLE INTERMEDIATE FINANCIAL INSTITUTIONS (IFIs) AND LOAN TERMS
A. Eligible IFIs
B. Loan Terms to IFIs

VII. ELIGIBLE PRIVATE ENTERPRISES AND LOAN TERMS
A. Eligible Subborrowers
B. Eligible Subloan Purposes
C. Subloan terms
D. Other terms

VIII. USE AND DISPOSITION OF IFI LOAN REPAYMENTS
A. Section 106
B. Section 108

IX. SPECIAL STATUTORY PROVISIONS
A. Publicity Requirements
B. Mandatory Conversions of Local Currency to Dollars
C. Competition with U.S. Commodities in World Markets
D. Host Country Guaranties
E. Agricultural Technical Assistance

X. REPORTS, AUDIT AND FINANCIAL MANAGEMENT

I. INTRODUCTION AND SUMMARY

On December 23, 1985, the President signed into law H.R. 2100, the Food Security Act of 1985 (the quote Act unquote) (PL 99-198). Section 1111 of the Act, titled quote Sales for Local Currency; Private Enterprise Promotion unquote, contains a number of amendments to Title I, PL 480. These amendments are viewed by the Executive Branch as a major initiative to stimulate private enterprise in developing countries to promote economic growth and development. Section 1111 creates an innovative program that goes beyond normal PL 480 operations and provides new resources for support of private sector activities not currently benefitting from USG resources.

The amendments to Title I of PL 480, are described in detail below. The purpose of these guidelines is to describe the policies and procedures which will be used by the Executive Branch to implement these amendments. As we gain experience with this program, these guidelines will be amended and clarified.

II. THE AMENDMENTS

A. General Description.

Section 1111 of the Act amends PL 480 Title I by (a) directing that certain amounts of Title I commodities each year shall be sold for local currency, and (b) requiring that such local currency be used, without further appropriations, for private enterprise lending in developing countries. Also, Section 106 is amended to provide that host country-owned local currency generated in customary Title I sales on dollar credit terms be jointly programmed for the same purposes.

All such loans are to be made and repaid in local currency and shall be made to intermediate financial institutions (IFIs) in the developing countries. The IFIs, in turn, will relend the local currency to eligible privately-owned enterprises or private citizens for certain private enterprise projects or activities. Funds loaned by IFIs are not to be used to finance state-owned or public sector enterprises. Nor are the resources to be directed to enterprises that produce agriculture products in competition with U.S. products.

The statute separates the local currency lending authorities into two categories: (a) PL 480, Section 106, which deals with host country-owned local currency generated from the country's resale of Title I commodities, and (b) PL 480, Section 108, applying to local currency received by the U.S. in full or part payment for the Title I sale and deposited to an interest earning U.S.-owned (FT) account, in cash, when or shortly after the Title I commodities are delivered.

For each of the fiscal years 1986 through 1990, the President is encouraged to channel local currencies, in an amount equivalent to a total of 25 percent of the value of Title I commodities, for private sector lending under Sections 106 and 108, to the extent that there are appropriate proposals for such use. The statute mandates that at least 10 percent of the annual value of Title I commodities shall be sold for local currency for private sector lending under Section 108.

In providing for these new authorities, the Conference Report recognizes the will of Congress to direct foreign assistance more toward the private sector. Furthermore, the Conferees state that they intend to judge the performance of the administration of these authorities on the quality of investments made under the program, and not upon the volume of funds directed to IFIs. The Conferees state that they intend that the performance of these and other programs with mandatory minimums or targets be examined thoroughly during the next reauthorization of PL 480 in 1990.

B. Host Country-Owned Local Currencies (Section 106).

Section 106 of PL 480 provides for private enterprise promotion activities under sales of agricultural commodities for dollars on credit terms. Local currency proceeds from the sales of these commodities are placed in quote jointly programmed accounts unquote and thereafter loaned to IFIs for relending to eligible private enterprises. In the case of a cooperative or private and voluntary organization, local currency proceeds may be granted to defray the startup costs of becoming a financial intermediary.

C. U.S.-Owned Local Currencies (Section 108).

Under Section 108, the major portion of this new initiative, the President is authorized to enter into agreements for the sale of Title I commodities for local currencies. The local currencies shall be paid into a U.S.-owned (FT) depository account. Thereafter, disbursements from this account shall be made to IFIs pursuant to the terms of loan agreements between the U.S. and IFIs.

For each of fiscal years 1986 through 1990, the Act provides that no less than 10 percent of the aggregate value of PL 480 Title I commodities shall be sold for local currency for Section 108 purposes, provided that this requirement may be waived in any year in which meeting the minimum would result in a significant reduction in the volume of commodities furnished under Title I.

Included in the Title I sales agreements shall be a schedule permitting the eventual conversion of these Section 108 currencies to dollars over an intended 10 to 30 year period following delivery of the commodities. The rates of exchange for the conversions will be those in effect at the time each conversion takes place. The Conference Report expressly recognizes that the U.S. Government may bear some of the foreign exchange risk.

Loans to IFIs are to be made at reasonable interest rates as determined by the President. Generally, these will be consistent with business practices. However, preferential rates of interest are authorized for cooperatives and private voluntary organizations for startup costs of becoming a financial intermediary. Local currency grants are also authorized to the foregoing to help defray startup costs of becoming a financial intermediary.

Once the financial intermediaries begin to make repayments of their loans to the United States-owned depository account, these reflows may be: (a) reloaned to IFIs to finance additional private investment, (b) used for agricultural market development, (c) used, subject to appropriations, to pay any U.S. obligations within the recipient country, or (d) converted to dollars.

To the maximum extent practicable, at least 5 percent of the local currencies deposited in the United States-owned depository accounts shall be used to provide agricultural technical assistance, including the funding of market development activities.

Procurement and other contracting requirements normally applicable to appropriated funds shall not apply to Section 108 local currency used for private enterprise lending.

Statutory history states that the program is not intended to affect existing currency use payments.

III. HOST COUNTRY SELECTION AND SUITABILITY

A. General Policy.

To meet the development purposes of the statute, it is Executive Branch policy to actively promote Section 106 and Section 108 lending programs in as many Title I countries as may be practicable.

B. Country Allocations.

To facilitate Executive Branch compliance with annual statutory lending targets and (if necessary) permit a more rational allocation of Section 108 sales-for-local-currency authority, each in country Policy Group (quote IPG unquote as later defined) will be requested, annually, to estimate the ability and willingness of the cooperating country to negotiate Sections 106 and 108 private sector lending provisions in the following year's Title I Sales Agreements. Requests for such estimates will help determine whether on a global basis Title I countries can be expected to meet or exceed the

25 percent combined Sections 106 and 108 statutory lending target, based on the most current Title I country budget levels, and whether any one country can meet or exceed the 10 percent Section 108 lending target. To the extent practicable, these annual estimates will include amounts intended to be allocated to PVOs and Co-ops on a grant basis for start up costs.

IPG knowledge of local IFI absorptive capacity for local currency as well as cooperating country attitudes toward this private sector lending program will be important in responding to such annual requests. Analysis of the sum of these field responses will give the DCC's Food Aid Subcommittee an early Quote snapshot unquote of whether the Executive Branch will be able to meet or exceed the statutory targets.

It should be noted that the 25 percent and 10 percent statutory targets are aggregate target levels; individual country levels may be higher or lower. However, IPGs are encouraged to seek ways to use this private sector approach to development.

C. Eligible Countries.

All countries participating in Title I sales programs are eligible for this program. Programs should be designed in a manner which ensures consistency with or does not undercut efforts of the U.S. Government or international financial institutions to promote financial sector policy reform.

IV. PROGRAM DEVELOPMENT, REVIEW, AND APPROVAL PROCEDURES

A. Uses of Section 106 and 108 Resources.

These guidelines and guidance on loan and grant terms shall be administered by In Country Policy Groups (IPG), chaired by the Ambassador or designee and consisting of the A.I.D. mission director, agriculture attache, economic counselor, and other embassy representatives from the other DCC agencies and departments or their designees. The IPG also has the authority for the final selection of the IFI or IFI's. Specific Section 106 and 108 programs shall be developed and administered by resident A.I.D. missions. A.I.D. is responsible for the negotiations with the IFIs. On OPIC-related projects, OPIC will be responsible for the negotiations with the IFIs.

In those countries where OPIC has relevant experience and competence, the IPGs are instructed to take this experience and competence into account fully. OPIC shall be advised in a timely manner of Title I negotiations so it can make proposals for IPG approval.

Prior to the commencement of the Title I negotiations, the interagency group in Washington shall exercise central budget control, and allocate funding levels requested for Section 106 and 108 uses, including amounts to be allocated on a grant basis.

B. Uses of Reflows Under Section 108.

Local currency repaid by IFIs to the U.S. may be reused for additional private enterprise lending to IFIs, the development of new markets for US agricultural commodities, the repayment of U.S. obligations (subject to appropriations), or conversion to dollars. The interagency group shall consider, and approve as may be necessary, proposals for the use of reflows on the recommendations of the IPGs.

V. PROGRAM IMPLEMENTATION PROCEDURES

A. Agreements.

As provided for in negotiating instructions, Title I Sales Agreements will include Section 108 local currency payment terms and secure cooperating country support in general for planned or anticipated Section 106 and 108 activities.

Once a Section 108 designated depository account is established in a country, separate loan agreements, contracts, and grant agreements are required by law to obligate the U.S.-owned currencies for Section 108 purposes. A.I.D., and as appropriate, OPIC shall be the implementing agencies for loans and grants to IFIs. USDA, using normal contracting procedures, shall be the implementing agency for technical assistance activities to increase markets for U.S. agricultural commodities.

B. Method for Host Country Deposits of Local Currency Into the Section 108 USG-Owned Account.

The Title I agreement payment terms may be expressed in local currency terms, or in a combination of dollar credit and local currency terms. In the latter case, a specified portion of the commodities shall be purchased for dollars on credit terms and a portion shall be purchased for local currency on cash terms. The local currency shall be payable within one hundred twenty (120) days after the date of disbursement by the U.S. bank to the US exporter (i.e. approximately 120 days after delivery of the commodities to vessels at U.S. ports when title shifts to the importing country.) The local currencies shall be deposited in interest earning bank accounts.

C. Deposit into a Section 106 (Country - owned) account.

Preferably, the Section 106 account will be a separate account. However, the IPG may permit Section 106 funds to be commingled with other self-help funds and/or handled in accordance with local custom for the deposit of PL 480 counterpart funds. Provision shall be made to secure audit reports on the use of Section 106 funds.

VI. ELIGIBLE INTERMEDIATE FINANCIAL INSTITUTIONS (IFIs) AND LOAN TERMS

These guidelines are applicable equally to Section 106 and Section 108 lending programs unless otherwise indicated.

A. Eligible IFIs.

An eligible IFI is a bank, financial institution, cooperative, nonprofit voluntary agency, or other organization determined by the President to have the capability to make and service a loan in accordance with this statute. Non bank financial institutions such as export finance companies also may be included at the discretion of the IPG. Indigenous PVO's and Co-ops may be eligible IFI's.

An IFI shall be located in or operate in the host country. It shall be organized under the laws of the host country, or if organized elsewhere, be duly licensed to operate within the host country. The IFI shall have full legal authority to borrow from the USG (as well as from the host government under Section 106) and engage in relending as contemplated.

Generally, (except for certain private and voluntary organizations and cooperative proposals encouraged under the statute) IFIs shall be sound, going, financial concerns, with a history of stability, financial strength, and experience. The selection of a specific IFI shall be based upon a conclusion that in the event of a default, the US would be able to commence legal action for damages and collect upon any judgement rendered in favor of the U.S.

For Section 106 lending purposes only, strong preference shall be given to wholly privately-owned and controlled IFIs whose ownership is substantially in the control of nationals or firms of the cooperating country, the U.S., or other friendly less-developed countries. Where there is a choice, the USG and the cooperating country should select private sector IFIs, the implementing agency shall assure that notwithstanding the public sector ownership of the IFI, its lending activities are conducted on private market based principles.

However for Section 108 lending purposes, it is Executive Branch policy that only privately-owned IFIs, with no public sector ownership, shall be eligible to receive loans.

B. Loan Terms to IFIs.

In loan agreements between the USG and IFIs, the interest rate charged IFIs for both Section 106 and Section 108 should normally approximate the cost of obtaining lendable resources of comparable maturities from the free private capital market in the individual cooperating country. If interest rates within that country are held down artificially by government policies, the rate charged the IFIs should be set within the context of US efforts to encourage overall policy reforms.

While the statute permits lower interest rates to be charged private and voluntary organizations and cooperatives for startup costs of becoming IFIs, it is Executive Branch policy to provide local currency for these purposes on a grant basis.

All USG loans to IFIs shall transfer the full credit risk to the IFI. The USG shall not share the credit risk of IFI subloans.

The maximum loan maturity to an IFI shall be negotiable. Efforts shall be made however to make loan maturities conform to local credit market conditions.

The implementing agencies shall negotiate loan terms with IFIs subject to these Guidelines and policies set by the IPG. Fixed or floating rate terms are acceptable, subject to local market conditions.

C. Form of Loan and Grant Agreements.

Sample loan and grant agreements between the USG and IFIs shall be supplied together with annotations indicating which clauses are mandatory. Loan Agreements between IFIs and subborrowers shall follow the IFI's standard practice.

VII. ELIGIBLE PRIVATE ENTERPRISES AND LOAN TERMS

A. Eligible Subborrowers.

Subborrowers may be individuals, private and voluntary organizations, cooperatives, corporations, or other entities formed or operating substantially within the cooperating country.

(a) Nationality.

To be eligible to receive a subloan from an IFI, an individual shall be a national of the cooperating country or of any other friendly less developed country. Firms or other entities as subborrowers must be owned directly or indirectly by firms or nationals of the cooperating country or those of any other country eligible for Title I sales; provided that up to 49 percent of such ownership may be held by citizens of the U.S.; and provided further that if ownership is held by nationals of third countries, substantial ownership and control shall be vested in nationals of friendly less developed countries. The loan agreement with IFIs shall require the IFI to assure the eligibility of subborrowers.

(b) Private Sector.

Subborrowers shall not be owned or controlled, in whole or in part, by the public sector or by any governmental division, authority, or subdivision of the cooperating country. International organizations, municipal authorities, parastatals or other entities not wholly owned and controlled by private firms or individuals are not eligible subborrowers. The statute is clear in its intention that the subloans be made to wholly private firms and individuals, not subject to government control.

B. Eligible Subloan Purposes.

The statute (Section 108) provides that IFI subloans shall be made for the purpose of financing:

Quote (a) productive, private enterprise investment within such country, including such investment in projects carried out by cooperatives, nonprofit voluntary organizations, and other entities found to be qualified by the President;

(b) private enterprise facilities for aiding the utilization and distribution, and increasing the consumption of and markets for, United States agricultural commodities and the products thereof; or

(c) private enterprise support of self-help measures and projects. Unquote

The IFI loan agreement shall require an IFI, to the maximum extent feasible, to give preference to the financing of agricultural related private enterprise with the funds provided under this section.

Section 106 refers more generally to quote private sector development activities unquote without reference to a preference for agricultural purposes. Nevertheless, as a matter of policy, the permissible purposes of Section 106 and 108 shall be read together and read broadly to include a wide variety of loan purposes and a preference for agricultural-related activities. To the extent practicable, Section 106 and 108 funded IFI loan agreements shall be similar in their terms and purposes.

C. Subloan terms.

USG policy is that interest rates for private borrowers should not be less than prevailing free market interest rates or a rate which approximates the opportunity cost of capital in the individual developing country. The interest rate charged to the subborrowers by the IFI should cover costs of lending in a manner consistent with commercial practice.

In many of the developing countries prevailing rates are distorted by low legal ceilings on interest rates, other direct interventions in the local capital market by the government, or inappropriate fiscal and credit policies. In such countries, interest rates to be charged to private enterprises should be set within the context of efforts to encourage the government to progressively remove the impediments to a free capital market.

D. Other terms.

Procurement regulations applicable under the Foreign Assistance Act and other USG statutes including, but not limited to, rules for competitive procurement and the quote Buy America unquote provisions are not applicable to private enterprise procurement with US-owned currencies loaned by IFIs.

VIII. USE AND DISPOSITION OF IFI LOAN REPAYMENTS

A. Section 106.

The Title I sales agreement will provide for a jointly programmed account for Section 106 local currency loan uses. Consideration should be made to negotiate a fixed life of this account, during which debt service repayments

by IFIs will be made to the account rather than to other host country accounts. After the account is terminated, debt service payments will be made directly to the cooperating country.

B. Section 108.

All the Section 108 uses of reflows are available without charging an appropriation except use for payment of U.S. obligations. See Section 108(d)(2) and (3). The Title I Sales agreements containing provisions which provide for Section 108-related accounts shall provide, to the extent practicable, that the U.S. shall be entitled, at its own option, to use reflows for all of the four purposes authorized by the statute. Because of the need for some central budget control, the Food Aid Subcommittee shall allocate local currency reflows to potentially competing requests for such currencies. Annual field requests for Section 108 authority shall include, as appropriate, requests for the reuse of reflows.

IX. SPECIAL STATUTORY PROVISIONS

A. Publicity Requirements.

The statute contains two references to publicity: Section 108(a)(2) and 108(c)(7). The former provides that prior to lending the local currency, the President shall take such steps as are necessary to assure that the availability of local currencies to financial intermediaries is adequately publicized within the purchasing country. General press guidance on the food Security Act of 1985 released by the USG in 1986 and published by the foreign press will meet some of the requirements of this Section. The preferred method for further compliance is to make this information known in press releases which announce the execution of the Title I agreement containing private enterprise lending provisions. Such press releases will also solicit proposals from IFIs who desire to participate in the program.

The second publicity provision relates to IFI borrowers publicizing the availability of local currency resources for the private sector. Standard language in the form of loan agreement between the USG and an IFI calling for IFIs to publish facts about the program in local newspapers will allow this requirement to be met.

Efforts shall be made to include similar publicity requirements in Section 106 programs.

B. Mandatory Conversions of Local Currency to Dollars.

Section 103(m), as amended, provides that foreign currencies to be used under Section 108 quote acquired under an agreement for the sale of commodities unquote be convertible to dollars during the period beginning not later than 10 years after the date of the last delivery of commodities and ending 30 years thereafter. The sales agreement shall establish a schedule for the conversion. The exchange rate for each conversion shall be the highest rate, yielding the most dollars, applicable in the cooperating country on the date of each conversion.

Standard negotiating instructions for Title I agreements will provide that an amount equal to the principal amount of local currency initially deposited in the Section 108 account shall be subject to this host country promise of convertibility. This sum shall be fixed when full initial deposit into the Section 108 account has occurred. It is intended that this local currency sum will be gradually converted to dollars over a time period negotiated in the Title I Sales agreement and repatriated to the C.C.C. In its request for a Section 108 program, the IPG shall propose terms for this conversion and receive instructions from the interagency group.

This Section 108 conversion right shall be in addition to all other conversion rights otherwise available to the USG in the respective cooperating countries.

C. Competition with U.S. Agricultural Commodities In World Markets.

Section 106(b)(4)(B) and Section 108(c)(5) operate to prohibit subloans which would promote the production of commodities or the products thereof that the President determines will compete in world markets with similar items produced in the U.S. This requirement is operable only with respect to exports, not local consumption. For proposed IFI subloans involving agricultural exports the IFI loan agreements shall require the prior approval of a designated U.S. official in the field. A list of such commodities will be provided under separate cover. USDA/FAS will provide additional guidance from time to time.

D. Host Country Guarantees.

Section 108(c)(6) provides that the President may not require a developing country to guaranty an IFI's repayment of a Section 108 loan. The USG shall take the credit risk on each loan to an IFI.

E. Agricultural Technical Assistance and Foreign Market Development.

Section 108(d)(2)(B), re-use of reflows on currencies repaid by IFIs, calls for the use of local currency to develop new markets for U.S. agricultural commodities.

Section 109(f) also allows the President to provide quote agricultural technical assistance unquote to further the purposes of Section 108, including the funding of market development activities. To the maximum extent practicable, at least 5 percent of the Section 108 designated local currencies shall be used to carry out such assistance. IPG recommendations on this provision are requested. Specifically IPG recommendations of any market development assistance needs, including use of in-country cooperators, should be identified. USDA/FAS will also consider market development proposals that provide support for improved handling and distribution and increased consumption of agricultural commodities which are presented directly to FAS. IPG advice on any such direct proposals will be sought to facilitate Washington decision on these uses. These funds, however, cannot be used for general operating and administrative expenses of the program.

X. REPORTS, AUDIT AND FINANCIAL MANAGEMENT

A. Reports.

Section 108(e)(2) calls for reports to be submitted by the President to the Congress 180 days after the close of each fiscal year. This report shall be part of the PL 480 Annual Report to the Congress. Guidance on how this data is to be summarized and reported will be supplied later.

B. Audit.

Loan and Grant agreements with IFIs (forms for such agreements to be supplied later) will contain normal USG audit provisions allowing USG auditors to carry-out their normal functions. In addition, each agreement will require the IFI's own independent auditors to audit each Section 108 loan and require the results of such annual audits to be routinely forwarded to the administering agency which, in turn will forward these to the DCC.

C. Financial Management.

Financial management services for Section 108 loans and grants shall be provided by A.I.D. in accordance with procedures mutually agreed upon by the Food A.I.D. Subcommittee.

POLICY DETERMINATION
Agency for International Development

PD-2

September 29, 1982

Mixed Credits

PD-2
September 29, 1982

THE USE OF FOREIGN ECONOMIC ASSISTANCE RESOURCES FOR MIXED CREDIT FINANCING

Introduction

The use of mixed credits by foreign governments in support of their exports has become an important domestic and international policy issue. Such financing arrangements can distort international trade and has frequently placed U. S. exporters at a competitive disadvantage. As a result, U. S. government Agencies/Departments, including AID and the State Department, are faced with requests to undertake mixed credits in support of U. S. exporters. To assist Bureaus and country missions to respond to such requests, as well as to plan their programs, AID and the State Department have agreed on a policy that will govern the use of Economic Support Fund (ESF) resources for mixed credit purposes.

This policy determination sets forth this joint AID/State policy on mixed credit financing (i.e., the combining of AID concessional assistance resources with Export Import Bank (Eximbank) or Eximbank guaranteed credits for a single export transaction). Under this joint policy the use of AID Development Assistance (DA) resources for mixed credit financing is specifically precluded.

Policy on Mixed Credits

We are opposed in principle to the use of mixed credits for export financing. We recognize, however, that other donors are actively using mixed credits to promote their own exports and that this can put U. S. exporters at a serious competitive disadvantage. Therefore, until such time as an effective agreement is reached with other bilateral donors on restrictions in the use of mixed credits for export financing, consideration may be given to the use of such mixed credits using existing Economic Support Fund (ESF) resources <u>for defensive purposes in individual selective cases</u>, where the project in our view is of high importance to the LDC's development. In this context we

(a) will continue to support the Trade Financing Facility (TFF) in Egypt as an appropriate defensive response to mixed credit competition by other donors in Egypt;

(b) have adopted specific guidelines that set forth the circumstances in which we will participate in mixed credit export financing for defensive purposes and that are consistent with international economic objectives. They provide for the use of only ESF funding, in mixed credit arrangements that we decide to undertake.

Guidelines for the Use of ESF to Finance Mixed Credits

1. Mixed credits for export financing should only be considered in special circumstances on a case-by-case basis as a defensive response, where the project in our view is of high importance to the LDC's development.

2. Mixed credits for export financing will be made available only when a U. S. firm stands to lose a contract because of better financing terms offered by a competitor using mixed credits.

3. Mixed credit activities must be economically sound and important to the development process in the recipient country.

4. There will be no use of mixed credits, combining bilateral assistance and Eximbank funds in a single transaction, solely for export promotion.

5. The financing should not distort assistance programs within countries or allocation among countries.

6. The use of mixed credits for export financing should not cause a substantial drain on development resources; for the present, only ESF funds can be used in mixed credit activities.

7. Non-project assistance in the form of cash loans or grants or CIP funding should be the normal method of financing the concessional part of such mixed credits. The CIP program is already geared toward financing commodity imports.

8. If a mixed credit program or facility for export financing, such as the TFF in Egypt, is to be established in a country, it should only be established on a temporary, time-limited basis. Individual transactions from such a facility must meet the guidelines set forth here for such

mixed credits. This is important to ensure that the existence of such facilities do not undercut any future agreement on mixed credits that the U. S. is able to achieve with other OECD countries and to maintain the extraordinary, case-by-case nature of the U. S. policy on mixed credits.

9. Any request for a mixed credit for export financing will be subject to close and expeditious scrutiny by the appropriate State and AID bureaus, and should include in its justification for the use of this instrument, not only information regarding the nature of the transaction proposed but also a discussion of the relevance of this activity to the U. S. assistance program and strategy in that country.

Policy Review and Evaluation

We will review the status of international efforts to increase the transparency and reduce the use of mixed credits one year from now. In light of the results of that review, the issue of whether our policy should permit the use of Development Assistance (DA) funds, in addition to ESF or other measures, to support mixed credits will be reevaluated. At that time, many factors will need to be considered before the use of DA is permitted, including whether the use of DA is consistent with the requirements of current foreign assistance legislation (FAA) Such a step will be taken only after the most serious consideration of all factors.

M. Peter McPherson

September 29, 1982
Date

IV.D. (TM 1:35)
8/14/85

A.I.D. Policy Paper

International Disaster Assistance

U.S. Agency for International Development
Washington, D.C. 20523

May 1985

IV.D. (TM 1:35)
8/14/85

A.I.D. Policy Paper

International Disaster Assistance

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

May 1985

TABLE OF CONTENTS

Page

Introduction 1

Overview 1

Objective 1

Strategy 1

Elements of Disaster Assistance 2

Relief 2

Rehabilitation 2

Preparedness 3

Early Warning 3

Disaster Operating Policies 4

Policy Guidance Supplements 4

Funding of Disaster Preparedness and Early Warning Activities 4

Disaster-Related Technology 5

Hazardous Materials and Oil Pollution 5

Donated Relief Supplies 5

Disaster Assistance Staffing 6

Lessons Learned 6

Summary 7

Introduction

The Office of United States Foreign Disaster Assistance is the lead US organization for responding to "disasters" abroad. Disaster assistance manifests the humanitarian objectives of the American people. Our record of generosity is unparalleled.

Disasters have their origins in earthquake, flood, storm, volcanic eruption, tsunami, drought, civil strife, accident, fire, population displacement, epidemic and other events of nature and mankind, and are notable because of their dimensions in human suffering, loss of life, or destruction of property. Disaster may strike anyone, anywhere, any time, but developing countries are particularly vulnerable. Disasters exact their price not only in human terms and the immediate destruction of property, but they frequently damage the infrastructure needed for social and economic development. While we seek primarily to help people through this program of disaster assistance, there is a measure too of self-interest through the strengthening of international good will.

Following the Skopje, Yugoslavia earthquake of July 1963, the U.S. Government determined that a central authority was needed to coordinate disaster assistance offered to foreign governments and peoples. The next year the Foreign Disaster Relief Coordinator's Office was established within AID.

Over the next few years it became evident that immediate disaster relief, while necessary and humane, wasn't the entire answer, and that costs, damage and human suffering could be better reduced by helping disaster-prone countries prepare for the inevitable. In 1976, with an amended charter from Congress incorporating the preparedness element, the renamed Office of Foreign Disaster Assistance began encouraging disaster-prone countries to prepare for and become more self-sufficient in dealing with disasters. Preparedness alone, involving prediction and early warning, has greatly diminished the relief burden on the U.S. Government in several disaster-prone countries.

This policy paper, used in conjunction with AID Handbook 8 and the provisions of the Foreign Assistance Act, forms a policy framework for the operation of AID's Office of U.S. Foreign Disaster Assistance.

Overview

The AID Office of U.S. Foreign Disaster Assistance (OFDA) coordinates U.S. Government assistance with that of international agencies, other donor governments, and private and voluntary organizations. Its Director reports directly to the Administrator of A.I.D., the President's Special Coordinator for International Disaster Assistance.

From 1964 to 1984, the United States Government has, through OFDA, provided emergency relief for 772 foreign disasters which have killed over 2 million people and seriously affected more than 751 million others. Through fiscal 1983, $6.3 billion was provided in relief by the international community, of which about one-half was provided by the United States—$2.4 billion by the Federal Government and $281.5 million by the private sector.

OFDA responds to requests for emergency assistance an average of 37 times a year. This office monitors another 40 situations which could become disastrous, develops early warning systems, and provides technical assistance to strengthen relief agencies in disaster-prone countries. A 24-hour response capability is maintained to rush life support goods and services to disaster victims anywhere in the world.

Objective

Primary program objectives are to provide earliest possible alleviation of suffering from foreign disasters, with the principal beneficiaries being those in developing countries least able to survive without outside assistance. We focus particular attention on strengthening a country's ability to cope with disaster through reliance on its own resources. The program has four goals:

Emergency Relief and Rehabilitation,
Country Preparedness,
Early Warning, and
Mitigation.

Strategy

The Congress authorized foreign disaster relief in Chapter 9 of the Foreign Assistance Act of 1961, as amended, which provides for assistance:

A. to preserve life and minimize suffering by providing sufficient warning of natural events which cause disasters;

B. to foster self-sufficiency among disaster-prone nations by helping them achieve some measure of preparedness;

C. to alleviate suffering by providing rapid, appropriate response to requests for aid; and

D. to enhance recovery through rehabilitation programs.

Elements of Disaster Assistance

Relief

Disaster relief offers clear evidence of Americans' concern for people in other countries who become victims of disasters. International Disaster Assistance seeks to sustain life and mitigate the suffering which stems from disasters by providing emergency, life-sustaining aid.

The primary responsibility for disaster relief rests with the host government. AID responds only when the affected population and responsible host agencies are unable to cope with the problem. AID's assistance supplements, supports, and is coordinated with that of the host government.

It is the responsibility of the U.S. Chief of Mission to insure that our government's assistance is based on priority humanitarian needs and is coordinated with the activities of the host government and other donors.

To insure that response is appropriate, timely and cost effective, OFDA provides technical assistance in assessing damage and need.

To be most effective, disaster relief must be implemented as soon as practical.

The relief which OFDA furnishes may take the form of commodities, services or transportation. Commodities may be either disposable or returnable, and the host government should be urged to recover and maintain excess reusable and disposable items such as tents, plastic sheeting, water containers, and medical supplies. Certain capital type equipment such as water purification systems, electrical power generators, and portable high intensity lighting systems are provided only on a loan or reimbursable basis. It is the responsibility of the U.S. Mission to insure that recovery or disposal of capital equipment is consistent with instructions from OFDA.

Commodities may be purchased at local or regional markets if time and cost considerations warrant, but wherever practical commodities of U.S. origin will be provided. Whenever feasible, U.S. commercial transportation will be used.

Rehabilitation

The basic purpose of A.I.D.'s disaster assistance program is to provide immediate humanitarian relief to the victims of natural and man-made disasters abroad. The Congress has also recognized that disaster assistance should include, when appropriate, the following types of short-term rehabilitation efforts immediately following or concurrent with relief activities.

International Disaster Assistance funds may be used for rehabilitation during a 90-day period (which may coincide with the initial emergency period) beginning as soon as plans are developed and funds become available. The rehabilitation period does not extend beyond the 90-day period unless approved by the Director, Office of U.S. Foreign Disaster Assistance. Short-term rehabilitation activities are not intended to supplement long-term development or technical assistance projects.

Rehabilitation provides material and technical assistance looking toward restoration of essential community facilities and services, including shelter, water supply, sanitation, agriculture, health maintenance and infrastructure.

Rehabilitation may also provide an important link between relief and reconstruction which is administered by A.I.D. regional bureaus and missions as an adjunct to the development program. The rehabilitation process, through repair designed to bring the community to a state of self-sufficiency, can point the way by which reconstruction can add significantly to future protection of the affected populations by better construction techniques and design. In a like manner, rehabilitation of potable water supplies and health care capacity may lead to larger scale improvements in health maintenance in the reconstruction and development processes. Rehabilitation of agriculture (provisions of seed, emergency water supply, etc.) may lead to the reduction of crop vulnerability by introducing drought, flood or wind resistant plant varieties or secure water sources.

To provide the best rehabilitation assistance, performance assessment throughout the rehabilitation process is required. OFDA will assist the mission in such assessment if its resources are inadequate. Assessment must address appropriateness of response in terms

of consistency with long-term development planning and cultural receptivity as well as immediate need.

OFDA's rehabilitation activities may be considered as "seed money" or "pump priming" and, through such leverage, have vastly greater overall effect. However, disaster assistance funding cannot be considered for reconstruction or development programs.

OFDA, as a matter of prudent management, seeks legal and procedural advice from the A.I.D. Offices of the General Counsel, Inspector General and Legislative Affairs to insure that planned actions are consistent with the OFDA mandate and Congressional history with regard to rehabilitation.

Preparedness

Preparedness assists officials, organizations and communities to plan for and respond to disasters. OFDA provides training, technical assistance, educational materials and assistance in the development of national and community institutions in preparation basics. Disaster management, risk analysis, mitigation, prediction and warning, and public awareness are promoted.

Such preparedness activities are designed to enhance the capacity of those responsible for the welfare of threatened populations to cope with disasters without outside assistance. The objective is to teach self-sufficiency and to improve technical competence in disaster managers and technicians.

Training venues may be in the United States or foreign sites, depending on the cost-effectiveness of transporting participants and instructional personnel. Wherever possible, national or regional expertise of the threatened areas is utilized.

Disasters pose an increasing burden to the cost of development. There is a growing body of information, however, which offers proven means of decreasing the risk of disasters. It is important then that AID offer disaster curricula in participant training programs and policy dialogues in those countries which are vulnerable to serious disaster threats, leading to development of counterpart institutional capacity to cope with disasters. Preparedness may address issues relating to both short-term and long-term impact of natural and environmental disasters.

Early Warning

OFDA's early warning activities transfer technologies and teach techniques to provide early recognition of, and to permit rapid response to, the predominant threats.

OFDA offers early warning assistance in two distinct time frames. Prediction pinpoints coming events with a good degree of certainty as to their location, time and magnitude. Forecasting deals with the probabilty of a given disaster occurring at a less determinable time and force in a given geographic location. Cyclone and flood effects may be predicted—at least in the short term. Earthquakes, tsunamis, landslides, volcanic eruptions and droughts may be forecast in terms of their probability. Both prediction and forecasting are based on the analysis of historical incidence and on current scientific data.

The objective of early warning is to provide valid information to populations and their public officials upon which they can base actions which will allow them to protect themselves from the effects of imminent or future disasters.

Such actions may be immediate (evacuation, emergency measures) or long term (building and zoning codes, physical adjustments such as dams and other mitigative techniques).

The end product of OFDA's early warning activities is the protection of populations and their property at the community level. To achieve that, a number of steps are required. First, technology, such as satellite meteorological observation, may be necessary to assess risk and to enhance prediction and forecasting accuracy. OFDA may transfer such technology through grants, temporary transfers or on a reimbursable basis, in conjunction with programs of the host government and other donors, as appropriate. Second, training and software development is provided to interpret the scientific hazard data derived from warning technology. Third, OFDA offers training in the decision-making processes which must weigh the political, economic and social costs of issuing public warnings. And finally, OFDA may support the development of communications networks to carry the warning to the threatened communities.

The last step in the warning cycle is the preparation of the communities at risk to respond in their own best interests to the warning once received. This phase is addressed in the public awareness component of OFDA's disaster preparedness program.

OFDA programming of early warning activities is based upon the imminence and

magnitude of threat and upon the immediacy with which the activity can provide protection and reduce the risk to communities which, in large part, are dependent on the awareness and commitment of the affected host government.

Disaster Operating Policies

AID Handbook 8, "Foreign Disaster Assistance," is the operational guide for anticipating and responding to disasters in the host country. The following is a brief overview.

The Ambassador or Chief of Mission (CM) has primary responsibility for providing U.S. assistance in the event of a disaster in a host country. The Office of U.S. Foreign Disaster Assistance, AID, is responsible for coordinating all United States Government international disaster relief. OFDA staff is available 24 hours a day to assist the Mission in determining whether assistance should be provided, in selecting the most effective forms of assistance, and in rapidly supplying the required relief specialists and commodities.

It is in the interest of the CM and the USG to anticipate and develop plans to be implemented in the event of a disaster. A first step is to designate a Mission Disaster Relief Officer (MDRO) who will be responsible for outlining key functions to be performed by Mission staff members; contacting host country government and voluntary agency representatives responsible for providing relief; determining the types of disasters to which the country is vulnerable; and locating inventories of relief supplies in-country.

When a disaster occurs, the Ambassador or CM may determine:

- that the disaster is beyond the host country's ability to respond adequately;
- that the host country desires assistance; and
- that it is in the interests of the USG to provide assistance.

The disaster determination allows the CM to provide on his own authority up to $25,000 in cash, supplies, or services to assist victims, for example:

- a cash grant to the local government relief agency;
- a cash grant to a local or international voluntary agency handling emergency relief;
- the local purchase of needed relief supplies; and/or
- the transportation of relief supplies to the stricken population.

OFDA must be notified once a disaster determination has been made. It will immediately provide appropriate funding orders and any guidance the Mission needs. OFDA approval is required for any assistance or expenditures over the $25,000 authority, and a disaster determination is needed before OFDA can provide funds. This applies to funds which OFDA may be requested to provide for transport of donated relief supplies. OFDA can supply a variety of immediate relief supplies (such as tents, blankets, or plastic sheeting) from its five U.S. and regional stockpiles, as well as technical assistance in the form of medical, sanitation, logistics, communications, engineering, or shelter specialists. It is also through OFDA that the services of the U.S. Department of Defense are obtained.

The Ambassador should be mindful of the importance of disaster preparedness which includes awareness of potential hazards to which the host country is vulnerable; analysis of the host country's ability to handle such disasters; and identification of prevention or mitigation measures which could be implemented. OFDA can provide disaster assessments, identify and recommend mitigation measures, and assist in funding preparedness activities, such as disaster management training, earthquake resistant shelter design, food/crop condition monitoring, and nutrition and health assessments.

Through effective preparedness, planning, and coordination, the effects of many disasters can be minimized, and the immediate needs of disaster victims can be rapidly met. Handbook 8 provides detailed guidelines for preparing and providing such a coordinated approach.

Policy Guidance Supplements

The following policy guidance supplements AID Handbook 8.

Funding of Disaster Preparedness and Early Warning Activities

International Disaster Assistance Account funds are devoted exclusively to reducing loss of life and human suffering. This is consistent with the goals of the development process supported by AID. Regional Bureaus and OFDA collaborate on in-country programs

and projects and assure that the development process is not destroyed by natural hazards.

Specifically, Regional and Country Development Strategy Statements are to be used to identify vulnerability where natural hazards suggest a strategy to avoid or reduce this vulnerability. Projects funded under Part I, Chapter 1, of the Foreign Assistance Act (FAA), will include components to implement this strategy. When specific country situations warrant such action, Bureaus and Missions are encouraged to advocate and establish projects with funding authorized under Part I, Chapter 1, which bridge the concerns of development and disaster vulnerability. Examples of such activity include:

- Agriculture Rural Development and Nutrition—projects in food security/nutrition surveillance, including contingency planning for food distribution following the onset of disaster;

- Population and Health—projects or project components in contingency planning for management during emergency periods of water and sanitation resources and directed toward the avoidance or management of threatened epidemics;

- Energy, Private Voluntary Organization, and Selected Development Activities—projects directed toward the institutionalization of national efforts in disaster prevention, preparedness, early warning, and response management; and modules in Operating Program Grants for disaster preparedness training and extension. Subsection 106 (d) authorizes programs of disaster preparedness including the prediction of, and contingency planning for, natural disasters abroad.

Section 491 of the FAA authorizes administrative flexibility in the use of the International Disaster Assistance Account for the initiation and execution of disaster preparedness activities. The fact that disasters claim an increasing number of lives and property loss suggests that medium to long-term funding support of critical disaster preparedness and early warning activities should be incorporated in country development programs as appropriate to a specific country situation. The OFDA Director, in collaboration with regional Assistant Administrators, may recommend disaster preparedness activities for transition to, and inclusion in, country and regional development programs. The Director will also provide such technical expertise as may be necessary to assure the orderly transition of such activities, as well as for the design of disaster preparedness and early warning-related projects and project components.

Disaster-Related Technology

New technologies are continually being assessed for adaptation and application to disaster avoidance or mitigation and enhanced early warning. The OFDA Director can use International Disaster Assistance Account resources to incorporate these technologies in development programs and projects.

Experience has shown that application of new technologies for disaster prevention or mitigation purposes may also be of use to the general economic development process. Examples include:

- information upon which more informed macroeconomic decisions can be made in national resource planning;

- crop variety selection as an offshoot of food security monitoring; and

- information for better decisions in the usage of land and other resources, and in zoning and building codes for use in housing programs.

International Disaster Assistance Account resources can be used to "bridge" funding lags for incorporating risk reduction technology in development programs.

Hazardous Materials and Oil Pollution

Use of the International Disaster Assistance Account is appropriate for:

- incidents involving hazardous materials and oil pollution when there is a threat to life or human suffering or the risk of ensuing suffering (i.e., economic damage alone will not normally trigger such assistance); and

- technical assistance programs for disaster avoidance or mitigation which have specific components addressing hazardous materials or oil pollution.

After assistance is provided for hazardous materials or oil pollution incidents and legal responsibility can be assigned, AID, when legally feasible, will seek cost reimbursement from the parties responsible for the damage.

Donated Relief Supplies

Disasters often evoke spontaneous donations by the U.S. public. Many times these donated items are inappropriate, unidentifiable, or

even dangerous. AID's policy is to discourage, without exception, such unsolicited collections in favor of cash donations channeled through private voluntary organizations.

Generally, AID will consider transporting disaster relief supplies only when there has been prior:

- assurance by the government of the stricken country that such commodities are necessary and are not otherwise available soon enough;
- approval by the U.S. Mission in that country;
- certification by the requestor that the commodities:
  - are in the quantities and of the specifications needed;
  - have an effective and safe shelf life in excess of six months; and
  - are packed and labeled to insure proper distribution and safe usage; and
- agreement by the Director of OFDA to provide transportation for the commodities.

AID assistance in transporting donated relief supplies may utilize either:

- space available in commercial or military aircraft or other vehicles which are operating under the auspices and direction of OFDA;
- reimbursement as previously agreed upon for commercial transportation on U.S. flag carriers, unless this requirement is explicitly waived; or
- certification of disaster relief response need and priority to commercial and military carriers not funded from the International Disaster Assistance Account.

Disaster Assistance Staffing

Response to a disaster may require rapid temporary additions to the U.S. Country Team in the stricken country or OFDA in Washington. OFDA will, if practical, deploy qualified officers and contracted specialists to disaster sites.

It is important that Assistant Administrators and AID principal officers at field posts give highest priority to temporary duty assignment to the Country Team of qualified individuals requested by the OFDA Director. Bureaus and Offices will temporarily detail to OFDA previously designated individuals whose skills and experience qualify them for specific tasks during relief operations, as requested by the Director.

In order to enhance U.S. response to foreign disasters and improve disaster planning in country and regional development programs and projects:

- disaster assistance (preparedness and relief) units will be incorporated in training programs for in-service AID employees and for International Development Interns;
- Washington training programs for selected International Development Interns will include rotational assignments in OFDA; and
- OFDA will conduct orientation sessions in disaster assistance for Washington employees. Employees should attend to help meet the needs of their bureaus in disaster management.

Lessons Learned

OFDA policy is based on 20 years of experience responding to more than 700 disasters. The "Lessons Learned Information System" is a tool used to avoid the mistakes of the past and forms the basis for much of OFDA's operating policy. The following lessons are representative of hundreds which are routinely referenced for policy and procedural guidance. They are included here to illustrate the breadth of issues which may arise during disasters which may have policy implications.

No. 239—The view that disaster victims are totally helpless and impotent is usually a myth. Victims are not psychologically incapacitated by the shock of a disaster, nor is there the panic and breakdown of social order that some emergency and relief officials assume. Victims rarely lose all their pre-crisis goods and resources; they are rarely bewildered, resourceless, and dependent, as some news bulletins depict them. The victims themselves carry out most of what needs to be done in an emergency, including transport of victims to hospitals, evacuation, and provision of emergency shelter.

No. 004—The OFDA task force should wait until the host government has assessed that the disaster is beyond its own relief capabilities before allocating any USG funds. Immediate reaction to pressures of early stories and reports may result in a response that is unnecessary or inappropriate.

No. 150—Where feasible, a strict limit should be established with the host government on

the length of time the water purification units will be deployed. The units tend to create a disincentive for the community to restore its regular water supply. An inventory receipt of all equipment with serial numbers should be prepared and a copy given to the local responsible authority when the water purification units are delivered. The local group should sign for the equipment and acknowledge their responsibility to protect and return all the equipment in undamaged condition by the pre-established termination date.

No. 253—The people who have the most time to devote to obtaining relief are often those who least need it. The neediest are too busy recovering lost items and constructing temporary shelters, and they have no time to stand in relief lines. Churches and social organizations must seek out this group.

No. 701—Solar cookers are ineffective in societies where people prepare most of the food in the early morning before the sun is high or in the evening.

No. 155—The use of a priest to bless the water purification operation showed good cultural sensitivity and enhanced the legitimacy of the operation in the eyes of the local community members, many of whom may have been somewhat skeptical of the unit's ability to purify contaminated water.

No. 527—Canned foods often do not come with can openers. It is important to procure can openers and ship them with canned food.

No. 187—The disaster coordinator should maintain control and only provide assistance when and where there is a demonstrated need. The difference between effective aid and public relations should be kept clearly in sight. During the Ecuador flood relief operation, the USG was able to resist the normal emergency reaction of sending in large quantities of food, medicine, and clothing, and instead was able to develop relief projects with clear, well defined goals. It is often preferable that U.S. aid be self-contained, i.e., that it doesn't place additional burdens on already strained host country resources.

Summary

The key elements of U.S. foreign disaster assistance policy are:

- To render emergency relief, in coordination with the host government, other donors, international agencies, and voluntary organizations, to all victims of foreign disasters. Such assistance can be provided to the people of any nation. The United States has demonstrated over the years that the generosity and humanitarian instincts of the people of the United States generally overrides other considerations in responding to disasters.

- To assist in rehabilitation when such rehabilitation is beyond the capacity of local resources.

- To encourage and participate in preparedness through the provision of technical assistance and international training programs.

- On a case-by-case basis, where there has been severe social and economic disruption, to provide a planning basis for longer-term reconstruction through U.S. economic development assistance programs.

- To increase the United States' technical capacity to define vulnerable populations and to recommend disaster prevention measures.

- To encourage participation of other donors in preparedness and relief activities.

To accomplish these goals, OFDA is uniquely configured and empowered to cut through red tape and draw needed expertise from anywhere in the government. The OFDA annual appropriation from Congress can be supplemented by drawing down other functional accounts under the provisions of the FAA. It can also appeal for supplemental funding from the congress. Worldwide disaster conditions are monitored constantly. With the resources of preparedness activities, prepositioned supplies, and access to commercial and military survey/lift capability, OFDA can respond anywhere in the world within 72 hours.

When a nation is overwhelmed by natural or man-made calamities, it can turn to the United States for swift, effective assistance.

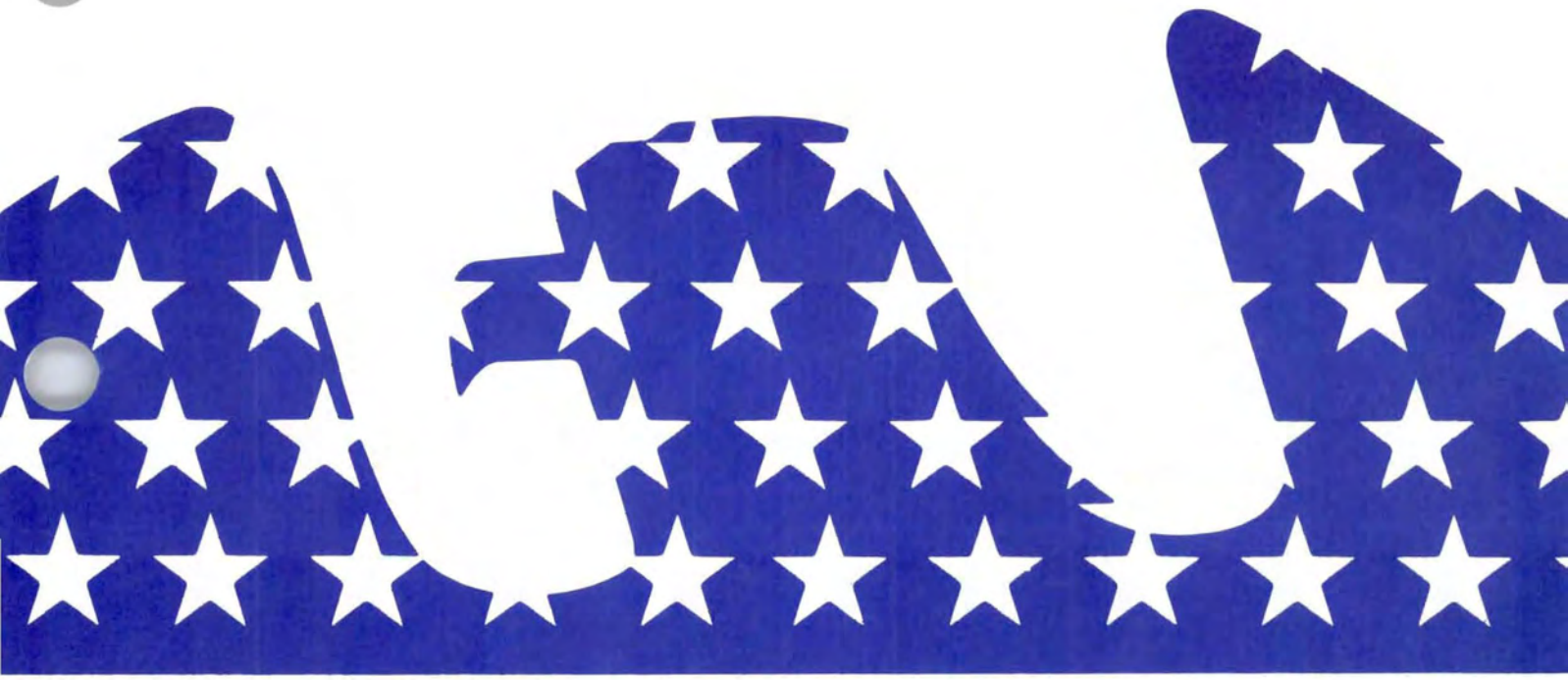
POLICY DETERMINATION

Agency for International Development

PD-4

October 5, 1982

TITLE XII



PD-4
October 5, 1982

Policy Directive on Title XII

Summary

Over the past five years, the Agency has made much progress in facilitating the application of Title XII resources, assisted by BIFAD and its mechanism, in the planning and implementation of activities under the Title XII mandate. However, since becoming Administrator, I have felt that this legislation was not being implemented as fully as it could be. This feeling was reinforced by a GAO Report to the Congress dated October 16, 1981 which stated that there was a lack of clear policy direction on Title XII and poor communication and guidance between AID and its missions, contributing to uncertainty about how to implement Title XII within country programs. I am therefore issuing this Policy Directive to clarify and reaffirm the Agency's commitment to carrying out the mandate of the Title XII legislation and to provide guidance for its more effective implementation. It is my intention that the Agency take immediate and continuing steps to:

-- Continue emphasis on Title XII-type activities in agriculture and food-related areas;

-- identify each project or sub-project falling under Title XII definitions, as early as possible in project development; and

-- mobilize the best and most appropriate Title XII resources for each project need, rapidly and effectively, either alone or together with non-Title XII resources, using all mechanisms at our disposal.

To recap, Title XII was enacted into law in December, 1975 to improve the participation of U.S. agricultural universities in the Agency's efforts to apply more effective agricultural sciences to the goal of increasing world food production, and to encourage the provision of increased and longer-term support to the application of science to solving food and nutrition problems of the developing countries.

1. Definitions - Projects or sub-projects which qualify as Title XII activities are those which have as a primary objective the development of the LDC capacity for research, education, and/or extension, the training of participants, the conduct of research, the building or strengthening of related institutional infrastructure, and/or the provision of university advisors to development projects, all in agriculture, aquaculture, nutrition, agriforestry or closely-related fields. Also included under the purview of Title XII are the

new initiatives of the Collaborative Research Support Program (CRSP) and the Strengthening Program, as well as such long-standing programs as support to the International Agricultural Research Centers whose work is integral to other Title XII resources.

A Title XII activity is implemented through a contract, cooperative agreement or grant; it may involve a single university, a cluster of universities or a mixture of universities and USDA or NOAA, and/or an agribusiness or non-profit firm, to the extent that their own personnel are required for the activity. There may be exceptional circumstances when a non-Title XII resource, with special capabilities, is chosen to implement what by subject-matter definition might otherwise be classified as a Title XII activity. However, normally, as the Title XII legislation indicates, the involvement of the U.S. agricultural universities in these types of projects is essential not only for their scientific expertise and professional backstopping, but also for their experience in building institutions, for feeding the development assistance experience back into teaching and research in a cumulative and systematic fashion, and for involving LDC colleagues in the continuing academic and scientific world-wide network.

For classification purposes, a Title XII activity may be a project in itself or a sub-project as a component of a larger project, in which case the remainder of the project (the non-Title XII components) might consist of commodities or construction, for example, and would not be included in the Title XII listing. For institution-building activities, where the costs for laboratory equipment and library materials (relatively modest) are part of the university contract, these costs are included for the purposes of reporting total Title XII expenditures to the Congress; however, capital costs (usually quite large) are excluded for general development projects such as those in irrigation or agricultural credit, and only the costs of the technical assistance of university advisors are included as a Title XII expenditure.

The following factors have <u>no</u> bearing on the definition of a Title XII activity:

-- <u>Funding Source</u> - AID activities meeting the above substantive criteria are considered to be Title XII regardless of funding source. They may be financed from Section 103, other sections of DA funds (such as an agricultural education project under Section 105), ESF or the Sahel Development fund.

-- <u>Contracting Mode</u> - The Collaborative Assistance Method of contracting obviously comes the closest to meeting Title XII objectives. However, since the Standard Uni-

versity Contract is appropriate for shorter-range, more highly specified activities, both modes are included in Title XII, as well as both direct AID contract and host country contract.

-- Date of Authorization - A few projects meeting the substantive Title XII criteria may have been authorized prior to the enactment of the Title XII legislation in December 1975. Since they are not distinguishable, in any substantive way, and continue to benefit from Title XII mechanisms and resources, they are also included in Title XII.

2. Identification of Resources - It is intended that Title XII activities, as defined above, should be carried out, insofar as possible and appropriate, by Title XII institutions, with any additional non-Title XII resources as may be needed, under sub-agreements. It is therefore essential that missions identify Title XII activities at a very early stage in project development. If, for some reason, it is felt that the resources of Title XII institutions are inappropriate for a particular task, or if a non-Title XII resource is uniquely appropriate, the rationale for such resource selection must be documented. In such cases, the activity would subsequently be dropped from the list of Title XII activities. The Agriculture Sector Council can assist in the application of Title XII definitions. Projects or sub-projects thus determined to be Title XII activities will be flagged as such (by the notation "XII") in project descriptions, and will have the assistance of all Title XII mechanisms, as appropriate, throughout the development, design, implementation and evaluation of the project.

Particular attention will be placed on improving the process of matching the highest quality and the most appropriate U.S. institution, cluster of institutions, or existing consortium, to the task to be undertaken. In order to determine the nature and mix of the resources required for a proposed project, it is absolutely essential to have a well-thought-out statement of project needs in the PID. (This step is frequently deferred to the PP which, in the case of the Collaborative Assistance Method of contracting, means that the contractor is to be selected before there is adequate information on which to base such selection.) When a mix of resources is required (several universities, Title XII/non-Title XII entities, etc.), attention should be paid to an effective management arrangement, normally under the lead of the entity providing the bulk of the resources required. This entire matching process, in which the Title XII mechanisms are prepared to engage, may involve considerable interaction, even site visits, between the academic community and the mission, host country and/or AID/W. For Title XII activities so identified, we are committed to be both

expeditious and effective in mobilizing these resources, whether from within the academic community itself or combined with agribusiness, foundation or other federal agencies. We expect this process to be monitored for futher refinements, or improvements.

3. BIFAD Mechanisms - To assist in the application of these resources to programs and activities under Title XII, the legislation established a Presidentially-appointed Board for International Food and Agricultural Development (BIFAD), with provisions for its support from subordinate committees and staff. The primary mission of BIFAD is to help the Agency mobilize and utilize the faculty and institutional resources of Title XII institutions, and to advise and assist AID to develop and implement activities. BIFAD's Joint Research Committee (JRC) and Joint Committee on Agricultural Development (JCAD) have recently been combined into the Joint Committee on Agricultural Research and Development (JCARD). While this body reports to the Board, it consists of members from Title XII institutions, USDA, NOAA, the private sector and agricultural officers from the four regional and three central bureaus.

The BIFAD Support Staff provides staff support to the Board and JCARD. It is located in the Office of the Administrator and is headed by an Executive Director who reports to the Board Chairman who, in turn, advises the Administrator on matters pertaining to Title XII. This Staff consists of IPAs from the university community and Agency people on detail assignments. It facilitates the effective application of Title XII resources to Agency needs, maintains the Registry of Institutional Resources, and serves as Secretariat to the Board. It will focus its efforts on the identification and recommendation of the best mix of university resources for individual Agency projects.

4. Joint AID/BIFAD Resolution - In May 1981, BIFAD Chairman Clifton Wharton and I signed a Joint Resolution (Attachment A) which agrees that:

-- U.S. universities are a special resource to be utilized fully and completely under Title XII;

-- BIFAD's primary mission is to help AID mobilize and utilize these resources and develop and implement Title XII program components; and

-- both AID and BIFAD are committed to prompt action necessary to carry out this Title XII mandate.

In carrying out this Resolution, I expect greater emphasis and attention to be focused on Title XII-type projects in which human skills and knowledge, and institutional capabilities are

strengthened and applied to developing country food and nutrition problems. It is important to recognize, as the legislation states, that our efforts in these areas must be approached on a long-term basis, both in the planning stages and in our policies and procedures for implementation.

I expect the Missions to participate actively in the various CRSP efforts in preparing for effective host-country involvement in such research and in facilitating field activities to maximize the objectives of the program.

We are currently revising the Guidelines for Travel Under the Strengthening Program in which we will be asking the Missions to take a more active role (as some are already doing) in placing Strengthening Grantee personnel so that they might gain longer-term work experience more relevant to future contract assignments. I hope the Missions can also find ways to utilize the technical expertise of these personnel as they gain useful country experience.

5. Some New Initiatives - The effectiveness of Title XII, in the final analysis, will be measured by the effectiveness of the involvement of Title XII institutions in the development, design and implementation of specific Agency projects and programs. To this end, we are developing appropriate mechanisms for getting the universities involved more directly and effectively in the field where programs and projects are initiated and implemented. The Agency, with BIFAD's help, is dedicating itself to ensuring that needed new mechanisms are put in place by the end of this fiscal year. Concerted action is being taken on the following fronts:

-- In light of the problems caused by utilizing host-country contracts for university projects, I have modified Agency policy to indicate that direct contracting may often be the better choice where universities are involved.

-- We are negotiating Memoranda of Understanding (MOU) which among other things, will define the technical and geographic areas in which AID expects to utilize each university's expertise, and will identify a core of staff professionals who will be designated for long-term participation in Agency programs.

-- We have drafted an Operations Manual and a model agreement for a Joint Career Corps (JCC) under which university professionals would agree to spend about 1/3 of their time with AID in 2-4 year tours, (mostly overseas) and 2/3 back at their university. We are attempting to identify 25 positions at present.

-- We have drafted procedures for the Joint Enterprise Mode (JEM), designed primarily, but not exclusively, to involve specialized expertise at the smaller, less-LDC-experienced institutions in joint agreements with the more experienced insitutions in Agency work. A pilot project is being developed to try out the new arrangement.

-- As we are completing the analysis of the overall Strengthening Program, as planned for this third year, and as we are moving out of the initial phase of reorienting administration and faculty, we are revising the guidelines and procedures for these grants, increasing the focus and structure of individual activities, including subject and geographic concentration, to be more directly related to ongoing and anticipated projects with AID.

-- We have awarded three TSMs (Technical Support to Missions) by which a university provides assistance to a Mission in designing, analyzing or evaluating its programs and projects. By working with institutions having significant in-country experience, Missions can have rapid access to current, readily-available expertise based on specialized, accumulated experience.

Similarly, the university community is recognizing its responsibilities in increasing university effectiveness in Agency programs. Discussions between AID and BIFAD led to an exercise which produced a "Statement of Principles for Effective Participation of Colleges and Universities in International Development Activities" (Attachment B) prepared by the National Association of State Universities and Land Grant Colleges (NASULGC).

Also, following a request from the Agency, BIFAD, through NASULGC, has set up a Task Force to establish a set of Standards of Performance for use in evaluating the work of universities in the implementation of AID-funded projects. This will be transmitted when completed. The Board and its Staff stand ready to assist in the resolution of issues arising in the implementation of Title XII projects. I strongly urge missions to bring any such issues or problems to the attention of AID/W early on so that it may work with BIFAD Staff on corrective action. Problems must not be allowed to fester.

6. <u>AID/W Backstop</u> - Questions on the general interpretation and application of this Policy Directive should be addressed to S&T/RUR (Research and University Relations, formerly S&T/XII). Questions regarding BIFAD mechanisms and responsibilities (paragraph 3) should be addressed to the BIFAD Staff. BIFAD

and its Staff and S&T/RUR have participated in the development of the policies on which this Directive is based and will continue to consult in responding to questions on policy and procedures.

2 Attachments:
Attachment A - A Joint Resolution
Attachment B - Statement of Principles

S&T/RUR:CHBarker:dma:9/9/82:58929:W3003A

State 050845
October 20, 1987

HB 1, Part IV

(TM 1:41)

FROM: A/A/AID:JMORRIS

ESF CASH TRANSFER ASSISTANCE - AMPLIFIED POLICY GUIDANCE

Following is a revised and amplified A.I.D. Policy instruction regarding ESF cash transfers. It implements the statutory requirements regarding separate accounts for (a) dollars and (b) any local currency which the recipient government may be required to deposit pursuant to ESF cash transfer agreements. It applies only to ESF cash transfers and not other forms of disbursement under ESF assistance (CIPs, projects). Effective immediately, this guidance supersedes reference (a) in its entirety, as well as any other guidance on cash transfer separate accounts issued to date.

When using the term to characterize a mode of A.I.D. assistance, A.I.D. defines cash transfers as the furnishing of rapid-disbursing balance of payments assistance on a cash basis to a recipient in furtherance of United States national security, economic and developmental objectives. Specific purposes vary among recipient countries as set forth in documentation, usually a PAAD, accompanying the cash transfer request. Cash transfer assistance for balance of payments support purposes is to be distinguished from program sector assistance as characterized in ref (c), as well as contributions to international funds. Congress has traditionally recognized the unique and valuable characteristics of cash transfer assistance, and has explicitly recognized the distinction between the cash transfer and commodity assistance program modes. Various legislative requirements, such as cargo preference, normally applicable to other forms of assistance, e.g. CIPs, sector programs, and projects, have never applied to cash transfers. The FY 87 CR maintained this long standing rule when it established separate accounts by specifying that funds may be obligated and expended as cash transfers notwithstanding other provisions of law which are inconsistent with the cash transfer nature of such assistance. ESF cash transfer assistance agreements, therefore, continue to be exempt from the procurement regulations applicable to project assistance and commodity import programs which are inconsistent with the nature of the assistance. At the same time, both A.I.D. and the Congress are concerned about the potential for inappropriate use of foreign exchange provided under cash transfers.

In accordance with statutory provisions contained in the FY 1987 Continuing Resolution, all countries receiving cash transfer assistance in excess of dollars 5 million obligated after February 1, 1987, will be required to establish a separate account or accounts into which will be placed the dollar assistance and a separate account or accounts for deposits of local currency. The legal requirement for separate accounts is made applicable to FY 1988 by the Continuing Resolution. (Special instructions for dollar accountability in

the case of West and Central African monetary unions are included in ref (b) and are under review, as are Southern Africa rand and Eastern Caribbean currency union cases. Further guidance for cases such as these is being developed. Note also that if the cash transfer assistance agreement does not provide for local currency deposits, separate local currency account(s) are not required.) The House Appropriations Committee report accompanying the Continuing Resolution also directs that deposited local currency be trackable and not be commingled. The Senate Appropriations Committee report expresses concern over third country competition with U.S. exports with reference to the use of cash transfer dollars.

Disbursement of dollars shall be made by A.I.D. upon recipient's request after satisfaction of any conditions precedent. Recipients of cash transfers will be expected to account for the disposition of dollars after disbursement by A.I.D. In all cases, the dollar account into which the funds are deposited and from which the funds are released for agreed-upon uses must be separate, and the funds may not be commingled. Prior to the use of any dollars from a separate account, A.I.D. and the recipient will agree on the general uses of the dollars and such uses wherever possible will be identified in the cash transfer assistance agreement. Documentation pursuant to the agreement may amplify requirements, but preferably should not substitute for an understanding on uses in the principal agreement. Agreements should also reflect that, as a matter of A.I.D. policy, dollar or local currency separate accounts are to be interest-bearing, to the extent such accounts are permitted under host country law or regulation and, in the case of local currency accounts, do not undermine internationally-supported stabilization agreements or sound monetary policy. Any interest earned on dollar or local currency accounts must be programmed and used as if it were principal.

The FAA and FY 87 appropriations bill and their legislative history recognize the distinction between the cash transfer assistance mode and other forms of ESF assistance, and make it clear that statutory provisions that apply to project aid and CIP assistance (eg. cargo preference, strict source/origin/componentry rules, the Competition in Contracting Act, and so on) do not apply to cash transfer aid, since they are inconsistent with the cash transfer nature of the assistance. However, judgements do have to be made as to which uses of dollars in the separate account should be permitted and specifically approved in the agreement. Appropriate procedures for specifying and tracking uses of dollars released from the separate account, and associated accountability arrangements, will vary, depending upon the nature of the assistance, the recipient's foreign exchange and import regimes, the integrity of its accounting systems, the political environment, and other factors. (See also paragraph 6 below.) The basic spectrum of foreign exchange and accountability regimes is essentially characterized in the following subparagraphs. A.I.D.'s overall preference is for U.S. import financing with ESF cash transfer dollars, whether through direct disbursement, reimbursement or auction arrangements. Debt service is an alternative, as is a blending of import financing and debt service in some instances. In concert with the relevant regional bureau, preferably during the PAAD approval process, missions should review these regimes and make a judgement as to which

most closely reflects the situation in their respective host countries, and then proceed to tailor dollar use and accountability arrangements to suit the individual country context within the parameters of the basic regimes provided. Note that each of the approaches requires adequate monitoring and audit rights agreed to by the recipient, a monitoring commitment by A.I.D. staff, periodic substantive reporting by the recipient, and dollar redeposit or other remedial action in cases of noncompliance with the agreement on uses.

(a) In those recipient countries where imports, foreign exchange allocations, and, presumably, exchange rates are strictly controlled by government or monetary authorities, and where substantial liberalization of such controls is not underway or anticipated, A.I.D. prefers that cash transfer dollars be used to finance imports either directly or on a reimbursable basis. In the event this imports financing arrangement is used:

(i) Priority should be given to imports from the U.S., with imports permitted by the mission from other sources on a case by case basis.

(ii) Dollar use should normally be limited to raw materials, intermediate and capital goods, and essential consumer goods imports as approved by the mission, and dollars must not be used to finance imports, such as military or police equipment, that A.I.D. could not procure directly.

(iii) Where needed, the import approval and verification process should include a price checking arrangement to assure that U.S. funds are not being used to effect capital flight through overinvoicing.

(iv) Reimbursements must be for specific import transactions and should be part of a timely sequence for completing such transactions. This type of reimbursement is to be distinguished from ex post attribution made after release of dollars from the separate accounts, a procedure employed in some ESF recipient countries.

This approach approximates the one currently used in the El Salvador program and may be applicable to other cash transfer recipients with similar foreign exchange/imports control arrangements where cash transfers are a substantial component of available foreign exchange. Implementation procedures developed for the El Salvador program may be useful as guidance for other missions, and are available upon request.

(b) In those recipient countries where substantial liberalization of foreign exchange and imports controls is underway or is at a relatively advanced stage of negotiation, and A.I.D. wishes to avoid impeding or wishes to support host country moves toward open market forces, use of an auction or auction-like mechanism to disburse cash transfer dollars may be appropriate. Many auction systems have been developed as part of a successful multi-donor dialogue with the host government, and are supported by those donors and general foreign exchange reserves of the recipient government. A.I.D. cash transfer dollars can be used to support an auction or auction-like system if:

(i) Cash transfer dollars can remain segregated until utilized and can be tracked to identifiable import transactions.

(ii) Auction procedures permit the implementing authority to ensure that A.I.D. cash transfer dollars are not used for military, paramilitary, or luxury imports. This negative list should be at least as limiting as the A.I.D. Handbook 1, Supplement B, Chapter 4D listing of ineligible commodities (i.e., military equipment, surveillance equipment, police and law enforcement commodities and services, abortion equipment and services, luxury goods and gambling equipment and weather modification equipment).

(iii) The recipient government agrees to use cash transfer dollars, following each individual auction, for financing of U.S. import transactions approved at the auction as first preference and other Free World transactions as second preference. Preferential financing of imports will not be used, and is not meant to, redirect the allocation of foreign exchange to any specific types or sources of imports in a manner inconsistent with the market-determined nature of the foreign exchange auction.

Because of the above provisions, totally unrestricted auction systems are not appropriate modes for the use of cash transfer dollars. Any auctions of A.I.D. cash transfer dollars must permit the use of separate accounts and provide for trackability.

(c) In certain instances where recipient country debt service is a significant barrier to growth and development, or where institutional arrangements may preclude the traceable use of cash transfer dollars otherwise, cash transfer assistance may be used to effect debt service payments. The use of cash transfer dollars for debt service may be particularly justified when such servicing will have a significant effect on leveraging additional flows of development finance. However, A.I.D. does not consider appropriate the use of cash transfer dollars for servicing of certain categories of debt which might be perceived as having a non-developmental character. Therefore, debt service is permitted subject to the following provisos:

(i) Cash transfer dollars may not be used to cover the service of loans or credits that originally financed military imports or other military requirements, e.g. FMS debt, unless, as determined by the Administrator, such use of cash transfers in individual country cases is recognized by statute as amplified by legislative history as valid.

(ii) Service of debt known to have been incurred to finance other (non-military) items that A.I.D. could not finance because of specific legal prohibitions, e.g., abortion equipment, is precluded. This prohibition has particular application to currently or recently contracted debt where relevant information is or should be readily available to the mission and where it might be inferred that cash transfer financing of debt service could have been anticipated. It is not intended to require a review of the documents related to the loans to be serviced, a requirement which would not be administratively feasible.

(iii) Consistent with the agreed restructuring arrangements and payments scheduling of the Paris and London Clubs, where applicable, service of debt owed to the U.S. Government (exclusive of FMS debt) shall have first priority.

(iv) Cash transfer dollars may be used for servicing of debt owed to multilateral development banks and the IMF, subject to prior concurrence of the appropriate regional assistant administrator.

(v) Servicing of debt other than that covered in subparagraphs (i) through (iv) may be approved on an exceptional, case by case basis by the appropriate regional assistant administrator in consultation with PPC.

(d) In the case of the relatively-advanced ESF recipient countries which have essentially market-determined foreign exchange allocation systems, liberal import regimes, and well-established standards of financial accountability, separate accounts and trackability are still required, but A.I.D. should avoid any accountability procedures which would have the effect of reimposing foreign exchange or import controls. Examples of such countries include the NATO allies which afford the United States with base or access rights and developing countries which have largely liberalized policies and institutions around market-oriented principles. Procedures used, determined on a case by case basis, should be simplified and de minimis but still permit segregation and tracking of dollars; use of cash transfer dollars for debt service or large scale import transactions would usually be appropriate in these instances. Simplified monitoring procedures are also appropriate in those countries where A.I.D. does not have a development presence.

The cash transfer assistance agreement should provide appropriate audit and redeposit provisions which will sufficiently protect the agency. The agreement should require a redeposit to the separate account of funds applied to a disallowed use, thus permitting such funds to be reprogrammed for a permitted use. Recipients will be required to periodically report on the disposition of dollar funds. Typically, the report should attest that financial documentation, books and records covering the use of dollar funds are being maintained or caused to be maintained, in accordance with generally accepted accounting principles and practices consistently applied, and are available for inspection by A.I.D. or any of its authorized representatives at all times as A.I.D. may reasonably require for a period of three (3) years after the date of last disbursement by A.I.D. under the cash transfer. Financial records shall be suitable, at a minimum, to document the withdrawal and disposition of dollar funds from the separate account and their tracking to final acceptable uses. For example, this may include central bank and commercial bank documents demonstrating that A.I.D. funds were transferred from a host country central bank-controlled account to an account identified for external debt repayment, and that debt service payments actually were made with the transferred dollars.

Local currency deposits must be used in accordance with FAA Sections 531(d) and 609. Section 531(d) requires that at least 50 percent of local currency generated by ESF CIPs or other program assistance support activities

consistent with Section 103-106 objectives. Section 609 requires that local currencies associated with ESF grant CIPs and--by the provisions of the FY 87 CR--cash transfer assistance be used to carry out the purposes for which new funds authorized by the FAA would themselves be available.

The extent to which Missions must monitor the actual uses of the local currency will depend on the agreement with the recipient government.

(a) If A.I.D. should choose to directly associate jointly programmed local currency with host government projects or private sector activities, the mission should have reasonable assurance that the activities have been designed in accordance with sound technical, financial, and environmental practices, that implementation and monitoring capabilities of the implementing entities are adequate, and that periodic audits of relevant activities will be undertaken. Projects that are funded and monitored by A.I.D. would provide such evidence. Projects funded and monitored by other donors also usually provide such assurances; the same applies to projects undertaken by strong, highly respected host government or private sector institutions. Otherwise, missions should be prepared to take a more active role in implementation oversight in addition to reviewing the project documentation and host government procedures prior to approval of funding for the activity. If and when subsequent allocations of jointly programmed local currency for project level activities are being considered, the mission should take this opportunity to review progress in moving toward project completion. Periodic reporting by the host government should be required, and field visits may be useful in monitoring.

(b) If A.I.D. and the recipient government program the local currency for more general purposes, for example, an agreement that local currency will be used to meet development budget requirements of, say, the Ministry of Agriculture, the role of A.I.D. may be limited to ensuring that documentation exists demonstrating that the local currency indeed was transferred to the Ministry's development account. The mission need not trace the funds to specific budgetary or end-use items since A.I.D.'s development goal is a level of overall financial support to a program or institution; indeed, once transferred from a separate account to a program or institution, the funds will generally have been combined with other budgetary funds and will not be traceable. However, the mission should generally be satisfied on the quality of overall program activities and the technical and administrative capability of the implementing entity or entities to carry out the program. Furthermore, periodic reports on budgetary allocations should be required over the period of the agreement to enable the mission to assess compliance with agreed priorities. Finally, the mission should assure itself post hoc that the government has accorded an appropriate emphasis to priority programs. This can then be used as a basis for making judgements about future local currency allocation decisions.

To reiterate, A.I.D.'s retention of monitoring and approval rights, as well as the right to receive reports, is directly related to the programming burden that A.I.D. assumes for itself in the agreement describing how local currency

will be used. Retention of these rights in the agreement should be consistent, then, with the agreed upon programming responsibilities of A.I.D. but, at a minimum, should be adequate to ensure that A.I.D. with timely access can take an independent look at supporting documentation to verify that the agreement on uses of local currency has not been violated.

As necessary, regional bureaus will follow up with country-by-country guidance. A.I.D./W as a whole will also continue to evaluate the implementation of this guidance to ensure clarity, consistency, and consonance with legislative intent, and will amend or update guidance as circumstances warrant. Missions are invited to provide comments on the content of this guidance. A.I.D./W will respond expeditiously to inquiries.

Attachment A

A JOINT RESOLUTION OF AID AND THE BIFAD

Title XII of the Foreign Assistance Act in the 1980's: Science and Technology in Support of AID's Programs

Whereas: U.S. Agricultural universities have assisted AID, and its predecessor agencies, to carry out U.S. assistance programs these past 30 years in developing countries around the globe; and

Whereas: U.S. agricultural university involvement resulted in training significant numbers of people in developing countries, and building and strengthening local institutional capacity which clearly contributed to the achievement of "graduate" status in some former AID Countries; and

Whereas: The Title XII Amendment in late 1975 reaffirmed and enhanced the role of universities in AID's agricultural and rural development programs, and gave greater Congressional mandate to their involvement; and

Whereas: The Title XII Amendment changed the mode of university involvement in AID programs to one of greater collaboration and partnership, in a longer term setting; and

Whereas: The U.S. Agricultural universities provide a strong human and institutional resource to support, advise and assist developing countries in planning and executing selected elements of their agriculture and rural development programs.

Therefore, be it resolved and agreed by AID and BIFAD that:

1. AID recognizes that U.S. universities are a special resource and intends to make every effort to involve and utilize them fully and completely in accord with the provisions of the Title XII Amendment;

2. BIFAD recognizes that its primary mission is to help AID to mobilize and utilize the faculty and institutional resources of eligible universities, and to advise and assist AID to develop and implement the components of the Title XII program;

3. Both AID and BIFAD are committed to taking prompt action necessary to carry out fully the mandate of Title XII in terms of using the resources of U.S. universities in achieving developing country agricultural and rural development and nutrition goals.

M. Peter McPherson
Administrator, Agency for International Development

May 20, 81
Date

Clifton R. Wharton, Jr.
Chairman, Board for International Food and Agricultural Development

May 26, 1981
Date

STATEMENT OF PRINCIPLES FOR EFFECTIVE PARTICIPATION OF COLLEGES AND UNIVERSITIES IN INTERNATIONAL DEVELOPMENT ACTIVITIES*

There has been a growing awareness in the U.S. in recent years of global interdependence, and a recognition of the need for greater cooperation between the U.S. government and the American higher education community in international development work. This perspective is fully in keeping with the community's long standing sensitivity to the broad needs of society, and with a developed attitude of enlightened self interest which dictates that institutional sensitivity and commitment extend to the needs of societies of other nations, particularly the less developed.

Colleges and universities across the nation are seeking ways of strengthening their capacities to participate, particularly in international development assistance, and to do so with optimal effectiveness and accountability. The purpose of this statement is to set forth some basic principles of good practice for such participation.

Universities and colleges engaged in international development contracts should be expected to perform professionally in ways most likely to lead to success abroad, in keeping with the acknowledged importance as well as the difficulty and complexity of the task. International development contracting cannot be taken lightly. It calls for a special effort and attention to certain policies and practices which are in addition to those followed for successful domestic programs.

Recognizing the healthy diversity among U.S. colleges and universities and the considerable variation from one international contract project to another, there are certain basic principles of good practice which experience supports as being critically important. Each principle is important. Lack of attention to one or more would show lack of determination or seriousness of purpose, and would not auger well for the institution's performance in international project relations. Yet, each might be pursued differently on different campuses and in different contractural arrangements.

The following are considered necessary factors to provide a basis for effective institutional participation in international developmental activities:

1. Evidence that the administration and faculty of the institution are <u>committed</u> to international development work.

2. Adequate internal administrative and faculty review procedures to assure that the choice of overseas project opportunities is consistent with the institution's mission, commitment and competencies.

3. Availability of requisite personnel resources to assure effective, continuous institutional involvement in chosen projects.

---

* Adopted by the NASULGC Executive Committee, Feb. 13, 1979

4. Personnel policies and practices which assure that high quality, professionally active faculty members have incentives to become involved in developmental activities.

5. Appropriate administrative practices and policies to facilitate the provision of timely logistical support and professional services for individuals and groups abroad for varying time periods and in diverse locations.

6. Concerted effort, in the planning process, to gain a full understanding of the unique cultural variations applicable to each project, provisions for adequate cultural orientation for project personnel, including language when appropriate, and due consideration of the sensitivity of individuals to cultural variations in the selection of project personnel.

7. Established procedures within the institution for seriously evaluating its international work so that projects can be monitored on a continuous basis and performance corrected promptly when necessary.

8. Deliberate and sustained effort to assure that the benefits of international development experience are integrated into both ongoing campus programs (e.g. curriculum, research, individual courses) and relationships with institutions abroad.

9. Policies and practices recognizing not only the training component needs of development projects, but also the concomitant special requirements related to matriculation, advising, programming, and support services needed to provide appropriate training for foreign students, particularly participant trainees.

February, 1979

V SPECIAL TOPICS

PART I - INTRODUCTION

VI. CASE STUDIES

BANGLADESH/FAMILY PLANNING SERVICES
SOCIAL MARKETING SUB-PROJECT

Background and Description: With over 96 million people at the start of 1984, Bangladesh is the most densely populated agrarian country in the world (about 1700 persons per square mile). Allowed to continue growing unchecked at its current annual growth rate of 2.4 percent, the population will swell to 140 million at the century's end and 196 million thirty years from now. If the country's resource and production bases had the potential for even faster longterm growth, the population explosion would not be as threatening to the prospects of increases in per capita production and consumption but Bangladesh is primarily an agricultural society, and the agricultural land base already is an inadequate source of employment for the rural population. The poor masses are ill-equipped for modern non-farm employment. Also, education and social services are hard pressed to keep up with population growth.

The key to solving this problem, of course, is a reduction in human fertility through a quantum increase in birth control practices. Demographers estimate that contraceptive prevalence will have to increase from the currency estimated 19 percent to 65 percent for Bangladesh's population to stabilize.

Population programs began in what was then East Pakiskan in the 1960's, mostly channelled through the ministry of health, but comprising activities in demography and statistics. The early 1970's saw the advent of more action-oriented programs that offered information and modern contraception through various channels. One of these was the effort in social marketing, which is a concept first used in India in the late 1960's. The Indian experiment, which has evolved into the largest social marketing project in the world, demonstrated that there was a great demand for modern contraceptives that could be made available nationwide at prices affordable by the majority. The only way to make them affordable, however, was to subsidize the price. Hence the term social marketing: using the marketplace to distribute a consumable for the social good. although the program as a whole operates at a financial loss, local wholesalers and retailers make normal profits, and modern principles of marketing are used to maximize cost effectiveness and efficiency in the system.

In 1974, a centrally funded project (S&T/POP) was initiated in order to test this concept in two countries. Bangladesh was one of the countries selected. Population services international (PSI), a non-profit corporation based in New York, was contracted to implement the project in Bangladesh. One project advisor was assigned to Dhaka to hire staff and establish a viable relationship with the government, which was a time consuming but necessary quid pro quo for project success.

Once government approval was received, project management researched and pretested brand names and packaging for the two products to be sold initially, a condom and an oral contraceptive. The raja logo was selected for the condom and maya for the pill. An advertising firm was contracted to develop and pretest press, radio and television advertising. National distribution was done by a major pharmaceutical house in Banglades, Fisons, which received both products at a subsidized price. Local wholesalers and retailers resold the product at normal market profit margins. Sales began and during the first year, over 10 million condoms were sold, along with some 1,500,000 cycles of orals.

Since the initial sales another oral contraceptive (low dose) and another condom (panther) have been added to the product line, as well as a foaming tablet barrier product (joy). In the last several years, the SMP has been marketing a safe delivery kit, intended for use by traditional midwives.

Sales have now grown to over 100 million condoms and 2.5 million cycles of pills annually, as well as 5 million foaming tablets. These are sufficient quantities of contraceptives to protect well over 1 million couples for one year. The cost (net of sales income) to deliver these products, not including the procurement cost of the products themselves, is dols. 1.66 per couple per year, one of the most cost effective family planning projects AID funds.

In the interest of increasing cost effectiveness, the SMP conducted informal price elasticity of demand studies in 1982. The price for Raja was increased from 40 paisa for a packet of three to 60 paisa. For singles sold from a retailer box of 100 the price was increased from 13.3 paisa to 15 paisa per piece. (The retailer box of 100, introduced in 1981, has resulted in substantial savings in packaging costs). The informal tests showed no reduction in sales, so the price increases were put into effect nationwide. Sales increases for Raja have averaged about 25 percent per annum over the past eight years. In 1983, a new brand of condom (panther) was added to the product line at 50 paisa per piece, a quote up-market unquote, high-priced brand.

Sales of Panther have grown to about 4 million condoms per year, but growth in sales already has begun to fall short of Raja sales increases. In 1984, it is planned to add a third condom brand, quote Majestic unquote, which will be given a price positioned between Raja and Panther.

From the conception of the project, the hypothesis has been that the private marketplace can be highly efficient in the delivery of these health related services. In fact, the social marketing project (SMP) now delivers 68 percent of all condoms used in Bangladesh and 21 percent of all oral contraceptives, demonstrating that the private sector is capable of assuming a major role in nationwide distribution of contraceptives. Many consumers have chosen to pay a price for contraceptives readily available from private wholesalers rather than rely on government programs to supply the same contraceptive free. At the same time, it should be noted that SMP distribution is not able to serve the poorest of the poor.

Point of Policy: This subproject illustrates certain aspects of AID's policy on private enterprise development. It conforms to the policy stated in the foreign assistance act that quote United States cooperation in development should be carried out to the maximum extent possible through the private sector...unquote. More specifically, it exemplifies one of the four priority sectors identified in the AID policy paper on private enterprise development, that of using privately operated service enterprises as alternatives to public delivery systems.

Strictly speaking, the social marketing project, taken as a whole, may not be considered a private enterprise, because it is not profit making. However, it is organized and operates independently of the government, it uses modern

management and sales techniques employed by private businesses, and at the end of its distribution chain it utilizes local wholesalers and retailers, all of whom do market contraceptives for profit. The SMP offers an instructive example of the use of the marketplace to promote social welfare.

One critically important element in the success of this project is the distance it has been able to maintain from the government.

The secretary of the ministry of health and population control chairs the governing council of the project which provides only policy guidance. Day-to-day operations are managed by experienced marketing professionals, who are paid salaries competitive with the private sector and whose dedication to continuous improvement in sales techniques, advertising, management and product introductions has led to the ultimate success of this effort.

Mission Comment: Since the beginning, this subproject has met with varying amounts of resistance from the government. The creation of the governing council was a key step in getting that approval and has resulted in stronger support in the long term. There has been several attempts to extend the domain of the governing council to include selection of personnel, but these attempts were recognized to be harmful and were never achieved. An important facet for any social marketing effort is to ensure that personnel are marketing professionals, not former civil servants or other persons lacking the needed skills.

One noteworthy departure from the original design of the project has been the change to an in-house distribution system. Given the low prices at which SMP contraceptives are sold, the normal percentage markups for wholesale distributors provided insufficient profits for fisons, the original distributor, to supply SMP commodities nationwide. SMP was faced with a choice between increasing retail prices to provide a greater profit for fisons or taking over (and subsidizing) the initial stage in the national distribution system. SMP chose the latter course on the assumption that the financial costs of a subsidized distribution system were far exceeded by the social benefits of the higher contraceptive use attributable to lower retail prices.

The SMP sales force has aggressively penetrated rural markets. It now has eight area sales managers and ninety sales personnel. These salesmen have linked SMP with local private wholesalers who now supply village retailers with pills and condoms as well as their traditional consumer staples like cigarettes, matches, salt, etc. There are now over 100,000 retailers and an estimated 45,000 additional outlets for SMP contraceptives through itinerant sales people (Pan Wallahs).

DOMINICAN REPUBLIC RURAL ROADS MAINTENANCE AND REHABILITATION

Background and Description: The Dominican Republic [DR] is a relatively small nation of about 5.6 million people with an area of about 49,000 square kilometers [Kms]. Development of much of the rich agricultural potential of the DR has been hampered by the lack of adequate surface transportation. Effort to construct a national road network did not begin in earnest until after WWII, and still continues today. Presently, there are approximately 5,500 Kms of paved primary roads, 12,000 Kms of rural feeder roads and an unknown quantity of trails.

The condition of rural roads, particularly those which are not paved, was affected adversely by a combination of popular attitudes, Government of the Dominican Republic [GODR] policies, and the Dominican terrain and climate. Four almost parallel mountain ranges extend in a northwesterly direction in the western part of the country, while a single range in the east runs roughly east to west. Heavy rainfall in the late spring and fall causes serious erosion and frequent flooding in most of the country.

Longstanding patterns of personal influence [personalizing] and paternalism have contributed to the development of dependency patterns in the relationships of poorer, particularly rural, groups toward the government. This has been coupled with a highly centralized government structure, resulting in the provision of public services based upon personal or political favoritism. Thus, the emphasis of the GODR was traditionally oriented toward the construction of highly visible rural roads without reference to the economic efficiency of the investment. Maintenance was not a high priority, particularly of roads built by previous administrations. Consequently, a cycle developed of construction, deterioration due to lack of maintenance, and then expensive rehabilitation of the same road.

An analysis of this system showed it to have high social, economic and financial costs to the GODR. In many parts of the country, public transportation was erratic or non-existent because of the condition of the roads, reducing the effectiveness of the health delivery system, food distribution, and public communication. Costs to producers increased for agricultural inputs at the same time that losses were incurred from unreliable, expensive transportation of surplus to markets. Under the system in use prior to the project, which included essentially no maintenance, a major rehabilitation of rural roads was carried out every 3 to 5 years at a cost of approximately 17,500 pesos per Km.

Frequently, roads were not rehabilitated as required. In some cases, this resulted from the simple fact that the Directorate General of Rural Roads [DGCV], which was administratively centralized with little inspection of rural roads, did not know that a road needed rehabilitation. But in many other cases road rehabilitation and new construction was directly related to political spoils. Because the roads themselves were highly visible symbols of central government largesse, there was a definite political incentive to maintain the centralized, politically motivated system on the part of all the political parties. This view of the system held until it was demonstrated that, with technological and institutional change, a change of policy was possible which would benefit many more rural areas.

The rural roads rehabilitation and maintenance project was designed to develop the capacity of the DGCV, which is a dependency of the Secretariat of State for Public Works and Communications [SEOPC], to rehabilitate and maintain rural roads at the national, regional and local community levels. At the national level, the DGCV has the following responsibilities: national administration; major purchasing, accounting and budgeting; planning of the road network and keeping a road inventory; establishing design standard selection criteria, and carrying out materials research; carrying out socio-economic studies; developing appropriate technologies, training methods and materials, and methods for community organization.

The bulk of project operations takes place at the regional level, and it is at this level that most of the strengthening takes place. Seven regional centers were constructed, staffs of approximately 20 full-time employees were trained, and complete equipment for road rehabilitation and maintenance was purchased, including spare parts. Regional centers carry out rehabilitation of rural roads, as well as twice annual quote passovers unquote in support of local maintenance workers. Each center also has a training coordinator to work with regional technicians and train local committees and maintenance workers.

The backbone of the maintenance system, and the project, is formed by the 700 local level community organizations which are responsible for the day-to-day maintenance of the rural roads. The local organizations, selected on the basis of their capacity and desire to maintain the road, were all functioning prior to the project. Most of these groups were either farmer cooperatives, village committees, or ad hoc work exchange groups. Thus, the

project does not create new entities, but takes advantage of community participation within each organization a road maintenance committee is formed which selects an individual for approximately each 5 Kms of road.

This person becomes a full-time employee of DGCV, and is responsible for his section of road. Both the individual workers and the committee are given several days of training in maintenance, and then they are issued hand tools. In addition to the daily maintenance by the road workers, the committee and community assist in the bi-annual quote passovers unquote. The quote passover unquote involves regional office heavy equipment, equipment operators and engineers. Each road receives grading, shaping and compacting during this process, and material such as gravel or culvert pipe are delivered by the regional office, if needed. With local volunteers performing the hand labor, about 3 Kms can be completed per day.

This system heightens the community's awareness of the value of the rural road and makes greater use of the unskilled and semi-skilled labor, almost always in surplus in rural DR.

During the final stages of the design of this project, the DR was struck by an extremely destructive hurricane, increasing still further the need for rehabilitation of rural roads. At this time, the 5 million dollar grant was added to the 10 million dollar project loan, and private sector contractors were hired to supplement the rehabilitation of rural roads by the DGCV. Subsequent analysis of the costs and timeliness of rehabilitation work, as well as the quality of the rehabilitation, showed that generally the private sector provided a better service at a lower price in less time than could the DGCV. As a result, all rural road rehabilitation is now contracted to the private sector, leaving the DGCV to concentrate on maintenance and thus establishing new policy for the GODR.

Point of Policy: The rural roads maintenance and rehabilitation project addresses practically every critical area of concern in institutional development as detailed in the policy paper.

A. Analysis and reform of the policy environment: Prior to the initiation of the rural roads rehabilitation and maintenance project, an extensive dialogue between

USAID/DR and the GODR established first the need for new policy regarding the upkeep of this critical infrastructure. Once the problems of the previous policies were understood, the DGCV entered the project with a flexible, analytical approach to the provision of service to rural areas. Rural roads in need of rehabilitation were ranked using cost-benefit analysis and repaired according to these criteria. This new openness to policy alternatives then permitted the further shift in policy of private sector contracts for rehabilitation of rural roads.

B. Consideration and introduction of organizational alternatives: Two major alternative modes of operation and concomittant organizational changes were introduced under this project. First was the establishment of regional level offices as actual operational units. Prior to the project intervention, these offices did not exist and the regions were simply designations vaguely defined on the directorate's maps. Second, the inclusion of the local organizations in the maintenance of rural roads moved toward a more labor-intensive operation, which lowered DGCV's costs and at the same time increased the perceived value of the road in the eyes of its beneficiaries, while providing ongoing repair capability.

C. Development of institutional learning capacity: Under the project with technical assistance, DGCV began to develop the ability to gather and analyze data about the rural road network. It was through a rural road inventory, for example, that the extent of the network was found to be double the 5,000 to 6,000 Kms believed to be under DGCV's stewardship at the beginning of the project. The Directorate now carries out research on road materials, and construction and maintenance techniques, and selects roads for rehabilitation based on the social and economic returns of rehabilitation.

D. Analyses and improvement of institutional linkages/ coordination: As mentioned earlier, the establishment of linkages with private sector contractors, principally for rehabilitation work, and with local community groups for maintenance of rural roads have greatly increased the cost-effectiveness of the DGCV.

E. Improvement of management systems: The most significant improvement in management systems is the shift from no maintenance at all prior to the project, to the present one using regular, intensive maintenance.

The previous system required a major rehabilitation at a cost of 17,500 pesos per Km once every 3 to 5 years. The system implemented under the project is based upon an intensive maintenance program which makes rehabilitation necessary only every 10 years. Annual maintenance costs are 850 pesos per Km, plus the rural roads themselves are almost always in better condition.

One of the most favorably received improvements under the project has been the control systems established for maintenance and repair of DGCV vehicles, including spare parts inventory systems. These were implemented at the regional levels and supported with fully equipped garages and parts stocks, as well as the authority to purchase replacement parts at the regional level. These systems would not have functioned well without the extensive training of all personnel from supervisor to mechanic to operator/driver.

F. Provision of skills and training: Virtually everyone with DGCV received highly specific, job-related training under the project, from the central office to the community level road maintenance worker. Training will continue after the project; the DGCV now has the capacity to identify training needs and satisfy them, either with in-house expertise or through outside technical assistance.

G. Capitalizing upon local capabilities and participation: The reversal of attitudes, from quote the government's road unquote to quote the community's road unquote, was critical to the success of the project and was recognized as such from the early stages of project design. The use of extant community organizations rather than newly created ones built upon bottom-up participation. Individuals selected as local DGCV road workers were given not just a full-time job, but also considerable responsibility and a potential source of pride; the worker's sections of roads were identified by signs with the worker's name.

H. The role of institutions in the development of supporting infrastructure: This project exemplifies the need for a proper balance between human resources development and capital assistance in institutional development needed for physical infrastructure support. Both the well-equipped regional centers and local community hand tools probably would have been misused or not used at all had DGCV personnel not been adequately

trained. Conversely, without the additional tools, the trained personnel would have been frustrated with their new skill. Together they bring a new dimension to what was viewed before as strictly physical infrastructure.

Mission Comment: Obviously, USAID/DR considers the rural roads rehabilitation and maintenance project to be successful, worthy of expansion, and an exemplary institutional development effort. It must be pointed out, however, that the development of the project and its initial stages of implementation required exceptional effort to bring about these dramatic changes. Much of the credit must go to the USAID Direct-Hire engineer and the excellent FSN engineers who nurtured first the concept and then the institution. At the same time, this project has several other advantages which should be mentioned. First, it addressed a well-defined and quantifiable need, which gave great strength to negotiation with the GODR prior to project design. Second, the project established an essentially new institution which was highly decentralized with great regional autonomy. This avoided much of the resistance which generally undercuts the effectiveness of institution building which requires major organization and/or decentralization efforts. Finally, this project came on-line at a time of great need and bureaucratic confusion in the DR, in the wake of hurricanes David and Fredrick. Therefore, the sense of urgency was heightened and the willingness to experiment enhanced, which gave early project success, added visibility and value in what is certainly an unglamorous pursuit, rural road maintenance.

Indonesia Provincial Area Development

Background and Description: Unlike most countries, Indonesia has a variety of credit programs to support petty traders and small entrepreneurs. Flush with oil revenues through much of the seventies, the Government heavily capitalized these credit programs and place high priority on their disbursement of funds. More austere conditions in the eighties have forced the Government to adopt new priorities, giving greatest emphasis to efficiency and financial viability for the credit programs. Central Java's Badan Kredit Kecamatan (BKK) Program has pioneered many of the efforts associated with promoting the new objectives of greater efficiency and financial solvency and serves as a model for strengthening rural credit programs in Indonesia. USAID/Jakarta, through its Provincial Development Program, has played an instrumental role in the development of the BKK program and is directly involved in applying the lessons from this experience to other rural credit activities.

The two USAID-supported Provincial Area Development Programs (PDP I & PDP II) were initiated in 1977 and 1978 as part of the Government of Indonesia (GOI) revenue sharing program. These programs, referred to in Indonesia as the Inpres Programs, date back to 1969 and the inauguration of the first Five Year Plan. Early efforts of Inpres primarily focused on rehabilitating rural infrastructure. PDP, in contrast, provides block grants to provinces for locally planned and implemented projects in agriculture, small industry and credit.

The long range goal of PDP is to increase the productivity of rural people. The chief instrument for achieving this goal is the decentralization of funding and authority for development programs supported by PDP to the planning boards (BAPPEDA) and in turn to technical agencies at the province and district level. USAID and its counterparts in the GOI do not view PDP strictly in terms of a formal program but more as a means for testing locally generated ideas for development programs which, if proven successful, could serve as prototypes for larger scale activities beyond the scope of PDP itself. The BKK program of central Java is an excellent illustration of this process.

PDP support of the BKK program in central Java is directly related to PDP's emphasis on identifying local needs and supporting local programs which respond to those needs. Initial studies of rural poverty in this province, the most densely populated in all of Indonesia, indicated that a large percentage of the people no longer earned most of their income from agriculture. Instead, diverse economic activities such as trading, handicrafts, food preparation and retailing provided the main source of household income. This ability to engage in different activities as the seasom and the micro-economic situation changes provides a degree of economic security for the households as they constantly shift labor and capital to the activity giying the highest return. At the same time, the absence of a formal credit institution responsive to the needs of this clientele was identified as an important constraint in enabling households to shift rapidly from one economic activity to another or to expand existing operations.

Badan Kredit Kecamatan (BKK)

PDP efforts to adress the above problem identified the BKK Program, with its average loan size of under U.S. Dollars 50 and emphasis on the creation of village posts to reduce the transaction costs of the borrowers, as the most appropriate institution to meet this need. The BKK Program, launched in 1970, was to provide small, short-term loans to rural families for off-farm productive purposes. The BKK Program, from its inception adopted a very innovative approach to rural credit and in designing the program an explicit effort was made to blend the speed, ease, convenience and reliability of informal credit systems with the lower rates and profitability of the commercial banks.

To encourage and assist the growth of this hybrid credit program, the planners combined local autonomy with a system of political and administrative accountability. Thus, each BKK unit is an independent credit body that is locally administered and financially autonomous. At the same time, it has been incorporated into the local government structure, with the Governor of Central Java presiding over the program and operational responsibilities delegated to the sub-district chiefs. An important advantage resulting from this strategy is that the BKK units were able to rely upon character references from local officials for loan eligibility rather than on the availability of collateral or lengthy staff analyses of proposed enterprises. The political accountability built into the program was strengthened further by assigning the provincial development bank (BPD) overall responsibility for the technical supervision of the program. The BPD's effective execution of its technical supervision mandate to a great extent is the cornerstone upon which the successes of the BKK Program have been built.

Several additional innovations were introduced into the day-to-day operations of the BKK units. In an effort to reduce risk, initial loans to new borrowers are quite small with the possibility for repeat loans with a higher credit ceiling a primary incentive for full and timely repayment. Secondly, village posts have been established by BKKs to increase coverage and to reduce borrower transaction costs. Thirdly, quarterly bonuses based on the unit's performance are issued to BKK employees to enable them to share in the profits of their enterprise. Lastly, interest rates charged by the BKK were not subsidized and covered expenses including the cost of funds.

The BKK Program was capitalized in 1972 with a RP 200 million (Dollars 476,190) loan from the Central Java Provincial Government, through the BPD, to the BKK. Individual BKK units received a three-year loan of RP 1 million (Dollars 2381) at 1 per cent interest per month with a one-year grace period on principal repayment. The interest charge was to cover BPD supervisory expenses during the three-year term. BKK units, in turn, were authorized to lend money to clients at a monthly rate of 2-5 per cent depending on the length of the repayment period. All loan payments were to be in equal amounts with interest due repaid before any principal installments.

In the initial years of the BKK Program, greatest emphasis was given to establishing BKK units and to rapid disbusrement of loan funds. Within a short timespan, the BKK Program demonstrated its ability to meet these objectives. Only four years after its inception, the program approached universal coverage with units in 486 of Central Java's 492 sub-districts. Growth in terms of total funds loaned was equally impressive, increasing from RP 442 million in 1972 to RP 2.6 billion in 1976.

Other indicators of program performance were not so promising, however. The number of loans issued in 1972 totalled about 120,000. This figure tripled (to 370,000) in two years as new BKKs were established. However, by 1976 total loans fell to 300,000 and in 1978 to 212,000. Loan turnovers dropped from a high of 3.31 to 2.00 during this same time period. Clearly, the early momentum generated by the initial capital infusion and by BPD technical supervision was flagging. A survey conducted in 1978 indicated that one-third of the BKK units were either closed of continuing at very low operating levels. Serious consideration was being given to abandoning the effort. It was at this point that USAID/Jakarta, through its PDP Project, became involved with the BKK Program. Within a few short years, the BKK Program had regained its early monentum and now serves as a model for rural credit systems.

Point of Policy: The greatest challenge facing the Indonesian financial sector during this decade is the efficient mobilization and utilization of domestic resources. This challenge is most keen in the rural areas where the need for capital to support enterprise development is felt most severely. A major constraint to developing the financial support structure in rural areas is the shortage of institutions which can provide a reliable and reasonably priced source of credit.

The BKK program in Central Java has demonstrated that a rural financial institution that extends down to the village can be economically viable. The achievements of BKK have provided the government with a model for the development of similar systems in other areas and thereby contributed to the overall goal of increasing the efficiency of the economy's financial sector.

USAID assistance through the PDP Program has played a central role in the achievements of the BKK Program and has been instrumental in formulating policies supportive of similar financial institutions in other rural areas of Indonesia. Initially, however, USAID involvement had little to do with policy formulation as such. Basic BKK policies, established prior to PDP assistance, were for the most part sound formulations. Thus:

- interest rates on loans to borrowers were not subsidized;
- transaction costs to borrowers were minimized;
- character references rather than collateral were used as the basis for loans;
- loan default risks were reduced by establishing very low ceilings on initial loans

Of first concern to PDP, from a policy perspective, was to demonstrate the soundness of basic BKK policies and the viability of establishing a self-sustaining rural credit system.

PDP assistance to the BKK Program began in 1979 with the two principal inputs being foreign technical assistance and capital transfer. PDP efforts focused on 65 of the total 486 BKK units with the participating units serving as learning laboratories to test new procedures and initiatives which, once proven, would be implemented across the board.

The initial PDP strategy for strengthening the BKK Program called for an additional capital input of Dollars 500,000. As in the case of the loan that established the program, the funds were loaned to BKK units at an interest rate of 1 per cent to support BPD technical supervision. Unlike the initial loan,

these monies were placed in a revolving fund enabling BPD to reloan principal payments and most importantly providing the BPD with a continuous source of funds to finance the cost of their supervisory activities.

In addition to providing additional capital for the program, PDP's strategy attempted to significantly strengthen the capacity of the BPD to carry out its role. Central to this effort was the establishment of a classification system to stratify the 65 participating BKK units by the size and profitability of their lending operations. In simplest terms, this information enabled the BPD to set credit ceilings for the newly recapitalized BKK units based upon a minimal set of performance criteria. In more general terms, the classification system allowed the BPD to track developments in the units and respond appropriately to these developments. Thus, Unlike many public sector financial institutions, the BPD does not continue to provide new capital to units with poor performance records. Instead, BPD supervisors analyze why the BKK is performing poorly and insist on its making the necessary corrections before recapitalizion begins. In this way, resources flow to units in proportion to their administrative capacity and financial strength.

The results of BPD's assistance to the BKK Program became apparent within a few years. Of the 65 BKK units assisted by PDP, 26 were initially listed as Class V or defunct units. After three years of assistance 73 percent of these units were once again in operation. In the first year of assistance, none of the 65 units was listed as Class I; within three years 10 had achieved this highest ranking.

The impact of BKK operations on the clientele, the majority of whom are female, was equally impressive. The loans had substantially benefitted the majority of borrowers enabling most to expand their business and a significant percentage to initiate new activities. Backward linkages and income multiplier effects resulting from the development of these enterprises were also substantial. A positive, albeit moderate, effect on employment generation occurred.

The most important result of the successful experience of there 65 units as that it demonstrated the viability of the BKK Program. Many of the new procedures and initiatives introduced in the 65 experimental units quickly became established procedures for the entire BKK system.

In 1981 the central government demonstrated its strong support of the BKK Program with the Ministry of Finance extending a RP 3 Billion (Dollars 4.7 Million) BKK Program laon to the provincial government. This loan is being channeled through BPD. Support from the provincial government

was also forthcoming. Roughly Dollars 500,000 of new capital, targetted for the weakest units, was provided in addition to Dollars 100,000 to retrain BKK staff and to cover administrative costs of the classification surveys which preceded disbursement of the central government loan.

USAID efforts to strengthen the BKK Program are on-going. Diversification and expansion of the loan portfolio is being encouraged; improvement in the management information system and administrative procedures introduced. Policy dialogue remains as a focal concern. Attention, however, has shifted to savings mobilization, and from the interest rates charged borrowers to the interest rates chanrged institutions.

The first decade of the BKK Program focused on building an economically viable rural credit institution. PDP assistance to the BKK Program in the past few years has given increased attention to the program as a savings institution. Present BKK policies regarding savings accounts have been the focus of these discussions. The principal source of BKK savings has been the "forced savings" accounts of its borrowers. In the majority of units, clients do not have ready access to their savings accounts, and are paid very low savings account interest rates. New policies reducing savings disincentives have recently been formulated. These policies strive to meet the client's need for a secure, easily accessible, high interest yeilding savings program.

In a second on-going effort to improve policies, i.e., costing structures, associated with the program, the project is closely examining the cost of BPD supervision of the BKK. Currently, these costs are financed by the 1 per cent monthly interest rate charged by the BPD for funds loaned to the BKK units. The project will encourage the adoption of an interest rate structure including the cost of funds.

USAID assistance to the BKK Program is in the process of being transferred from PDP to a new project, Financial Institutions Development (FID). In addition to continuing support for the BKK Program, FID will expand USAID's support of village credit systems to three other programs located in West Java and West Sumatra.

The Dollars 27.8 Million FID project with approximately Dollars 10.0 Million counterpart funds is a strong testament to the initial successes of the BKK Program. Equally impressive is the wholesale policy reform occurring within the Bank Rakyat Indonesia (BRI), the country's largest rural financial institution. Lending terms are being revised as is the status of branch offices within the BRI structure. These changes significantly parallel the standard operating procedures of the BKK Program.

Mission Comment: USAID/Indonesia's support of the Central Java BKK Program illustrates a variety of critical issues associated with the Mission's approach to policy dialogue and strategy for proceeding with policy implementation. Of overridng importance to the Mission's policy thrusts is an acceptance of the complexity of the policy formulation process. Policy dialogue is not viewed in terms of simply establishing the most cost-effective means for achieving specific ends. Rather, policy formulation is approached as a complex, long-term, undertaking involving social and political as well as economic considerations. The experience of the BKK Program and its influence on the development of self-sustaining rural financial systems highlights the key features of this approach and demonstrates their efforts in bringing about the desired results.

Contrary to accepted practice, USAID involvement in the Rural Financial Institution's policy formulation process began with implementation rather than negotiation. The basic policies of the BKK Program, as mentioned earlier, were sound. USAID's initial efforts focused on strengthening a small number of BKK units to demonstrate first the practicability of the policies and the viability of locally managed, small trader-oriented, self-sustaining, rural credit institutions. The advantages to the mission of starting small and focusing on implementation rather than policy formulation were numerous. During the early years of involvement, project management was able to focus on making a small number of BKK units effective credit bodies supported by the Provincial Development Bank (BPD). At the same time, they were able to build an experiential base from which the appropriateness of specific policy interventions could later be assessed.

The limited scope of involvment in the first years of project implementation and other advantages.
In addition to developing a knowledge base regarding rural credit, the first years of activity were used by the project staff to develop a familiarity with the individuals and institutions which would of necessity of choice be included in an expanded effort. The converse was equally important and the confidence which the counterparts eventually placed in the project staff was essential to involving them in the policy formulation process.

Within a short period of time, two to three years, PDP working with a small number of BKK units had demonstrated the basic soundness of the program. Efforts of the project staff them slowly shifted to policy concerns, in particular those associated with improving the efficiency of the program and expanding its activities both in terms of scope as well as client coverage. Backed by experience, well acquainted with

the key individuals, and knowledge of the critical institutional interrelationships, the project staff then played and continues to play an integral role in shaping policies and establishing procedures related to their implementation

A final key point in understanding USAID's successful association with the BKK Program and involvement in the formulation of policies concerning rural financial institutions is the substantial continuity of project personnel. Without this continuity, the essential lessons learned during the early years of project implementation, the understanding acquired of the project environmnet, and the relationships established could not have been gradually integrated into a policy dialogue of major import.

Egypt/Small Farmer Production

Background and Description: The Egyptian economy in general is characterized by heavily subsidized input and output prices. This subsidization extends to the agricultural sector specifically in the form of artificially [and arbitrarily] low interest rates on Agricultural credit and low prices on other agricultural inputs and in the form of artificially low farm gate prices on agricultural production. These price distortions are accompanied by other market irregularities, such as agricultural input shortages or other restrictions on input availability [e.g., high collateral requirements for credit], crop production quotas and other production constraints. These problems inhibit increased agricultural production and productivity. However, removal or even relaxation of many of the policies that impose the subsidies and other distortions is a very sensitive issue politically in Egypt. While many Government of Egypt [GOE] policy-makers agree with the principle of loaning at rates approaching market levels, many others also argue that the artificially low prices serve to protect farmers who could not afford to pay market prices.

Within the Egyptian agricultural sector, the principal Bank for Development and Agricultural Credit [PBDAC] is the sole source of institutional credit and selected other agricultural inputs [e.g., fertilizer] for Egypt's farmers. In 1962, it distributed over LE 600 million [About dollars 500 million] in short- and medium-term loans to some three million small farmers. Despite this large volume of loans, however, there are a number of problems in PBDAC operations, regarding both the bank's internal management and administration and the broader market problems discussed above.

In an effort to address some of these agricultural constraints, USAID/Cairo initiated the Small Farmer Production Project in 1979. This project was designed to demonstrate, on a pilot basis, that many of the PBDAC operational problems could be overcome at the village bank level. In order to demonstrate this, the project provided a package of improved agricultural inputs [credit, extension, fertilizer, etc.] in 27 selected village banks in three governates of the country. The project's expectation was that, given the greater availability of critical agricultural inputs and opportunities, Egyptian small farmers would perceive the greater income potential and would be willing to pay higher interest rates for agricultural credit as a result.

Point of Policy: In support of this project design, the PBDAC agreed to implement several policy changes: Project interest rates were established at 10 per cent [a rate closer to the

market rate of interest and favorable in comparison to the 6 per cent on GOE credit funds]; collateral requirements were eliminated; and crop production quotas for credit recipients were waived. Given the long-standing commitment to subsidized interest rates, the PBDAC's agreement to raise project interest rates well above its normal bank rate of 6 per cent was a noteworthy policy change. In return for greater ease in securing credit (at higher interest rates), farmers receiving project credit agreed to follow extension agents' advice in using improved technologies. The project design anticipated that, with greater amounts of capital to invest [through credit] and with new technologies and techniques gained from the extension service, Farmers' production would increase; therefore, their incomes would rise.

Progress in Implementing Policy: By December 1983, some 16,000 loans at the 10 per cent rate had been made under the project, reaching about 10 per cent of the farmers in the pilot project areas. On the average, project recipient farmers cultivate less than two acres and have an annual cash farm income of less than LE 500 [ABOUT dollars 400]. In other words, they are the targeted small farmers as planned in the project design. Loans have been made for a wide range of farm investments, e.g., improved breeds of water buffalo and cows, small cultivating and harvesting equipment, etc. The average loan size has been LE 900 [ABOUT dollars 750], and loan repayment has exceeded 98 per cent.

The project hypothesis has been borne out, at least in the pilot areas, i.e., despite the higher interest rates, the greater availability of credit in combination with other agricultural inputs has allowed participating farmers to realize greater farm production and, therefore, increased incomes. The very high loan repayment rate alone speaks for the profitability of the investments made. In many instances, the loans have permitted farmers to expand and diversify their production, e.g., in adding an egg battery to the family's existing agricultural activities [Note: an egg battery is a hatchery production operation as opposed to production of chickens for sale in the marketplace] . Such additional activities can increase the family's income significantly as well. For example, annual farm income from a family egg battery is about LE 350 [ABOUT dollars 290]. Where this income is additional to on-going farm activities, it can mean a major boost to the family's standard of living.

The initial years of the project thus have allowed the USAID and the GOE the opportunity to begin to implement a policy change [increased interest rates], albeit on as yet limited basis. Further, an effective form of policy dialogue has developed as the confidence of the Egyptians has risen in seeing that interest rates can be increased without adversely affecting the performance of the credit system. Based on these experiences to date, the PBDAC itself initiated two further policy changes in 1983 as a part of a project amendment: [1] project interest rates will be increased from 10 per cent to 14 per cent and [2] a substantial portion of its ordinary [government subsidized] 6 per cent interest rate portfolio will be lent out at the new 14 per cent rate in an expanded project area. These represent significant steps toward a more rational structure of interest in Egypt.

SENEGAL RURAL HEALTH SERVICES

BACKGROUND AND DESCRIPTION

Senegal, a francophone West African State of approximately six million people, two thirds of whom live in rural areas, has long been viewed as a leader by other African States in the introduction of democratic systems, beginning in the early 1970's with the establishment of tax-based rural communities. In developing a primary health care (PHC) program which will be self-sustaining without external financing, Senegal is truly in the avant grade. A USAID-financed activity, the Senegal Rural Health (SRH) project, has been instrumental in the development of Senegal's forward looking health policy. That policy encourages the payment of user fees, the local management of the revenues thus generated, and local participation in the financing of the recurrent costs associated with the supervision of the village level health teams.

Even before the celebrated PHC conference in Alma Alta, in 1978, Senegal had opted for the development of a PHC program which would feature the use of minimally trained health workers at the village level to provide simple preventive and curative services. To promote that policy, USAID and the Government of Belgium agreed to finance major PHC activities in the Sine Saloum region and in Pikine, a large low-income satellite of Dakar. The following pages describe the evolution of the Senegal rural health project and its influence on the development of health policy in Senegal.

As originally designed, this five year, 3.3 million dollar activity was to train Community Health Worker (CHW) teams in 600 villages in the Sine Saloum region and to develop the supervisory system needed to support them. The project, which began in late 1977, trained three types of village level worker: A first aid attendant, a sanitarian and a birth attendant. These community health workers were chosen by the villagers, were minimally literate and were trained for a very brief period, i.e., two weeks. Their work was to be supervised at monthly intervals by fully trained nurses stationed at the dispensaries, which was most peripheral fixed center in the Senegalese Health Care System. As the system was designed, the villager was to finance the system by paying a consultation fee each time he saw the CHW for a new illness. In return for the payment of this consultation fee, the villager received the medicine required to treat his malady. At the level of the state-supported fixed centers (the dispensary, or above that, the Health Center) people continued, in theory at least, to receive completely free care. In fact, care was not completely free because, although drugs were to be available without charge, the state was chronically short of drugs. Patients were given prescriptions at the time of their consultation and told to buy medicines at the nearest private pharmacy where they cost dearly. Nonetheless, the principle that the State provided free consultation at its fixed centers

remained intact. Patients, by and large, preferred these centers to the village units.

POINT OF POLICY

A study of the experience in Sine Saloum convinced the Ministry of Health that it must adopt a new and entirely consistent health policy if the primary health care system to which it was committed was to survive. In fact, this PHC system offered the only practical possibility of access to health care to Senegal's rural population, about 65 percent of the country's total. The study found that villagers were not supporting or using the community health workers located in their own villages (where they had to pay a consultation fee) but were walking, sometimes five to ten kilometers, to the dispensary where they hoped to receive quote free unquote care. The Ministry realized that it would have to correct this inequitable situation whereby people at the most peripheral level, and presumably poorer, were asked to pay a user fee while other people using the state-supported fixed centers were not. Fortunately, at the time the Ministry of Health was studying the experience in Sine Saloum it was also experimenting with charging a user fee for consultation at the level of the health center and dispensary in the Belgian-sponsored Pikine PHC project. This program demonstrated that people in a peri-urban area would pay a fee, approximately 25-50 cents, for consultations at the fixed centers.

Based on these experiences, Senegal became in 1980, the first country in West Africa, perhaps in all of Africa, to officially institute a nation-wide health quote participation unquote policy. This policy dictated the payment of a user fee at all levels of the system - from the village to the national hospital. For a government which was justifiably proud of its place in the fore-front of the international socialist movement to impose a user fee on a population which had always believed that the provision of free medical care was one of the most basic responsibilities of the State required considerable political courage. In fact, Senegal did even more than this. Having learned from experience in both the Sine Saloum and Pikine projects that local committees could be trained to manage the receipts collected from the sale of PHC medicines, the Ministry of Health decided to leave responsibility for the management of the revenues collected at the fixed centers (through the participation system) to a locally constituted committee. Although the Ministry has issued guidelines as to the range of possible uses for the user fees, Ministry personnel act only as advisors to the local committees and do not decide the use of these funds. In Senegal this is referred to as the quote self management unquote policy and represents an important step in the decentralization process.

MISSION COMMENT

In spite of having promoted highly desirable policy changes, the project was in serious difficulty at the time of the mid-point evaluation in 1980. Some of the difficulties were attributable to the previous, less desirable policies, some to incorrect assumptions during the design and some to sub-optimal project management by both the Ministry of Health and the USAID. Based on an impact evaluation, undertaken with Ministry participation, and to the subsequent redesign of the activity, the MOH and the USAID began an

amended project in early 1981. As a result of the policy and management charges, a second evaluation in 1983 found a vastly improved project. In fact, most observers, certainly including the Senegalese themselves, believe the project to be a model for primary health care development in Africa.

The system of supervision in place, however, will not be sustainable without outside financing for the foreseeable future. The much improved management of village level activities is due, in large part, to the fact that the redesigned project provided each health post nurse with a motor bike (or quote moped unquote) to use for transport between the post and the village, thus greatly facilitating the supervision of the community health workers. The project paid for the amortization, maintenance, repairs, and fuel for this moped, amounting to dollars four hundred to five hundred per year. The MOH could not cover these recurrent costs, yet all agreed that monthly supervision of the CHW team by the health post nurse would be necessary for the foreseeable future.

USAID and the government have now agreed to finance a second phase of the project which will, among other things, test the hypothesis that the costs of the moped can be paid by local communities using a combination of locally collected taxes, payment of user fees and other sources. The government's agreement to test this hypothesis followed an entire year of involved economic analysis and difficult negotiations - the epitome of the quote policy dialogue unquote. This process culminated in April 1984 at the Third Annual National Primary Health Care Conference when the Ministry of Health accepted the recurrent cost committee's recommendation that the financing plan proposed for the Phase II, USAID-financed, PHC project be made official national policy. If experience proves that the recurrent costs of supervision, including the amortization of motorized transport, can be paid from locally collected monies, the experience will benefit PHC programs throughout Africa.

LESSONS LEARNED

USAID/Senegal believes there are two very important lessons to be learned from this experience. First, this productive policy dialogue was greatly facilitated by the close working relationship which was carefully cultivated between USAID staff, Senegalese technical assistants hired as personal services contractors, and Ministry of Health personnel. The process required very considerable inputs of USAID staff time, not only from the health office but from other support offices such as the management, controller's, and commodity procurement offices. As USAID/Senegal continues to try to do quote more with less unquote this kind of close working relationship with the government may be thrown in question.

Secondly, this critically important progress on the community financing front was achieved at some cost in terms of the development of such technical components of the project as immunization and oral rehydration. Certain very thoughtful international public health experts believe that developing affordable infrastructure before providing workable technical packages which reduce mortality is putting the horse before the cart. The reverse side of

this question, however, is that it makes no sense to dramatically reduce mortality through an expanded program for immunization, for instance, if the strategy used is not affordable and sustained. USAID and the Government of Senegal, in Phase II of the project, will continue to seek to strike a reasonable balance between the competing necessities of fast action to reduce mortality and deliberate, measured action to test affordable systems.

VII. POLICY CABLE/MEMORANDA

State 066308
March 6, 1985

HB 1, Part VII
Oct. 30, 1985
(TM 1:36)

FROM: AID Administrator

POPULATION ASSISTANCE THROUGH NGOS

Experience has shown that successful family planning programs tend to occur in countries where there is a strong commitment by the host government, an infrastructure with capacity to deliver services throughout the country, strong private sector involvement in family planning, and social cultural acceptance of the concept of family planning. Although the commitment of governments to increased availability of family planning services remains an important factor in the success of U.S. population assistance, experience in a number of AID-recipient countries demonstrates that programs operated by private sector institutions often can be more cost-effective than government-operated programs and are often more acceptable family planning users. Therefore, and in keeping with AID present emphasis on private sector development initiatives government infrastructures should not be viewed as the only or even the primary vehicle for the delivery of information and services. In almost all countries eligible for AID assistance, there are currently private sector institutions many of them already providing other types of health or social services, which can and should be encouraged to provide family planning. These institutions include profit-making enterprises as well as private voluntary organizations.

I believe we must give enough support through government channels so that we have evidenced our willingness to participate with the host government in family planning. However, U.S. assistance should increasingly stress the role of the private sector. This may include Mission support of private sector initiatives directly. It should also include mission encouragement to host governments, as part of the policy dialogue, to enlarge the role of the private sector in national programs. AID assistance is premised on voluntarism and informed choice. Choice may be enhanced by expanding the number of channels for service delivery which can be done by supporting greater private sector involvement in service delivery.

Examples of the private sector initiatives which should be encouraged include: contraceptive retail marketing, the inclusion of family planning in public and private health insurance schemes, health maintenance organizations and health cooperatives; the inclusion of family planning services in health clinics operated by large industrial and agrobusiness concerns and other institution in the organized sector; and mechanisms to improve services delivered by private health practitioners.

In FY 1984 and FY 1985 approximately 48 percent of AID's population assistance account (including funds from S&T/POP and from regional and mission budgets) has supported the work of private organizations. I encourage you to give preference to support for family planning through non-governmental channels wherever this is feasible, and where it will be more effective than the government can be. At the same time, the role of government in establishing and implementing policies which support the availability of a wide range of acceptable methods of family planning should be emphasized in policy dialogues with host officials.

UNCLASSIFIED

HUMID TROPICAL FORESTS: AID POLICY AND PROGRAM GUIDANCE

1. SUMMARY: This message is a statement of AID's recognition that the destruction of humid tropical forests is one of the most important enviromental issues for the remainder of this century and, perhaps, well into the next. It states our concerns about the consequences for host countries and global environment. It briefly describes the extent and impact of deforestation; states our policies, and provides general programmatic guidance. This cable supplements the environment and natural resource policy determination issued on April 26, 1983 (PD-6), the Forestry Policy and Programs Policy Determination issued on May 16, 1983 (PD-7), the Environment Strategy Paper issued October 1983 and the Forestry Strategy Paper issued February 1984. It also recognizes the intent of Congress in November 1983 in amending the FAA by adding a new Section 119 on endangered species. This new guidance recognizes the unique role and special environmental characteristics of humid tropical forests. In issuing this cable, AID, as a major advocate and supporter of development, acknowledges its responsibility, in coordination with other U.S. government agencies, to engage in policy dialogue on this issue with host country governments and other bilateral and multilateral donors--all of whom must take action to address the problem.

2. DEFINITION: Quote tropical forests unquote are broadly defined to include all forests and shrublands within the geographic tropics (between 23.5 degrees north and south of the equator and in generally frost-free areas outside the geographic tropics). Quote humid tropical forests unquote are those with a continuous canopy comprised of single or multiple layers found in the geographic tropics where the mean annul biotemperature in the lowlands is greater than 24 degrees celsius and where annual rainfall equals or exceeds potential evaporative return of water to the atmosphere.

3. BACKGROUND: Humid tropical forests are unique ecosystems essential to the survival of vast numbers of species of plants and animals both within the forest areas themselves and throughout the rest of the world. While our knowledge of these areas is increasing as a result of relatively recent scientific attention, many elements of the relationship between these forests and the well-being of life on this planet are not fully known. However, those which are known verify the importance of these forests to a large number of other activities which take place within the forests, beyond the boundaries of the forests, and even outside of the countries in which they are contained. A few examples which illustrate the importance of these forests are:

A. There is a significant, although not fully understood, inter-relationship between these forests and global climatic conditions. Their destruction may reduce rainfall and may contribute, in some areas, to the desertification process. Destruction of humid tropical forests is suspected of releasing carbon dioxide into the atmosphere contributing to the global quote greenhouse effect unquote although there is no direct evidence of this. The remaining humid tropical forests are often situated on fragile soils which are subject to erosion on removal of the forest resulting in siltation of rivers and dams and damage to the fisheries resource. These consequences also occur when the soils are not fragile.

B. Humid tropical forests are highly complex ecosystems of great biological diversity, containing perhaps as many as 50 percent of all known species on earth. Many of these species are not found elsewhere. Consequently, the forests are unique sources for organic materials which are important to many aspects of human needs such as food, medicine, and raw materials for production processes. In a 1982 AID-financed study, the National Research Council reported that of the 3,000 plant species known to possess anti-cancer properties, 70 percent come from humid tropical forests.

C. Of particular significance is that humid tropical forests are an immense reservoir of genetic materials. Our knowledge of this resource is only in its infancy. Besides the great array of species, there is great diversity within the gene pool of each species. These gene pools possess the potential for adaption of the world's cultivated crops to new climate conditions and for resistance to new diseases and new infestations of insect pest. The conversion of forest lands to genetically uniform cultivated crops eliminates many of the raw materials essential for future scientific and industrial innovation.

4. Deforestation: Humid tropical forests are coming under intense pressure from the growth in population and the desire of countries with such forests to expand traditional economic activities into these areas. In 1980, an interagency task force on tropical forests estimated that closed tropical forests have already been reduced by human activity by more than 40 percent. The task force further estimated that one to two percent of the remaining closed tropical forests are being cleared each year. If present trends continue, as much as one-half of the remaining tropical forests could be lost by the year 2000. The consequences of such deforestation, according to the National Academy of Sciences, is that one-third of all tropical organisms--almost a million species--may become extinct by the end of this century.

(Note: AID recognizes that there are also severe environmental problems associated with depletion of dry-land forests (e.g., Sahel) and upland forests (e.g. Nepal and Latin America's Altiplano and the issuance of this cable is not meant to detract from these concerns or our efforts related to these problems.)

5. In the past, with sparse populations living in the forests, traditional slash and burn agriculture was carried out without great or lasting environmental damage. Today, population densities in the forests are such that subsistence farmers must now curtail fallow periods and prematurely slash and burn. The result is that there is insufficient time for the land to return to its original fertility leaving successive crop production less than during previous periods. The extraction of nutrients and loss of forest cover on poor quality soil combine to leave the area barren and eroded; unfit for even the subsistence agriculture which was attempted.

6. Of emerging importance is the conscious effort of development programs to open the forest lands to commercial activities such as logging, cattle ranching and commercial farming. While the conversion of these forests to other uses often derives from a well-intentioned effort to expand agricultural production or develop an export so that productive employment and the basic necessities of life can be obtained by the citizens of these countries, such conversion of forests for commercial development often does not reflect the true value of forests to the longer-run physical and economic well-being of the country's and the world's population.

7. AID policy related to humid tropical forests: AID's interest in forestry is stated in the previously cited Policy Determinations and Strategy Papers. These documents indicate that AID resources should be used to help expand the production of forest products in environmentally sound ways. In particular, the agency seeks the long-term, sustained production of forest products without depletion or loss of biological diversity. The agency also places high priority on developing sound plant conversion and wildlife management programs. In the case of humid tropical forests, while the same general policy applies, there is a special need to recognize that the most valuable products of these forests may not as yet be fully identified, are unique to humid tropical ecosystems and essential to the survival of other ecosystems, or have a value which is not now nor will be in the immediate future accurately reflected in the market.

A. Given that the world's scientific community is just beginning to understand the importance of humid tropical forests, it is AID's general policy to exercise extreme caution in pursuing development projects which lead to the full or partial conversion of these forests. The development of programs affecting these types of forests should be approached from the perspective that a top priority is conservation and sustainable management of their unique resources.

B. AID recognizes that in the near term, the pressures of increasing population and development investments will continue to result in the conversion of humid tropical forests to other uses. However, AID's participation in activities which produce this result must follow from a careful analysis of the best sustainable use of the land and the impact of the activity on biological diversity. (For guidance on environmental impact analysis, see Handbook 3, Appendix 2D).

8. Specific Program Guidance: AID will make a concerted effort to increase the awareness of other U.S. government agencies and other donors, both bilateral and mutilateral, of the immediate and long-term value of humid tropical forests. In countries which contain humid tropical forests, missions should adhere to the following guidance when developing country assistance strategies and considering program interventions that affect or use this resource.

A. AID is willing to support efforts to increase the awareness of host country leadership and citizens of the immediate and long term value of the humid tropical forests. In its policy dialogue with host country leaders, AID will stress the importance of preserving and properly managing this resource for the long run economic development of the country as well as the irretrievable economic loss associated with its conversion to other uses. This policy dialogue should identify and focus attention on those host country policies which directly or indirectly contribute to deforestation.

B. AID is willing to support government and non-government efforts to preserve and properly manage humid tropical forests. In particular, AID is willing to finance training and technical assistance in the various aspects of policy formulation, conservation, planning, management and administration of humid tropical forests.

C. In the interest of biological diversity, AID is willing to support programs which establish protected forest reserves.

D. In developing its project portfolio, AID will give priority consideration to those activities which can be designed to offer employment and income alternatives to activities which result in further deforestation. Missions should make a special effort to help host countries identify alternative programs to colonizing forested areas.

E. AID is willing to support research to expand our knowledge of humid tropical forests and to identify alternative means to meet needs that otherwise would be met by exploitation of these humid tropical forest in the short run.

F. AID is willing to support efforts to end destructive slash and burn agriculture by emphasizing the development of stable and more productive farming practices that conserve renewable natural resources in areas already cleared or degraded.

G. AID is willing to support agroforestry research and extension services focused on those areas most susceptible to destructive encroachment.

H. AID is willing to support training, research and other actions which lead to sustainable and more environmentally sound logging and forest management practices, including reforestation or other activities to rehabilitate degraded lands in humid tropical areas.

I. AID will not support or assist activity which results in the conversion of humid tropical forest lands to the rearing of livestock unless it can be demonstrated prior to the clearing of any forested areas that such an action will make a significant direct contribution to improving the livelihood of the rural poor and that such activity is the least destructive approach when compared to alternative development actions. In such cases, AID will fully consider the impact of such activity on biological diversity. AID support to livestock development projects in humid tropical forest areas should be designed as an integrated farm and forest system.

J. AID will not support or assist directly or indirectly construction, upgrading or maintenance of roads, including temporary haul roads for logging or other extractive industries, which pass through prime humid tropical forests in the absense of adequate safeguards to prevent uncontrolled destruction of the forests by virtue of this new or improved access route.

K. AID will not support or assist directly or indirectly the construction of dams or other water control structures which flood prime tropical forests unless it can be demonstrated that such an action will make a significant contribution to improving the livelihood of the poor majority and that such activity is the least destructive approach when compared to alternative development actions. In such cases, AID will fully consider the impact of such activity on biological diversity.

L. AID will not support or assist the procurement or use of equipment related to logging unless it can be demonstrated that the end users follow sound environmental management practices which preserve and sustain the ecological intergrity of the humid tropical forests.

PROGRAM SECTOR ASSISTANCE GUIDANCE

1. This guidance covers program sector assistance, i.e., assistance which is not projectized. Because of recent mission interest in sectoral assistance programs, and because, under certain circumstances such programs could be efficacious in achieving policy reform, I have decided to restate agency policy on these programs.

2. Projects are AID's primary mode of providing assistance. While almost all of the agency's projects are, in effect, in sectors, I expect sectoral programs will only be approved under exceptional circumstances. Accordingly, any departure from project assistance must be justified by demonstrating that the alternative assistance vehicle leads to more effective achievement of the U.S. government's objectives in a given country. I cannot stress enough that program sector assistance is exceptional and must be strictly in conformity with this guidance.

3. Program sector assistance provides foreign exchange (dollars) which may not be directly linked to specific project expenditures. In some sector programs, the foreign exchange uses are narrowly limited by requiring the importation of specific goods or categories of goods from specific exporting countries; in other programs the foreign exchange uses are unspecified. Similarly, the uses of local currencies generated by the program need to be specified in certain instances but not in others. However, it is necessary to specify the uses of either the foreign exchange or the local currency generations in every sector program. The degree to which the uses of either foreign exchange or local currency generations need to be specified depends on the purpose of the sector program, and will be discussed in paragraphs 3 to 5.

4. Program sector assistance is a non-project vehicle that can be funded by either the DA or ESF accounts. In most cases the source of funding has no bearing on the analysis, design, implementation, and evaluation requirements of a sectoral program. However, because the FAA permits use of ESF funds for short-term economic stabilization (a rational not generally acceptable for DA funding), ESF sectoral programs have an additional justification that is not appropriate to DA programs.

5. For the purposes of AID assistance, a sector is defined as a set of economic activities unified by a common output narrow enough to have an annalytical identity, and broad enough to contain significant investment and policy issues. Thus one can speak of health or agriculture or energy. Often it may be appropriate to narrow the sectoral focus to a particular subsector - e.g., livestock or forestry or primary health care.

6. The goal of program sector assistance is to increase incomes or improve the delivery of services to the poor in LDCS; the objective of program sectoral assistance is the alleviation of fundamental constraints inhibiting the growth of sectoral output and productivity. All sectoral programs must be justified in terms of being a more efficient vehicle for achieving this objective than traditional projects.

7. Program sector assistance is primarily justified as a mode of assistance for alleviating policy constraints to sectoral productivity and output. These constraints include, among others, subsidies, inappropriate pricing policies, inappropriate government provision of goods and services, and an inadequate share of budgetary resources being allocated to the sector. Institutional or infrastructural constraints can better be handled by specific projects which could be integrated with program sector assistance under a comprehensive strategy.

8. Any program sector assistance proposal must include an analysis of the problems and constraints facing the sector. Such an analysis should include:

A. A discussion of the role of the sector or subsector in both the overall development of the host country and the assistance strategy of the USAID (this discussion should include an examination of the linkages between macroeconomic policies and problems and sectoral policies and problems);

B. A description of the specific sectoral problems including policy issues, investment levels (public and private), recurrent resource availabilities, and capacity of key sectoral institutions both public and private, formal and informal, to fulfill their roles;

C. A strategy for addressing the sector's problems including a ranking of constraints in order of importance, and the specific changes in policy and resource availability which the program is intended to achieve;

D. An assessment of the social costs and benefits of the sectoral program, focussing on the impact of the program on different beneficiary groups.

E. An assessment of the host country's financial, political, and institutional capability for carrying out the sectoral strategy;

F. A discussion of the role of other donor activity in the sector and the way in which this activity complements AID's program; and

G. An implementation plan listing specific accomplishments to be achieved at specific times, and a plan for tranching AID disbursements to these accomplishments.

9. The level of analysis required to approve a sector program has been described in paragraph 8. Naturally not all this information is required at the PID stage. What is needed is enough information to ensure that going ahead with the design makes sense. Some preliminary analysis in each of the following areas is necessary:

(A) The role of the sector in AID's assistance strategy,

(B) A description of sectoral development constraints,

(C) An assessment of the host country's capacity for carrying out the sectoral program, and

(D) A discussion of the policy reform and resource allocation requirements necessary for the program's success.

10. A sector program does not need to address all constraints. It should address the most binding constraints which are amendable to AID influence.

11. Once the objectives of the program have been identified, the sector proposal must document the reasons a sector program is more likely to achieve these objectives than a project or series of projects. Such a justification may be linked to the following possible advantages of sectoral programs:

(A) Sector programs can lead to a more integrated and comprehensive approach to sectoral development needs, particularly with respect to economic policy. For example, input prices are linked to food grain prices which are linked to cash crop prices; therefore a policy reform package needs to be based on an understanding of the linkages.

(B) Policy reform may be more easily achieved with program sector assistance because: (1) the assistance is non-projectized (and therefore more highly valued by the host country because of the greater latitude provided for the use of the foreign exchange); (2) It will tend to concentrate AID funds in one larger unit than any of a series of specific project interventions; and (3) It is directed at the appropriate level, and leads to discussions with appropriate LDC officials (sector policy-makers).

(C) Program sector assistance is an ideal vehicle for providing recurrent cost assistance when such a program is consistent with the AID policy paper, "recurrent cost problems in LDCS".

12. Program sector assistance funded by the ESF account can be justified in terms of balance of payments support and economic stabilization. Such a sector program may have two objectives: providing resources to reduce the balance of payments constraint, and the achievement of increased sectoral productivity and output.

13. The degree of specificity necessary in programming the use of the foreign exchange must be determined by the purposes of the program and the details of the country situation. Where possible, specificity in terms of categories of goods to be purchased or source/origin of such goods, such as U.S. procurement, is preferred. However, in some cases, either because of the traditional trade patterns of a particular country or because specific commodity programs would decrease substantially the rate at which foreign exchange is disbursed and thus diminish the effectiveness of the program, it is not necessary to specify the use of the foreign exchange. In such a situation it must be demonstrated that tying assistance to U.S. procurement decreases the effectiveness of the sector program.

14. Similarly, the degree to which uses of the local currency generated by program sector assistance need to be specified depends on the sectoral constraints being addressed. If the foreign exchange uses are not specified then local currency generations must be programmed. In most cases local currency uses should be connected to the policy reforms being undertaken. Two Bangladesh subsector programs are instructive in this regard. The fertilizer distribution improvement program used foreign exchange for importing fertilizer and constructing warehouses, both intimately related to the reforms involved in transferring fertilizer marketing to the private sector. In this case local currencies were not programmed. The rural finance program, on the other hand, used the foreign exchange solely to purchase local currencies which were then programmed into the rural credit system. In this case the foreign exchange uses were not specified.

15. Even where AID is closely involved in programming local currencies this need not imply a direct role in project design, implementation and evaluation, which is primarily the responsbility of the host country. AID should be concerned with general categories (e.g., increasing the efficiency of the agricultural extension program) but not necessarily with the specific design of a project to accomplish that goal. In such cases, AID would monitor the host country's performance in meeting the agreed upon objectives. Our assistance should be tranched and disbursement tied to acceptable performance. Where possible, the program should be designed to accommodate most of the important policy undertakings as conditions precedent to disbursement of the assistance.

16. If a binding constraint on sectoral development is the scarcity of resources (capital and/or recurrent) going to a given sector, then increasing the level of governmental resources directed toward that sector is a legitimate policy objective. However, AID needn't require increases in real or nominal budget outlays. (For a number of reasons reduction in overall government expenditures may be called for). The AID sector assistance program should be designed to assure that the level of government resources is appropriate to the importance of the sector in the country's development, the proper role of government in the sector, and the overall level of government resources available. In some cases this may mean no change, or even a reduction in government expenditures in a given sector, while in others it may mean an increase.

17. The same overall country criteria for determining whether other forms of assistance should be loan or grant financed will also apply to program sector assistance.

UNCLASSIFIED

18. A few examples of existing, or proposed sector assistance programs may help clarify how program sector assistance can be used effectively:

(A) In Bangladesh, AID linked imports of fertilizer to policy changes in fertilizer pricing and marketing. As a result of this program:

(I) Farmer access to fertilizer has greatly increased;

(II) Prices paid by farmers for fertilizer under the new marketing system are actually lower than those paid under the old system;

(III) A new class of private wholesalers developed as intermediaries. Thus the use of a non-project vehicle, fertilizer inputs, was connected to a substantial policy change which, it is expected, will have substantial beneficial effects on the entire agricultural sector.

(B) Several years ago, the agency approved a "sector loan" that would not be acceptable under the terms of this guidance. In the first place, this sector program was not really a sector as such, but a large area development program with activities that cut across many traditionally-defined sectors such as Agriculture, Health, Education, etc. Secondly, it was not designed for either policy reform or recurrent cost support. The basic rationale was to provide fast-disbursing foreign exchange, while at the same time buying into a series of investments (projects) linked to the development of the given area. What was gained was flexibility and staff economies. None of these rationales - balance of payment support (for DA programs), flexibility, or staff economies is an appropriate justification for program sector assistance under the terms of this guidance.

(C) The recently approved Zimbabwe basic education and skills training PAAD is an excellent example of the way in which sector assistance can be used for both budget support and policy reform. Zimbabwe has committed itself to major expansion of its educational sector particularly secondary education. At the same time, the government realizes it is unable to pay for such an expansion without a radical change in the way it does business.

This sector program is designed to buy into an investment package within the sector which will improve the cost-effectiveness of its educational service delivery. It thus links sectoral policy reform to the financial resources necessary for implementing policy.

Since Zimbabwe imports substantial amounts of U.S. commodities (and there is a C.I.P. program in place), and since the foreign exchange requirements of the educational sector are minimal, the program is designed as a C.I.P. with commodities limited to raw materials and capital goods needed in the private sector. Local currency purchases will be used in the Ministry of Education's three year investment program to increase educational efficiency.

(D) A less happy example is a PID which was disapproved by AID/Washington. In the words of the outgoing cable:

"The PID and PID supplement give insufficient information to allow approval of either a sector grant or project approach in their present form. The presentation lacks an analysis of the reforms needed in the agricultural sector or a clear articulation of which reforms take priority... missing from the mission submission is an analysis or assessment of the sectoral problems and related policy constraints... such an assessment would normally describe public and private investment links and availabilities of resources for recurrent costs and an analysis of key sectoral institutions... from the analysis should flow a ranking of the constraints and changes required in policies, institutional structures, and resource allocations, and an assessment of... (the government's) capability to carry out the changes." In short, the proposal lacked an acceptable rationale for the specific agricultural sector interventions proposed.

19. This guidance should be read in conjunction with AID policy papers "Approaches to the Policy Dialogue" and "Recurrent Cost Problems in Less Developed Countries", as well as STATE 189715 (July 23, 1982), "The Role of Resource Transfers in U.S. Economic Assistance." This guidance on Program Sector Assistance will be incorporated in an AID policy paper on the role of Non-Project Assistance which will be forthcoming in 1983.

STATE 189715
July 9, 1982

HB 1, Part VII
Feb. 12, 1986
(TM 1:37)

From: AID Administrator

THE ROLE OF RESOURCE TRANSFERS IN U.S. ECONOMIC ASSISTANCE

1. I have been concerned about a number of current and planned AID-funded projects and programs that provide substantial amounts of resources to governments for commodities,physical capital or credit with inadequate attention to the effectiveness with which such resources are employed. Scarce AID resources should have the maximum possible sustained impact on the recipient country's development. This means we need to ensure that our assistance: (a) is provided in a sound, market-oriented economic policy environment that reinforces its developmental impact, or is provided in a way that leads the country to undertake the reforms that produce such an environment; (b) strengthens the country's private and public institutional capacity to solve its developmental problems; and (c) results in widespread application of more productive technology that accelerates the growth of production, employment and incomes.

2. I recognize that this is a complex area and that major AID policy papers addressing several of these subjects in greater depth have recently been approved for transmittal to the field. These include policy papers on approaches to policy dialogue, private enterprise development and institutional development. These papers should be read along with the following guidance, which seeks to provide some clarification of my concerns about resource transfers and the circumstances under which we provide them.

3. Strictly speaking, all forms of concessional assistance involve a transfer of resources, even if only the funds to cover the costs of training and technical expertise for technical assistance. Resource transfers in the sense used here refer explicitly to AID-funded projects and programs, including DA, ESF, PL 480 and HIGS, that provide substantial amounts of resources for the importation of commodities and capital equipment as well as local costs for construction, credit and recurrent expenses.

4. To help ensure that resource transfers have the greatest positive developmental impact, AID's programs and projects have been linked to technical or institutional change or policy reform. For example, many AID projects combine a resource transfer with technical assistance leading to technical and institutional change--e.g., financial assistance to construct or rehabilitate physical structures of an irrigation system linked to technical assistance and training (human capital formation) to strengthen the public and private institutions (e.g., water user associations) required for improved water management. Similarly, policy changes linked to resource transfers can improve their effectiveness and lasting impact--e.g., elimination of subsidies or converting to private sector distribution as part of fertilizer assistance; interest rate reform as part of assistance for agricultural credit.

5. Accordingly, AID will provide resource transfers when: (a) other sources of financing have first been explored, including possible co-financing arrangements between AID, other donors and/or private sources; and (b) such assistance is linked to changes or effective performance (as agreed by AID and the recipient country) in the areas of institutional development - technology transfer or technology development, and/or economic policy. Country performance will be closely monitored and evaluated to determine whether such assistance should be continued.

6. These requirements must be satisfied unless justified by exceptional circumstances, such as the existence of overriding foreign policy objectives. The burden of proof in such cases will rest with the mission.

7. In general, economic policy, technical and institutional changes that (a) support sustained, broadly-based economic growth; (b) strengthen free markets and encourage private enterprise; (c) stimulate savings, investment and employment; (d) result in the development, transfer, adaptation and/or application of more productive technology; and (e) encourage local community initiative are desirable and therefore legitimate subjects for policy dialogue between missions, governments and other donors.

8. While I believe that most country and project situations that we encounter present opportunities for needed policy changes that will increase the effectiveness of our resource transfers, I also want to observe that policy change is not repeat not an end in itself but rather a means to achieving development objectives. Therefore, missions should not view the emphasis on policy change as a mechanical, quote checklist unquote requirement. If a mission believes the policy environment for the provision of assistance is adequate, it may take this position but it must explain why this is so.

9. Furthermore, the policy dialogue must be selective. That is, the desired policy change or changes must (a) be important for the accomplishment of the intended development objectives of the proposed economic assistance; (b) represent real, not trivial, differences between AID and the host government; and (c) be amenable to host government action in existing political and socio-economic settings. These and other considerations important to the conduct of policy dialogue are thoroughly treated in the forthcoming policy paper on approaches to policy dialogue.

10. Some illustrative examples of projects with varying degrees of effective linkages to policy, technological or institutional change are presented below. These examples are purely illustrative and are intended merely to suggest only a few of the ways such linkages have (or have not) been established:

(a) The DA funded fertilizer distribution and improvement project in Bangladesh constitutes a positive example. The project (1) induced the government to transfer retail and first level wholesale distribution from the government to the private sector; and (2) strengthens the Bangladesh government's technical ability to assess programs and to assess the economics and technical characteristics of different fertilizers. An extension included agreement to test the decontrol of retail prices of fertilizer in one of the country's four regions as a condition precedent to the project.

(b) On the other hand, a project for fertilizer imports in India was not approved for the last tranche on the grounds that it did not involve policy or institutional reforms or technology transfer, including any reforms that would have decontrolled prices or increased private enterprise participation in the fertilizer sector.

(c) The Rajasthan medium irrigation project in India is a positive example that involves, along with financial assistance for construction, significant improvements in the planning and design of irrigation projects at the state level, e.g., bringing water closer to the farm (by servicing smaller units), using more supervisory engineers in the field, and paying greater attention to related inputs such as fertilizer and agricultural extension services.

(d) Balance of payments support to Jamaica to assist the country's new government in its efforts to bring about economic recovery and re-expansion of the private sector required acceptance of the macro-economic policy framework negotiated by the IMF and world bank. A condition for disbursement of the major portion of the first AID cash transfer funded by ESF was acceptance by the government of Jamaica of the terms of an IMF extended fund facility loan. Two conditions precedent to disbursement of the major portion of the second cash transfer were compliance with the conditions of agreement with the IMF, and agreement by the government of Jamaica to the terms of a proposed world bank structural adjustment loan.

(e) The Senegal PL 480 Title III program calls for reform in three areas: (1) decentralization of development through reform of government regional development agencies and encouragement of greater farmer and private sector initiatives; (2) reform of rural cooperatives, including expansion of functions and greater responsibility at the village level; and (3) a review of marketing and pricing policies in order to expand agricultural production and diversification.

A.I.D. Exchange Rate Policy Guidance

REFERENCES: See para. 6 of text

1.00 Background.

1.10 This message conveys A.I.D. policy governing the appropriate exchange rate at which A.I.D.: [a] exchanges dollars for local currency under development assistance, economic support, and operating expense funds; [b] requires deposits of local currency by recipient countries under cash transfer agreements; [c] generates local currency for the host government through the provision of commodities under CIPs; and [d] accounts for host country contributions to projects. The policy guidance presented here does not apply to sales of P.L. 480 commodities. The separate statutory authority and inter-agency guidance governing these commodities are summarized in paragraph 5.10 below.

1.20 Standard A.I.D. project grant and loan agreements in Handbook 3 provide that U.S. funds be exchanged for local currency at the highest rate per U.S. dollar which at the time of the transaction is not unlawful in the recipient country. Cash transfer agreements that require the recipient government to deposit local currencies in special accounts and non-project assistance CIPs that generate local currency, heretofore, have had no such standard exchange clause, but presumably have been implemented on the basis of the same formulation found in the A.I.D. Handbook. Yet, even in those cases where such language is included in the agreements, it may be subject to inconsistent and differing interpretations.

1.30 The purpose of this cable, therefore, is to clarify, reaffirm, and extend A.I.D. exchange rate policy. This message also provides guidance governing the negotiation of exchange rate provisions in new project and non-project assistance agreements and the interpretation of provisions in existing agreements. The guidance reaffirms A.I.D.'s commitment to encourage host governments to move toward a unified exchange rate, i.e. a single free market-determined rate of foreign exchange. The guidance asserts A.I.D.'s determination to obtain in all its currency transactions the highest rate per U.S. dollar not unlawful that is available to anyone on any transaction in a recipient country, while providing operational definitions meant to preclude conflicts with sound economic policy. This guidance therefore alters existing policy for Cash Transfers and CIPs, and supersedes reference [i] found in paragraph 6 below. The guidance elaborates and replaces the interim guidance issued by LAC, State 030295, January 30, 1986.

2.00 A.I.D. Policy.

2.10 Current Policy Coverage [see refs in paragraph 6].

2.20 New Policy for Local Currency Exchange, Cash Transfers, CIPs, and Host Country Contributions.

2.21 A.I.D. exchange rate policy as stated in this guidance cable aims at encouraging governments to adopt and move toward unified exchange rates at realistic levels. It is our firm belief that adoption of a freely determined market exchange rate for all transactions is a key element for stabilizing economies and stimulating economic growth. From the standpoint of prudent financial management, application of the exchange rate policy to A.I.D. financial transactions is also important because of the wide impact exchange rates have on our programs and because of the objective to obtain maximum impact from the assistance which we are entrusted to manage. Finally, the goal of one unified market determined exchange rate will help ensure that host country government budgets do not understate [in local currency terms] the cost of resources, especially of imported physical capital obtained concessionally or under commercial terms.

2.22 Henceforth, it shall be A.I.D. policy that U.S. dollar exchanges for local currency, deposits of local currency by recipients to fulfill conditions of ESF Cash Transfers, generations of local currency from the purchase of commodities under CIPs, and the accounting of host country contributions to projects shall be made at the highest rate per U.S. dollar not unlawful that is available to anyone in a recipient country, as further operationally defined below. This rate will be known hereinafter in this guidance as the HR.

2.23 The policy is applicable to all project and non-project assistance and to all mission operating expense transactions in which U.S. dollars are exchanged for local currencies, all cash transfer agreements that require the host country to deposit local currencies in a special account, all CIP agreements and all host country contributions for projects. It is applicable to project and non-project assistance agreements with both governments and non-governmental entities. Non-project assistance is understood to include program assistance and program-type sector assistance.

2.24 This policy does not apply to cash transfer agreements, or those portions of such agreements, that do not require a deposit of local currency into a special account.

2.25 For those local currency expenditures that are charged to U.S. dollar appropriations for project and non-project assistance and for the Operating Expense account, the appropriate exchange rate to use for conversion is the rate of exchange determined by the U.S. government's disbursing agent, the U.S. Treasury, through its authorized disbursing officer, the USDO of the Department of State, on the day the voucher is prepared. The Treasury Financial Manual which contains the cash management policy guidelines that the USDO operates under, states: quote Unless otherwise authorized by Treasury, exchange transaction for accommodation purposes or for official expenditures will be computed at the prevailing rate of exchange [TFM 8070.70], unquote where the prevailing rate is defined to be quote the rate that would be legally available to the U.S. Government for the acquisition of foreign exchange for its official disbursements [TFM 8070.15] unquote. Elsewhere the USDO rate for commercial transactions is defined to be the quote highest legal

rate obtainable from a legally authorized exchange dealer unquote [TFM 8070.30b]. If the USDO rate is lower than the HR [it is not likely that it will ever be higher], A.I.D. dollars are to be exchanged at the USDO rate until such time as a satisfactory solution to exchange A.I.D. dollars at a higher rate, be it the HR or not, can be negotiated with the recipient government. A.I.D. missions should consult with the Embassy, the relevant USDO and, as necessary, the U.S. Treasury and take steps to initiate an intensive exchange rate policy dialogue with the recipient government to resolve the situation in a timely fashion, including, if necessary, setting an HR for A.I.D. transactions above the USDO rate.

2.26 Since no U.S. purchase of local currency takes place for non-project assistance CIPs and cash transfers, A.I.D. is not bound by the USDO rate for these transactions and can thus immediately consider setting the HR rate for them and negotiating the change with the host country.

2.30 Procedures and Guidelines for Determining the HR.

2.31 From the short-term operational point of view, HR may mean different types of exchange rates for different countries. The following examples describe the appropriate HR's for different situations. Each mission should use the examples to determine the HR appropriate for its own country circumstance. It is a fairly exhaustive list. The examples should clarify the intent of the HR concept and assist each mission in arriving at an appropriate definition in cases not covered precisely by the examples.

a. In countries where there exists a unified exchange rate freely determined by market forces, the HR is the unified exchange rate.

b. In countries where a freely competitive auction system for foreign exchange has been developed, the HR is the auction rate. A.I.D. funds can be auctioned off or sold at the latest auction rate.

c. In countries where the commercial banks and other financial institutions are allowed to engage in foreign exchange transactions without being subject to penalty, the HR is the commercial bank rate, or the parallel or free market rate, whichever is higher.

d. In countries where foreign exchange transactions are controlled, but substantial unofficial, parallel or curb markets exist with rates that are significantly and persistently higher than the controlled official exchange rate, the HR is the higher of the commercial bank exchange rate if it exists, the parallel market rate if it exists, or the controlled official exchange rate. An unofficial, parallel or curb market representing an estimated 10 percent or more of total transactions is considered substantial and rates of 10 percent or more above the official rate are considered significantly higher for this purpose. In these countries, in order to help in establishing the HR, A.I.D. missions may wish to negotiate with appropriate government officials to develop an auction system for all A.I.D. dollars. The host country [usually the central bank] and A.I.D. can decide the frequency of the auction on the basis of local currency needs and administrative considerations.

e. In countries where foreign exchange transactions are strictly controlled under a single and official rate, where a parallel or free market foreign exchange market activity is not tolerated, and where there is no visible and tolerated unofficial curb foreign exchange market, the HR is the controlled official exchange rate.

2.32 The HR is not the illegal [i.e., subject to civil or criminal penalty] quote black unquote market rate, no matter how high it might be. In addition, HR does not mean special exchange rates well beyond foreign exchange market equilibrium that some governments have established for the purpose of promoting certain specific foreign exchange objectives, such as to increase earnings from tourism and workers' remittances.

2.33 If literally interpreted and enforced, the quote highest rate not unlawful unquote concept in rare cases could lead to adoption of an exchange rate greater than the market clearing rate, conflicting with sound macroeconomic policies. Missions should guard against such an extreme occurrence and inform AID/W if operational procedures for setting the HR seem to be causing this anomaly to occur.

2.34 Movement Around the HR.

2.341 Not all transactions involving exchange rates must use the precise HR figure established by a mission at a given time. Some programs or projects--for example, those involving private sector activities--may require somewhat greater flexibility, given the variety of functions that exchange rates may serve in commercial transactions. For example:

[a] In spot currency exchanges at commercial banks, the exchange rates offered are not negotiable; a private borrower that exchanges the proceeds of an A.I.D. loan for local currency at a commercial bank must accept the exchange rate offered, even if that rate is not the HR.

[b] In credit guaranty projects which use dollar letters of credit to guaranty local currency subloans made by a host country bank, exchange rates are used to establish the amount of subloan principal to be guarantied without any actual exchange transaction taking place. It has been standard practice in such transactions to use an easily accessible published exchange rate [such as a daily average rate or closing rate]. These exchange rates quite likely will approximate, but not always equal, the HR.

[c] Exchange rates are sometimes arrived at by arm's length negotiation between two parties, such as two banks, or a private firm and a bank, and may differ from the HR for commercially sound reasons.

Insistence on an exchange rate equal to the HR in such circumstances may be counterproductive and inhibit the orderly conduct of business transactions and the increased rate of economic growth that the policy seeks to stimulate.

2.342 It is not the purpose of this policy to disturb the conduct of commercial transactions among parties dealing at arm's length simply because A.I.D. is directly or indirectly involved, as long as the exchange rate used is not significantly and persistently different from the HR rate established by a mission. For the purposes of this policy, significantly different and persistently are defined as 10 percent plus or minus and 3 months in duration.

2.40 The Appropriate Exchange Rate To Be Used To Measure Counterpart Contribution.

2.41 The value of the real resource contribution provided by a host country for a project or program generally should be obtained by first pricing the host country's real resource contribution in local currency. This figure then is converted into dollars at the HR current at the time of the project agreement so that A.I.D. and host country contributions can be expressed in one common monetary unit and so that the real resource contribution by the host country can be expressed in percentage and dollar-equivalent terms. Thus, at the signing of an assistance agreement, the host country's real resource contribution is to be expressed both in terms of absolute dollars and a percentage of the total project based on the domestic and foreign prices and the exchange rate existing at that date. This forms the basis for determining host country's absolute real resource contribution and percentage share of the total project throughout its life, and insulates the host country's contribution from the effect of any exchange rate fluctuations which may occur.

2.42 The host country's/recipient's percentage share of project costs may be explicitly renegotiated on an exceptional basis if such adjustments are considered necessary for purposes of consistency with other A.I.D. assistance objectives, such as encouraging macroeconomic policy reform, and reducing domestic inflation. The rationale for such adjustments in host country/recipient contributions should be well documented and the adjustment executed in a project agreement amendment or the equivalent. In no case, unless authorized by waiver in the case of the relatively least developed countries, is the host country contribution, after recalculation of the entire project budget at the new exchange rate, to be an amount less than 25 percent of total project costs. Automatic downward adjustment in host country/recipient percentage contribution due to devaluation, inflation, and similar financial or economic events is not acceptable.

2.50 Devaluation, Excess Dollars, and Host Country Contribution.

2.51 For a project that contains a dollar component to be used to purchase local currency for procurement of goods and services on the local economy, a devaluation not accompanied by a corresponding inflation in the host country may create excess dollars in the sense that fewer dollars are needed for this component than originally contemplated. If it is determined that the original project's objective has been met, that there are excess dollars, and that these extra funds are to be used to either extend the existing project through an amendment or similar document, or are to be used for other projects or

programs within the USAID's portfolio, the appropriate counterpart contribution for these activities, if it is determined that such a contribution is required, will be based on the current exchange rate and not the original exchange rate.

2.52 To the extent this policy paper and Handbook 3 conflict, Handbook 3 will be revised to reflect the new provisions. Specifically, the standard counterpart contribution clause in bilateral grants and loans will be amended to reflect the policy.

3.00 Implementation.

3.10 New Agreements.

3.11 For new agreements, GC is reviewing the current model loan and grant agreement language in Handbook 3 to determine whether any changes are needed as a result of this policy. GC will advise missions within 45 days from the date of this guidance message. In the meantime, missions should continue to use the current model quote highest rate...not unlawful unquote language in Handbook 3 as now interpreted by this policy in paragraphs 1.30, 2.20, and 2.30. Exceptions must be justified on a case by case basis as provided in paragraph 4 below.

3.20 Existing Agreements.

3.21 Missions should make best efforts to modify existing project and non-project assistance agreements to reflect the above policy as appropriate. However, existing agreements that do not contain exchange rate clauses, or that provide for rates inconsistent with the policy stated herein, need not be amended to comply with the policy under certain circumstances. These circumstances are: [a] if a host government might view a requirement unilaterally imposed by the U.S. to renegotiate an existing agreement as quote changing the rules in mid-stream unquote; and [b] if the host government might view a substantial increase in local currency programming due to a higher conversion rate as an unwarranted foreign involvement in domestic budgetary affairs.

3.22 Since the definition of HR herein is consistent with existing Agency policy as expressed in many Bilaterals it will not be necessary to amend existing documents in most cases. In those few situations where the Bilaterals are clearly inconsistent, amendments may be required. GC or the RLAs should be consulted on such issues. Amendments to bilaterals require the Circular 175 process with approval by the Department of State.

3.30 Handling Hyperinflation.

3.31 In countries with hyperinflation, A.I.D. missions might negotiate with appropriate host government officials or private borrowers dollar disbursement schemes determined on the basis of needs. Gradual disbursements of dollars would reduce the problem of rapid depreciation of local currency deposited in special accounts.

4.00 Provisions for Exceptions.

4.10 A.I.D. recognizes that there may be circumstances in which deviation from the policy stated in paragraphs 2.22 may be appropriate. We are mindful that the exchange rate issue may be politically sensitive in particular cases. It could be argued that rigid insistence by A.I.D. on the HR would penalize a government that, through the use of multiple exchange rates, is making a good faith effort to move toward a realistic, market-based exchange rate one step at a time -- as opposed to a government that adheres to one artificially low exchange rate for all transactions. Similar situations can be accommodated under this new policy as noted in the discussion of the process for obtaining exceptions to the policy in paragraph 4.20. The HR guidance cases in paragraph 2.31 above were developed as a result of the concern that the insistence on one definition of the exchange rate for all countries might not provide the flexibility over the long run needed to get each country to adopt a unified, market-determined rate.

4.20 During its first year, the Administrator will review all requested exceptions to the policy in order to assure uniform handling of the foreign exchange rate policy as stated in this guidance cable. In consultation with GC, the involved Regional Bureau and PPC will prepare a joint action memorandum for the Administrator. It can contain a joint recommendation or, when there are unresolved differences of opinion, separate recommendations to the Administrator. This procedure supersedes foreign exchange rate guidance in Handbook 3, Section E on project assistance and establishes additional guidance for Handbook 4 on non-project assistance for cash transfers and CIPs.

4.30 Requests for authorization of an exception to general policy as provided in paragraphs 4.10 and 4.20 shall be in writing and shall identify in detail the economic and foreign policy considerations justifying a departure from the standard HR. Such justification must contain a comprehensive economic analysis of the benefits to be obtained by making the exception or the adverse consequences of failing to do so, and an explanation of the A.I.D. mission's approach for moving the host country to a unified market-determined exchange rate position. In those instances when a bilateral agreement governing the foreign exchange rate for Operating Expense transactions is inconsistent with this policy, amendment of that agreement should be considered. If renegotiation of the bilateral agreement might jeopardize other provisions that are important to the USG, it might be appropriate to request an exception to the policy for this particular set of transactions. The justification should cover both political and economic aspects of the problem.

5.00 General Policy Comments.

5.10 P.L. 480 Agreements.

5.11 The requirement for local currency conversion in P.L. 480 programs is controlled partly by statute [reference [e]] and partly by policy established by the Development Coordination Committee's inter-agency working group on food aid [reference [f]]. These requirements are stated in Article III G and

Article II F of Part I of the Title I Agreement, and pertain to two separate categories of local currency transactions involving currencies and commodities respectively.

5.12 The first category involves transactions in which the United States accepts local currency instead of dollars in payment for Title I commodities; e.g., currency use payments and repayments of the loan. For this type of transactions, Article III G of Part I of the Title I agreement provides that the exchange rate must be quote not less favorable...than the highest exchange rate legally obtainable in the importing country and...not less favorable...than the highest exchange rate obtainable by any other nation. unquote This provision is interpreted as being relevant to exchange rates for the same kind of transactions, not any transaction. Thus, if a country has one exchange rate for government to government transactions and another exchange for luxury imports, the former not the latter would be the relevant rate to consider.

5.13 The second category of transactions involves local currency generated by the sale of commodities in country, of which a certain minimum amount [equivalent to the CCC dollar value of the commodities] must be used for agreed upon purposes. Article II, F of Part I of the Title I agreement states that: quote The exchange rate to be used in calculating this local currency equivalent shall be the rate at which the central monetary authority of the importing country, or its authorized agent, sells foreign exchange for local currency in connection with the commercial import of the same commodities. unquote This language permits A.I.D. to accept a lower exchange rate for agricultural commodities where a multiple exchange rate structure exists. Until such time as it is changed, the standard language governing P.L. 480 transactions shall continue to apply.

5.20 Effects Of Overvalued Currency.

5.21 The general A.I.D. policy to encourage host governments to establish one market-determined exchange rate for all transactions will discourage host countries from subsidizing imports and penalizing exports, the two primary effects of an overvalued currency. It will also minimize windfall profits to importers and intermediaries [public, private, and parastatal] who obtain foreign assistance resources at a foreign exchange rate below the open market rate, and then sell those resources at prices determined by the market rate [reference [g], page 35]. Finally, it is designed to assure that host country government budgets do not understate [in local currency terms] the cost of resources, especially of imported physical capital.

5.22 To the extent this policy guidance accepts an overvalued exchange rate, windfall profits will tend to accrue to importers who obtain A.I.D. supplied commodities at the quote highest rate not unlawful unquote and then sell those commodities at prices determined by a higher parallel rate or by other import restrictions. Elimination of windfall profits is best achieved, as stated in the above paragraph, by an end to overvaluation of the local currency and the establishment of one exchange rate. Alternatively, auctions or surcharges could be used to reduce excessive gains.

5.23 An overvalued currency makes imported capital goods cheaper than they would be if the currency were properly valued, and leads businesses and governments to purchase more imported capital goods than they otherwise would. As a result, businesses and governments in LDCs will tend to use relatively less of an economy's relatively abundant labor resource and import relatively more capital goods than they would if the currency were not overvalued.

5.24 Even in the case of a U.S. dollar cash transfer without a special local currency account, a resource allocation distortion resulting from an overvalued currency still occurs as the dollars help finance import needs. The host government and local businesses in their domestic budgetary processes must ultimately value the machinery and equipment in local currency units. At an overvalued exchange rate, this will produce a local currency cost value lower than it would be if the exchange rate were not overvalued, and as noted above, will lead to the use of more imported capital goods than would be the case if the local currency were not overvalued.

6.00 References.

[a] Policy Determination No. 5 on quote Programming P.L. 480 Local Currency Generations unquote [February 22, 1983], which refers to the standard exchange rate provisions in Article II-F of Part I of all P.L. 480 Title I agreements;

[b] State 070833 on quote Guidance for Preparation and Submission of Mission Plans for Use of CIP, Cash Transfer and P.L. 480 Local Currency Generations unquote [March 10, 1984], which states that PD No. 5 applies to CIP and cash transfer activities as well as to P.L. 480 activities;

[c] A.I.D. Handbook 3, Section 6E and Appendix 6A on quote The Project Agreement unquote [September 30, 1982] for both loans and grants;

[d] A.I.D. Handbook 4, Chapter 4A on quote Non-project Assistance Agreements unquote and Chapter 7 on the quote Public Law 480, Title I Program unquote [September 30, 1975];

[e] Agricultural Trade Development and Assistance Act of 1954, as amended [P.L. 480], Section 103[h] on exchange rates, and Sections 105, 206, and 305 on special accounts [quote Legislation on Foreign Relations through 1984, unquote March 1985];

[f] AIDTO Circular A-487 [July 6, 1974] on quote P.L. 480 Title I -- Basic Negotiating Instruction and Draft Agreement unquote;

[g] A.I.D. Program Design and Evaluation Methodology Report No. 4 on quote Evaluation Guidelines for Non-Project Assistance [CIPs] and CIP-Like Activities unquote [August 1985];

[h] Foreign Assistance Act of 1961, as amended, Section 609 on special accounts [quote Legislation on Foreign Relations through 1984 unquote, March 1985];

[i] Manual Order No. 1512.1.1 On quote The Generation of Local Currency and the Acquisition and Allocation of Local Currency for Technical and Capital Assistance Projects unquote [September 23, 1970], which is superseded by this policy statement.

Additional Clearances

AID/DAA/PRE:CGladson [draft]
AID/AA/M:RTRollis [draft]
AID/IG:HBeckington [substance]

POLICY GUIDANCE ON CRITERIA FOR PAYMENT OF
SALARY SUPPLEMENTS FOR HOST GOVERNMENT EMPLOYEES

1. THIS CABLE CLARIFIES AND SUPERCEDES AGENCY POLICY GUIDANCE ON PAYMENT OF SALARY SUPPLEMENTS TO HOST GOVERNMENT [HG] EMPLOYEES CONTAINED IN REF [A]. AID/W HAS REVIEWED FIELD RESPONSES TO THE QUESTIONNAIRE ON SALARY SUPPLEMENTS CONTAINED IN REF [B] AND FOUND THESE RESPONSES HELPFUL IN IDENTIFYING NECESSARY CHANGES AND CLARIFICATIONS. MUCH OF THIS GUIDANCE IS IDENTICAL TO THE GUIDANCE CONTAINED IN REF [A]; HOWEVER, THE PARAGRAPHS BELOW DO PROVIDE NEW DEFINITIONS AND EXPLANATIONS OF THE COVERAGE OF THIS POLICY AS WELL AS ADDITIONAL REQUIREMENTS FOR DOCUMENTATION OF SALARY SUPPLEMENTS PAID BY A.I.D.

2. THE ISSUE OF SALARY SUPPLEMENTS REMAINS SENSITIVE AND A MATTER OF BOTH CONGRESSIONAL AND AGENCY CONCERN. IT IS A.I.D. POLICY THAT SALARY SUPPLEMENTS SHOULD BE CONSIDERED AN EXCEPTION TO NORMAL A.I.D. PRACTICE REQUIRING EXCEPTIONAL JUSTIFICATION.

3. DEFINITIONS:

A. A HG EMPLOYEE COVERED UNDER THIS GUIDANCE IS AN EMPLOYEE PAID BY THE HG, OCCUPYING AN ESTABLISHED POSITION, EITHER TEMPORARY OR PERMANENT, PART-TIME OR FULL-TIME, WITHIN A HG INSTITUTION. A HG INSTITUTION IS AN ORGANIZATION IN WHICH THE GOVERNMENT OWNS AT LEAST A FIFTY PERCENT SHARE OR RECEIVES AT LEAST FIFTY PERCENT OF ITS FINANCIAL SUPPORT FROM THE GOVERNMENT.

B. SALARY SUPPLEMENTATION OCCURS WHEN PAYMENTS ARE MADE THAT AUGMENT AN EMPLOYEE'S BASE SALARY OR PREMIUMS, OVERTIME, EXTRA PAYMENTS, INCENTIVE PAYMENT AND ALLOWANCES FOR WHICH THE HG EMPLOYEE WOULD QUALIFY UNDER HG RULES OR PRACTICE FOR THE PERFORMANCE OF HIS REGULAR DUTIES OR FOR WORK PERFORMED DURING HIS REGULAR OFFICE HOURS. PAYMENT, IN FULL OR PART, OF HG BASE SALARIES AND OTHER ENUMERATED PAYMENTS AT HG RATES WOULD BE SUBJECT TO THE AGENCY'S GUIDANCE ON RECURRENT COST [SEE HANDBOOK-1, PART III.A2]. WHERE THE MISSION PAYS THE SALARY AND ALLOWANCES OF HG OFFICIALS AT THE HG RATE, IT IS NOT CONSIDERED A SALARY SUPPLEMENT BUT RATHER RECURRENT COST.

UNCLASSIFIED

C. THE FOLLOWING ARE NOT CONSIDERED TO BE SALARY SUPPLEMENTS: PER DIEM; INVITATIONAL TRAVEL; HONORARIA AND PAYMENT FOR WORK CARRIED OUT OUTSIDE OF NORMAL WORKING HOURS. THE RULES GOVERNING THESE TYPES OF PAYMENTS ARE SUMMARIZED IN PARAGRAPH 5 BELOW.

4. RULES ON SALARY SUPPLEMENTS:

A. A.I.D. DISCOURAGES SALARY SUPPLEMENTS EXCEPT IN VERY SPECIAL CIRCUMSTANCES. HENCEFORTH, MISSIONS MUST SUBMIT ANY NEW PROPOSALS FOR SALARY SUPPLEMENTATION TO A.I.D. WASHINGTON FOR APPROVAL BY THE APPROPRIATE ASSISTANT ADMINISTRATOR.

B. A.I.D. NORMALLY EXPECTS THAT THE HG WILL FINANCE ANY NECESSARY SUPPLEMENTS TO COMPENSATION FOR ITS REGULAR EMPLOYEES WHEN THEY ARE ASSIGNED TO A.I.D.-FINANCED PROJECTS. THERE ARE INSTANCES, HOWEVER, WHERE AS A LAST RESORT A.I.D. FINANCING OF SUPPLEMENTS TO LOW HOST COUNTRY SALARIES MAY BE DEEMED ESSENTIAL TO THE ACHIEVEMENT OF HG AND A.I.D. JOINT PROGRAM OBJECTIVES. SUCH SUPPLEMENTS TYPICALLY TAKE THE FORM OF PREMIUMS FOR RELOCATION TO REMOTE PROJECT SITES, INCENTIVES, AND BONUSES NECESSARY TO ATTRACT HIGHLY TRAINED TECHNICAL SPECIALISTS TO DEVOTE THEIR EXPERTISE TO THE PLANNING OR IMPLEMENTATION OF DEVELOPMENT PROJECTS.

C. A.I.D. PROJECT FUNDS MAY BE USED FOR THESE PURPOSES ONLY IF THE FOLLOWING CRITERIA ARE MET:

-- THE PAYMENTS ARE PERMITTED UNDER HOST COUNTRY LAW AND REGULATIONS.

-- THE COOPERATING ENTITY HAS DEMONSTRATED THAT IT CANNOT MAKE THESE PAYMENTS FROM ITS OWN RESOURCES FOR VALID REASONS SUCH AS THE INABILITY OF THE ENTITY TO PROVIDE THE FINANCING WITHIN THE TIME REQUIRED TO MEET THE NEEDS OF THE ACTIVITY.

-- THE SUPPLEMENTS ARE JUDGED ESSENTIAL TO THE ACHIEVEMENT OF PROJECT OR PROGRAM OBJECTIVES.

-- EMPLOYEES DO NOT RECEIVE DUPLICATE PAYMENTS BY RECEIVING SUPPLEMENTS FROM ANOTHER SOURCE FOR THE SAME ACTIVITY.

-- THE RATES AND FEES PAID ARE IN ACCORDANCE WITH LOCAL STANDARDS AND ARE LIMITED TO AMOUNTS REASONABLE IN RELATION TO AN EMPLOYEE'S PAY AND, FOR CONTINUING PROGRAMS, IN AMOUNTS WHICH THE HOST COUNTRY ENTITY COULD BE EXPECTED TO MEET FROM ITS OWN RESOURCES WITHIN A REASONABLE TIME.

-- THE PROPOSED RECIPIENTS WOULD BE CARRYING OUT TECHNICAL, MANAGERIAL OR ADMINISTRATIVE SUPPORT RATHER THAN BROAD POLICY FUNCTIONS.

-- A MECHANISM EXISTS FOR PROVIDING THE SUPPLEMENTS WHICH PREVENTS POTENTIAL ABUSE IN THE DETERMINATION OF RECIPIENTS AND AMOUNTS TO BE PROVIDED; ENSURES FINANCIAL INTEGRITY IN THE PAYMENT SYSTEM; AND ESTABLISHES ADEQUATE MONITORING AND REPORTING.

D. IF THE ABOVE CRITERIA ARE MET, JUSTIFICATION FOR THE PROPOSED SUPPLEMENTS AND A MECHANISM FOR PROVIDING THE SUPPLEMENTS MUST BE SET FORTH EXPLICITLY IN AND APPROVED AS PART OF THE ACTIVITY DOCUMENTATION AND/OR AUTHORIZATION AND DESCRIBED IN THE RELEVANT AGREEMENT. WHEN SALARY SUPPLEMENTS ARE LIKELY TO BE INCLUDED IN A PROPOSED A.I.D. PROJECT OR PROGRAM, THIS SHOULD BE CLEARLY INDICATED IN THE PROJECT IDENTIFICATION DOCUMENT [PID], OR OTHER RELEVANT DOCUMENT. THIS JUSTIFICATION AND A DESCRIPTION OF THE MECHANISM FOR PROVIDING THE SALARY SUPPLEMENTATION MUST BE REVIEWED BY THE APPROPRIATE ASSISTANT ADMINISTRATOR. DOCUMENTATION OF THE LEGALITY OF SUCH PAYMENTS UNDER HOST COUNTRY LAWS AND REGULATIONS SHOULD BE MAINTAINED AND READILY ACCESSIBLE AS PART OF THE PROJECT OR PROGRAM FILES.

E. THIS POLICY GUIDANCE APPLIES TO THE USE OF A.I.D. DOLLAR RESOURCES, AS WELL AS TO U.S.-OWNED LOCAL CURRENCY AND HOST COUNTRY-OWNED LOCAL CURRENCY JOINTLY PROGRAMMED BY A.I.D. AND THE HOST COUNTRY WHEN THE PROPOSED USES OF THE LOCAL CURRENCY INCLUDE EXPLICITLY PAYMENT OF SALARY SUPPLEMENTS.

F. POLICY-MAKING OFFICIALS SHALL NOT RECEIVE A.I.D. PAYMENT OF SALARY SUPPLEMENTS IN ANY FORM INCLUDING A.I.D. PAYMENTS FOR PROJECT-RELATED WORK CONDUCTED OUTSIDE NORMAL WORKING HOURS AS DISCUSSED IN PARAGRAPH 5.D. BELOW. POLICY-MAKING OFFICIALS ARE DEFINED AS HIGH-LEVEL ELECTED OR APPOINTED OFFICIALS SUCH AS THOSE SERVING ON THE CABINET OR IN THE IMMEDIATELY SUBORDINATE SUB-CABINET POSITION.

G. THIS POLICY GUIDANCE APPLIES TO ALL NEW PROJECTS AND ACTIVITIES HENCEFORTH. IT MUST ALSO BE APPLIED TO ONGOING PROJECTS AND ACTIVITIES TO THE FULL DEGREE DEEMED FEASIBLE BY THE MISSION DIRECTOR AND WITHOUT JEOPARDIZING OVERALL A.I.D. COUNTRY PROGRAM OBJECTIVES PREVIOUSLY SIGNED BY THE USAID AND THE HG, INCLUDING THOSE FUNDED BY A.I.D. AND MANAGED BY PVOS OR OTHER NON-GOVERNMENTAL ORGANIZATIONS. APPROPRIATE ASSISTANT ADMINISTRATORS MUST BE ADVISED IMMEDIATELY OF SPECIFIC CIRCUMSTANCES WHERE ONGOING SALARY SUPPLEMENTS CANNOT BE BROUGHT INTO COMPLIANCE WITH THIS POLICY GUIDANCE. MISSIONS WILL PROVIDE SPECIFIC DETAILS TO THE ASSISTANT ADMINISTRATORS WHERE THERE IS ANY DOUBT REGARDING THE LEGAL BASIS OF SALARY SUPPLEMENTS [SEE SUBPARAGRAPH I BELOW].

H. USAIDS SHOULD DISCUSS THE ISSUE OF SALARY SUPPLEMENTS WITH OTHER DONORS IN AN EFFORT TO MINIMIZE THE PRACTICE, AVOID DUPLICATIVE PAYMENTS FOR THE SAME PROJECT OR ACTIVITY, MODERATE COMPETITIVE EFFORTS TO ATTRACT LIMITED CAPABLE PERSONNEL AND, IN CASES WHERE SUPPLEMENTATION IS NECESSARY, TO ARRIVE AT GENERALLY COMPARABLE LEVELS OF SUPPLEMENTARY COMPENSATION.

I. ANY LEGAL QUESTIONS SHOULD BE RESOLVED BY THE MISSION DIRECTOR IN COORDINATION WITH THE REGIONAL LEGAL ADVISOR. IF ANY DOUBT REMAINS CONCERNING LEGAL QUESTIONS, THE REGIONAL ASSISTANT ADMINISTRATOR OR HIS DESIGNEE IN COORDINATION WITH A.I.D./GC SHOULD MAKE THE DETERMINATION. ANY OTHER QUESTIONS REGARDING APPLICATION OF THIS GUIDANCE SHOULD BE DIRECTED TO THE REGIONAL BUREAU ASSISTANT ADMINISTRATOR AND AA/PPC.

J. EXCEPTIONS TO THIS POLICY AND ELIGIBILITY CRITERIA WILL BE GRANTED VERY RARELY AND MUST BE APPROVED IN ADVANCE BY THE APPROPRIATE ASSISTANT ADMINISTRATOR IN WASHINGTON.

5. RULES ON PAYMENTS TO INDIVIDUALS WHICH ARE NOT CONSIDERED TO BE SALARY SUPPLEMENTS:

A. PER DIEM IS PERMISSIBLE FOR PROGRAM OR PROJECT-RELATED ACTIVIES PROVIDED ANY SUCH REIMBURSEMENT IS PAID AT THE HG RATE, U.S. GOVERNMENT RATE OR ON AN ACTUAL COST REIMBURSEMENT BASIS.

B. IT IS PERMISSIBLE TO FUND THE INTERNATIONAL TRAVEL OF POLICY OFFICIALS ON INVITATIONAL TRAVEL ORDERS APPROVED BY THE MISSION DIRECTOR. IN SPECIAL CIRCUMSTANCES, SUCH AS WHEN HG

POLICY OFFICIALS ACCOMPANY U.S. GOVERNMENT OFFICIALS ON OFFICIAL TRAVEL WITHIN THE HOST COUNTRY, IT IS ALSO PERMISSIBLE TO FUND DOMESTIC TRAVEL OF HG POLICY-MAKING OFFICIALS AT THE U.S. GOVERNMENT RATE OR ON AN ACTUAL COST REIMBURSEMENT BASIS, EVEN THOUGH THE OFFICIAL IS NOT ON U.S. GOVERNMENT TRAVEL ORDERS. SUCH TRAVEL COSTS AND PER DIEM ARE NOT CONSIDERED SALARY SUPPLEMENTS.

C. HONORARIA MAY BE PAID TO UNIVERSITY EMPLOYEES AND TO MEMBERS OF RESEARCH INSTITUTIONS, WHO ARE HG EMPLOYEES SOLELY BY VIRTUE OF THEIR POSITION IN A UNIVERSITY OR RESEARCH INSTITUTION, CARRYING OUT PROJECT-RELATED ACTIVITIES OUTSIDE THEIR NORMAL DUTIES WHERE THE NORMAL PRACTICE OF THE HG CONDONES THIS TYPE OF ADDITIONAL WORK. ONLY NOMINAL AND OCCASIONAL PAYMENTS OF HONORARIA TO OTHER HG EMPLOYEES UNDER SIMILAR CIRCUMSTANCES MAY BE PAID PROVIDED SUCH PAYMENTS ARE CLEARLY FOR FUNCTIONS OUTSIDE THEIR NORMAL DUTIES AND DO NOT TAKE PLACE DURING NORMAL WORKING HOURS OR OTHERWISE CONFLICT WITH OFFICIAL DUTIES IN WHICH CASE THEY ARE NOT CONSIDERED SALARY SUPPLEMENTS. FREQUENT RECURRING PAYMENTS ARE PROHIBITED EXCEPT FOR UNIVERSITY EMPLOYEES.

D. PAYMENT FOR PROJECT-RELATED RESEARCH AND SPECIFIC STUDIES CONDUCTED OUTSIDE NORMAL WORKING HOURS AND PERMITTED BY HG PRACTICE AND LAW IS ALLOWABLE PROVIDED THE HG EMPLOYEE IS NOT COMPLETING THIS WORK DURING HOURS OF HIS REGULAR DUTIES PAID BY THE HG AND PROVIDED THE WORK DOES NOT CONFLICT IN ANY OTHER WAY WITH OFFICIAL DUTIES. A CLEAR RELATIONSHIP AND METHOD OF PAYMENT NEEDS TO BE ESTABLISHED FOR THESE SERVICES, E.G. - COOPERATIVE AGREEMENT, END PRODUCT OR PURCHASE ORDER. GENERALLY, A PSC IS NOT CONSIDERED AN APPROPRIATE MECHANISM BECAUSE OF THE IMPLIED EMPLOYEE/EMPLOYER RELATIONSHIP. MISSIONS SHOULD GENERALLY AVOID FINANCING PAYMENTS FOR INDIVIDUALS WHO ARE ALREADY CARRYING OUT SIMILAR ACTIVITIES AS PART OF THEIR NORMAL DAILY DUTIES OR OFFICIAL FUNCTION. ALSO TO THE MAXIMUM EXTENT PRACTICAL, THE WORK SHOULD BE PERFORMED ON A SITE OTHER THAN THE EMPLOYEE'S NORMAL WORK SITE. IT SHOULD BE KNOWN TO THE EMPLOYEE'S HG SUPERVISOR.

E. MISSIONS ARE RESPONSIBLE TO ENSURE THAT ADEQUATE DOCUMENTATION IS AVAILABLE IN PROJECT OR PROGRAM FILES TO SUPPORT ANY PAYMENTS MADE WITHIN THE SCOPE OF THIS POLICY GUIDANCE ON PAYMENTS TO INDIVIDUALS WHICH ARE NOT CONSIDERED TO BE SALARY SUPPLEMENTS.

- ANNEX A - OLD HANDBOOK 1 GUIDANCE RETAINED ON INTERIM BASIS

Annex A - Material in Existing Handbook 1 which has not yet been superseded by new PP's, PD's or transferred to other Handbooks

TABLE OF CONTENTS

A. Summary for Executive

PART I. INTRODUCTION

1. General

PART II. COUNTRY-SELECTION POLICIES AND AID TERMS

1. General
2. Least-Developed Countries
3. Higher Income LDC's

PART III. SECTOR POLICIES

1. Housing
2. Physical Infrastructure
3. Restricted Areas (abortion, public safety, mil. items, compet. w/U.S. business, non-food surpluses, gambling facilities, weather mod. etc.

PART IV. CROSS-SECTORAL EMPHASES

Economic-Social Concerns

1. Income Distribution and Employment
2. Labor-Manpower
3. Popular Participation in Development

Technical Concerns

4. Science and Technology
5. Research and Innovation

PART V. RESOURCE-USE POLICIES

1. General
2. Food for Peace

Non-U.S. Resources

3. General
4. Multilateral
5. Bilateral

PART VI. PROGRAMMING AND EVALUATION POLICIES

1. Program Evaluation

POLICY DETERMINATIONS

PD NO.

37. AID's Role with Respect to Non-AID Resources in the Total Foreign Assistance Effort

47. Guidelines on Research

48. Employment and Income Distribution Objectives for AID Programs and Policies

50. AID and the Relatively Less Developed Countries

51. Guidance Statement on Selected Aspects of Science & Technology

52. Policy Determination on Labor-Manpower

61. Requesting Accelerated Repayment on AID Loans

66. Criteria for Determining AID Loan Terms and for Requesting Acceleration of Loan Repayments

69. Development Administration

71. AID Financing of Palm Oil, Citrus, and Sugar Projects & Related Products

73. AID-U.S. Cooperative Organization Relationships

Policy Papers

Development Assistance
Security Supporting Assistance
Labor
Trade Investment & Dev.

NOTE:

The following material from the existing Handbook 1 will eventually be superseded by new Policy Papers and Policy Determinations or transferred to other handbooks. Please retain this annex as interim guidance until a cancellation notice is received.

INTRODUCTION

I-1: General

It is U.S. policy, in the words of Congress (FAA of 1961, as amended, Sec. 102), to "assist the people of less developed countries (LDC's) in their efforts to acquire the knowledge and resources essential for development and to build the economic, political, and social institutions which will meet their aspirations for a better life..." Accordingly, it is AID policy to encourage and support LDC efforts to (a) expand their output of essential goods and services, particularly food, (b) to distribute it more equitably, and (c) improve the quality of life of their people. AID policy also stresses an integrated focus on specific development problems, via both capital and technical assistance, so as to produce measurable lasting improvements in the lives of significant numbers of poor people in LDC's at the same time that their national economies are moving toward self-sustaining growth (i.e., growth without dependence on large-scale concessional transfers of resources).

This general policy approach and subsequent policy statements, though formulated for AID's development assistance, are intended to cover where feasible all forms of economic aid, including that given to support U.S. political/security objectives.

The emphasis is apparent in this Handbook: For example, AID's cross-sectoral policies (Part IV) stress the importance and benefits of (1) greater access by the urban and rural poor to employment opportunities and to appropriate technology and education, (2) greater participation by the people in decision-making and the process and fruits of development, and (3) the fuller integration of women into national economic life. AID's sector policies (Part III) emphasize helping LDC's solve the most pervasive problems of the world's poor, by projects and programs which increase their production and consumption of better food and improve their access to education, health, and family planning programs, so that they can function more effectively in their socio-economic environment. These policies are an expression of AID's commitment to carry out the Congressional mandate that our assistance -- in priority sectors as well as generally -- help particularly the poor in LDC's who need it most and who (by almost any definition) constitute the majority in the underdeveloped world. Benefiting from the greater employment opportunities as well as from the improved health and education resulting from joint LDC/donor efforts, the poor majority in LDC's can then participate more fully in the development process, increase their contribution to it, and share more equitably in its fruits.

To help LDC's achieve these broader goals at a time when AID funds are smaller and LDC needs remain large requires that AID influence over-all U.S. policies and programs, so that those which are relevant to development of LDC's support (or at least do not run counter to)

AID efforts. In that connection AID sees its intra-government role as being a spokesman for LDC development, wherever possible, as well as being the focal point for humanitarian assistance. In allocating its own funds, it is AID policy in general to use its development assistance resources to assist those countries which are most in need and also able to use both our aid and their resources effectively (Part II); to integrate AID resources to the fullest with those from LDC's as well as from other donors, both private and governmental and both bilateral and multilateral (Parts V and VI); and to help particularly the least developed countries to improve their development policies and programs, so that our efforts can more effectively reinforce theirs. In all areas, but especially in the sensitive area of LDC policies, this task calls for continuation of AID's "collaborative style" of consulting with LDC officials on important issues wherever and whenever appropriate.

The Agency's resources are also used to support U.S. foreign policy objectives, mostly in the form of security supporting assistance used for balance-of-payments support. However, since most of the security assistance enables the recipients either to support some economic development or to maintain a higher level of economic activity and stability than would otherwise be possible, the dividing line between these and other AID resources is not precise, in terms of either their uses or their economic impact; and it may become less so as circumstances change, either in the recipient LDC or in U.S. objectives. In fact, it is AID policy to help the LDC reach the point where circumstances favor replacing security assistance by development aid.

Development is the responsibility of the governments and people in LDC's. But if our assistance is to be fully effective, it must -- within funding and other limitations -- be innovative itself and encourage and support innovative and experimental LDC programs backed up by planning and research. Starting with recognition of the major differences among LDC's in social-economic circumstances, institutions, and values, Missions and Bureaus must therefore insure that both AID and LDC's focus on practical and flexible ways of achieving our individual and joint goals.

References:

1. FAA of 1961, as amended, particularly Sec. 102.
2. AID Handbook 17 (AID Organization).

PART II - COUNTRY-SELECTION POLICIES

COUNTRY-SELECTION POLICIES

II-1: General

It is AID policy to act as spokesman within the U.S. government on LDC development, guided on aid-allocation decisions chiefly by its assessment of (1) relative LDC needs for U.S. concessional assistance (taking account of other aid possibilities), (2) the relative ability and willingness of LDC's to use aid productively in ways that will improve substantially the lives of the poor majority of their people, and (3) such other factors as U.S. historical relationships with particular LDC's, population pressures in large LDC's, and the need to expand world food production. Final decisions as to which countries will receive U.S. economic assistance -- and how much and which kinds -- are of course also influenced by U.S. foreign policy considerations.

"Relative LDC needs" is an elusive concept even on strictly development grounds. Comparative levels of per-capita income are, however, a useful first approximation. As a rule of thumb, low-income countries (annual per capita income of $300 or less) are generally eligible for both concessional capital and technical assistance; those LDC's in the middle income group ($300 to $500 annually) may still need concessional loans and technical assistance; and higher-income LDC's (over $500 per capita annually) would generally not be eligible for concessional assistance, particularly if they have large and growing foreign exchange reserves, unless there are special political-economic-social considerations. While the eligibility of individual LDC's and the dimensions of even their strictly developmental needs can be ascertained only by intensive analysis, an LDC's membership in the second or third group or a large buildup in its foreign-exchange earnings or reserves should indicate to Missions and Bureaus the need to consider reducing or phasing out concessional aid to that LDC. In that event, AID should direct the LDC more toward such other assistance instruments as investment and housing guarantees and Export-Import or World Bank loans or toward AID technical cooperation (including worldwide or regional programs directed at priority groups or objectives) in which the costs are borne largely or fully by the LDC itself.

LDC ability to use aid is also an important determinant of the level of assistance it receives. Thus, LDC's will find the Agency particularly receptive if they can use technical and capital assistance for projects which directly benefit large numbers of their poor and which also contribute to long-range development through (e.g.) job creation, export earnings, and upgrading of skills, institutions, and management capabilities. AID recognizes that LDC's at a higher stage of development often receive more aid than the neediest, least developed LDC's, simply because they can develop projects and use resources more productively. It is therefore AID policy to enlarge the absorptive capacity of the poorest LDC's, as is noted in Policy Statement II-2.

AID may respond to the emergency needs of LDC's affected by natural disasters or man-made crises such as sharp changes in commodity prices; and it may provide some aid for non-development reasons. However, it is basically the long-term problem of helping LDC's speed up their development and alleviate their poverty which it is AID's responsibility and policy to address in its aid-allocation decisions.

COUNTRY-SELECTION POLICIES

II-2: Least-Developed Countries

Donors and recipients agreed unanimously at the third UNCTAD (UN Conference on Trade and Development, Santiago, 1972) that the Least Developed Countries should receive special assistance because of their extreme poverty, critical problems and inability to benefit substantially from existing aid programs.* It is AID policy, therefore, to seek ways to make aid to these countries more effective and to expand its volume and scope where feasible.

Accordingly, in addressing the development problems of the least developed countries, AID Missions and Bureaus should:

1. Expand their cooperation and coordination with other donors as appropriate, in particular with the UNDP on technical assistance activities, the IBRD and regional development banks on capital development matters, and the DAC on bilateral donor coordination.

2. Use new approaches, where feasible and appropriate, for accelerating the flow of aid and making it more effective, including (e.g.) greater use of grant funding, more flexibility in AID financing of local costs and offshore procurement of goods and services, and relaxed project requirements where necessary -- with the overall objective of helping the least developed countries to mobilize and use their own material and manpower resources more fully in conjunction with available foreign aid.

3. Encourage and support the expansion of innovative research and analysis directed toward ameliorating development problems in these countries -- particularly in agriculture, health and education but also in public administration and institution building generally -- again with the overall objective of helping the least developed countries to mobilize, allocate, and utilize their own resources more fully and effectively.

*The UN list included 25 countries, on the basis of low per-capita GDP ($100 or less annually), low proportion of GDP in manufacturing (10% or less), and low adult literacy rate (20% or less). African countries were Botswana, Burundi, Chad, Dahomey, Ethiopia, Guinea, Lesotho, Mali, Malawi, Niger, Rwanda, Somalia, Sudan, Tanzania, Uganda and Upper Volta; Asian countries were Afghanistan, Bhutan, Laos, Maldives, Nepal, Sikkim, Western Somoa, and Yemen; and the only Latin American country included was Haiti. AID finds the UN list generally acceptable. However, for various reasons, the Agency does not have programs in all countries on the UN list; and it accords concessionary aid to some LDC's not on that list, where justified by Missions and Bureaus.

4. Focus on the problems of individual least developed countries, to the extent AID resources allow, so as to better identify their needs, constraints and capacities as well as the opportunities and means for applying coordinated remedial assistance from AID and other donors.

References:
1. PD-50.
2. FAA of 1974, Sec. 49.

COUNTRY SELECTION POLICIES AND AID TERMS

II-4: Higher Income LDC's

Some less developed countries (LDC's), as a result of their own efforts and resources supplemented by donor assistance, are approaching a situation where they can service foreign debt at terms harder than the Agency's standard development loan terms. Accordingly, in a recent policy change, the Agency has instituted a procedure to identify those LDCs and to (a) harden its own loan terms for them and/or (b) help them to gain access, at reasonable terms, to appropriate commercial capital markets. These steps are considered as intermediary to a fuller reliance on commercial-term capital inflows to supplement their own resources.

A. Intermediate-term loans by AID

The intermediate terms, to apply to both supporting assistance and development loans, are 25 years maturity, including a 5-year grace period, with an interest rate of 5 percent for both the grace and 20-year amortization periods. Although harder than AID's statutory minimum loan terms (40 years maturity, with 2% interest during the 10-year grace period and 3% thereafter), the intermediate terms still satisfy the DAC agreement that Official Development Assistance (ODA) have at least a 25 percent grant element.

Identification of LDC candidates for intermediate-term loans will be based on an annual AID/W examination (between January 15 and March 15) of the position of all aid recipients with respect to four indicators of GNP and foreign exchange earnings. If an LDC meets any one of these criteria, which are spelled out below, this will constitute a signal for an intensive review of the LDC's economic position, including not only GNP and foreign exchange earnings but also its debt position, resource base, ability to mobilize domestic savings, and its intermediate and long-term economic prospects generally. The results of that review, together with (e.g.) LDC social/equity and U.S. foreign policy considerations, will be the basis for a final decision by the Administrator.

The four economic criteria are:

1. Per-capita GNP levels. With full recognition of deficiencies in its coverage, accuracy, and meaningfulness in view of distribution and conversion problems, the Agency recognizes per-capita GNP as probably the best single quantitative indicator now available of LDC performance and progress. Accordingly, a per-capita GNP level of $500 or more in 1973 prices will be used as a signal for more intensive review of the LDC's ability to service intermediate-term loans.

2. Growth of per-capita GNP. If per-capita GNP has grown in real terms during the past five years at a rate of at least 5% annually, and if its current level is at least $375 in 1973 prices, this also will be a sufficient signal for review.

3. Ratio of foreign exchange reserves to imports of goods and services. If foreign exchange reserves have been maintained in three successive years at a level of at least one-third that of imports, and if per-capita GNP is at least $375 in 1973 prices, again this will be a sufficient signal for review.

4. Ratio of current-account surplus to imports of goods and services. If this ratio has been at least 0.2 for each of the last three years, in the absence of unusual circumstances this alone (i.e., regardless of per-capita GNP levels) will be a signal for intensive review of the LDC.

B. LDC access to foreign capital markets

It is Agency policy to help qualified LDC aid recipients augment or replace their inflow of capital on concessional terms by borrowing in foreign markets on commercial terms. This Agency policy is beginning to be translated into programs of technical assistance which explain the intricacies of U.S. capital markets so as to help facilitate LDC access to them. Other aspects of Agency policy in this area (e.g., whether or not to seek national or international guarantees of LDC borrowing) remain to be worked out.

Reference:

1. PD-66

PART III - SECTOR POLICIES

SECTOR POLICIES

III-4: Education and Human Resources

It is AID policy to help LDC's provide particularly their poor majority with the knowledge, skills, and orientation to enhance the quality of their lives and enable them to participate more fully in, contribute more effectively to, and receive more benefits from national economic and social growth. To accomplish this with the limited resources available, LDC governments will need to make their total education and human resources system more efficient and effective in support of development, exploring new and traditional nonformal education alternatives as well as means to improve, expand, or reorient their formal education institutions. AID is particularly concerned that, in doing so, LDC's give higher priority to using education as a means for integrating women and the poor majority into the development process.

Education program development should begin with the identification of LDC/AID goals and analysis of their implications for LDC learning needs. A determination of how fully existing education activities are serving these needs should come next, followed by identification of economic, cultural, and political constraints - both overall and in priority development sectors -- as well as constraints within the education system itself. The planning and design of formal and/or nonformal education programs to help remedy the most important deficiencies is the final step in the process. All education analysis should be coordinated to the maximum feasible extent with the analysis and planning for other key development sectors, so that it is related to actual and potential work opportunities and needs.

The agency recognizes that LDC education problems and resources vary substantially and that even the best analysis, however helpful it might be, is unlikely to yield satisfactory and complete answers to the problems of identifying and satisfying "learning needs" for development. But it also believes that LDC decisions regarding education can be improved, especially at the margin, if LDC's consciously seek new approaches to benefit the poor, both men and women, adults and children. Central AID resources are available, or can be arranged, to help Missions and LDC's in their initial analysis as well as to help LDC's develop the analytical skills needed to design and operate more efficient and effective educational systems. AID funds are available to finance experimental or pilot programs to test the feasibility and cost-effectiveness of alternative education approaches to national and sectoral development objectives and to finance the ancillary analysis, design, training, and evaluation services.

Missions and Bureaus should emphasize, in AID financing, analysis and the development of low-cost easily replicable experimental or pilot programs focussed on the poor, taking full account of past and current evaluations of what is appropriate and feasible in each LDC in the light of its particular needs, capacity, and commitment to education for development. More specifically, experience suggests that the following interrelated educational means and objectives warrant consideration by LDC's and/or Missions:

1. Greater relevance to development and the learning needs of the poor majority. Nonformal education might be expanded to include (e.g.) skills training for farmers built around crop-specific field demonstrations, education components of health or nutrition activities, and more on-the-job training in industry, handicrafts, and

Construction (perhaps stimulated by tax incentives or direct government subsidies) so as to reduce reliance on formal vocational schooling which is often unsuitable as well as excessively expensive. In formal education systems, curricula may need to be changed to provide a clearer view of the modern world and how it operates, including development-reinforcing learning about nutrition, family planning, and improved agricultural practices. LDC (and donor) universities may need to reorient their research and teaching more toward national economic and social development, including the application of multidisciplinary approaches to particular development problems. Finally, all education and training should be closely geared to existing and expected work opportunities; and all projects in all sectors should be reviewed for training requirements, to ensure that LDC's can maintain as well as operate every facility constructed.

2. Access to learning for larger numbers of persons, especially the poor, including adult illiterates and women. For example, depending on such factors as the comparative unit costs of formal vs. nonformal means and the receptiveness of leaders and populace, LDC's might (a) expand their use of radio or other innovative techniques and (b) utilize more fully private voluntary organizations (e.g., labor unions, churches, and cooperatives) as well as the formal education system to provide adults basic literacy and calculating skills and specific job-related information and training.

3. Lower unit costs for formal and nonformal education systems, so as to make learning opportunities available for more people at levels the economy can support. Measures within and outside the formal education system to reduce failure, repetition, and premature dropout rates are difficult to devise but important to improve cost effectiveness. Better management and more intensive use of existing systems (e.g., adult evening sessions, year-round classes, and two-shift teaching of children) could also lower unit costs. The expanded use of new educational techniques may help, especially if the facilities are already in place. And greater involvement of local communities in the planning, implementing, and financing of both formal and nonformal educational programs could lead to economies not anticipated by central planners and budgeters.

4. Increased attention to improved human resources development strategies. If national and community leaders as well as educators become more aware of the substantial potential for development-related education in their countries, both inside and outside of the formal education system, they will be readier to (a) improve their capacities for analysis and evaluation of the learning needs of their people, (b) utilize and adapt existing means for learning, where appropriate, (c) set up pilot programs to discover new and more cost-effective means of reaching their poor majority, and (d) explore and improve noneducation factors such as public policies which affect job opportunities and health, so that LDC human resources can be utilized more effectively. Missions can sometimes speed up this process by financing in-country seminars and/or attendance at meetings in other countries where LDC leaders can talk over problems and observe new practices; and they can help institutionalize it by supporting the establishment of educational planning units within appropriate regional or national organizations where they can effectively influence decisions to accomplish the above objectives.

References:

1. AIDTO A-275, 4/2/75
2. FY 1976 Congressional Presentation, 5/75, especially Summary pp. 47-48.

SECTOR POLICIES

III-6: Housing

AID's goal in the shelter sector is to assist LDC's to develop the institutional, technological and financial capabilities to provide shelter under reasonable conditions particularly for the poor majority. While AID's top three priorities for appropriated funds are Agriculture and Rural Development, Population and Health, and Education and Human Resource Development, the Agency has important special authority and funds which can only be used in the shelter area. Moreover, the Agency considers that assistance to housing can contribute to development and that such aid is consistent with the Congressional mandate to improve the quality of life of the poor in LDC's.

Mission and Bureau decisions to undertake housing programs should be based on (inter alia) whether or not the recipient LDC attaches a high social and developmental priority to housing, whether the expected contribution of housing to overall economic-social development and its direct or indirect impact on the quality of life of the poor majority are high, whether the recipient LDC can service the debt, and U.S. developmental (and sometimes political) objectives.

AID's principal resource in the housing sector is the housing guaranty program which, for a fee, guarantees repayment of private U.S. loans made at near-commercial interest rates to private or governmental LDC borrowers. Housing guaranty funds are considered most appropriate for more advanced LDC's or for those whose balance of payments prospects permit repayment of such financing. Where consistent with LDC (and AID) priorities, development loans or grants may also be used selectively, usually in conjunction with housing guarantee funds, to finance LDC housing which will permit AID to achieve a more direct impact on the housing needs of lower income groups, facilitate the borrower's acceptance of the concept of non-subsidized low income housing, or assist in the design and implementation of low income housing.

Missions and Bureaus should encourage LDC's, where appropriate and consistent with LDC/AID goals, to analyze their housing requirements within an overall development framework; to develop national housing plans, standards, and policies to meet these needs (sometimes including new overall economic policies in such areas as interest-rate structure and creation of different financial institutions); and to mobilize currently underutilized local manpower and material resources for this purpose. In the latter connection it is particularly important that those persons who will be buying and living in the housing participate to the fullest extent feasible in the planning, design, construction, and later improvements and upgrading of the housing and related community facilities.

Missions and Bureaus can also assist LDC's through utilization of centrally funded reasearch aimed at housing policy, financing, and physical construction needs.* They can help LDC's to create or improve their housing institutions and programs generally, including arranging for feasibility studies and housing sector analyses. And they can encourage LDC's to facilitate the upgrading of their slums and squatter areas by assuring these dwellers greater security of occupancy as well as by providing them urban services at existing and new sites where the poor can improve and/or build their own low-cost housing. This approach would help LDC's conserve both foreign exchange and local resources.

All housing programs/projects, whether supported by AID development assistance or housing guarantees, must be forecast in a timely manner, included in annual field submissions as an integral part of AID country programs, and reviewed by standard AID project processes. In planning and implementing these programs, Missions and Bureaus should seek greater cooperation with other housing donors, particularly where these organizations have major housing programs underway or being planned. The Agency will continue to consider sympathetically requests for assistance for shelter reconstruction following national disasters and will seek to influence the reconstruction toward disaster - resistant designs, siting, materials, and construction.

*The latter research has focused on developing and improving construction techniques and materials which are lower cost, labor intensive, more efficient generally, and more resistant to earthquakes, windstorms, and other disasters (e.g., roofing from local materials).

References:

1. PD-55 (Rev.).
2. AID Handbook 7.
3. Foreign Assistance Act of 1961, as amended, Sec. 221-3.
4. PD-51.
5. AID Handbook 17(AID Organization), Chs. 18 (Sec. D) & 20.

SECTOR POLICIES

III-7: Physical Infrastructure

The Agency's policies regarding the financing of physical infrastructure in LDC's have changed significantly in recent years, partly because of changes in AID perceptions of development priorities but also because of larger multilateral lending in this area and lower AID assistance levels generally. Consequently, although the Agency still believes that often additions to an LDC's infrastructure (e.g., electricity, water, sewerage, irrigation, and roads) are almost a prerequisite to social-economic development, AID's priority for financing them from development assistance funds is much lower than in the past and is likely to remain so unless funding levels increase substantially.*

AID is nonetheless prepared to consider financing LDC infrastructure especially where it is clearly a prerequisite to operational or prospective programs in AID's three priority sectors. Even in LDC's qualifying under the "prerequisite" criterion (normally only the least developed countries), external financing of infrastructure would normally be by multilateral agencies. In LDC's other than the least developed, it is AID policy to consider financing infrastructure, normally, only where (1) the Agency's share of the project costs is modest; (2) the prospective social-economic benefits are relatively high (compared with costs) and will begin to be realized relatively quickly; and (3) the project is designed so that the benefits reach primarily the poor and also contribute to other AID cross-sectoral priorities (see Handbook Table of Contents).

The following are examples of infrastructure projects which might deserve serious AID consideration depending on individual country circumstances:

(1) Modest-cost additions to existing irrigation or electric-power distribution systems which would expand use of the entire system, thereby having a very high benefit/cost ratio--particularly if the expanded use would be mainly by the poor.

(2) Rural feeder roads which would be relatively inexpensive compared to highways and yet might contribute substantially to a priority AID goal of economic-social development benefitting particularly the rural poor.

(3) Community public works and other physical infrastructure--including infrastructure services financed by private U.S. loans under AID's Housing Guaranty Authority for new or existing housing sites occupied mainly by the poor--the output of which would help achieve AID's priority goals

*This policy statement applies to development assistance funding, although its principles may be useful as well for reimbursable assistance or aid given primarily to support U.S. foreign policy objectives.

(e.g. water and sewer systems for improved health) and the construction and/or operation of which would create significant numbers of new jobs and also contribute to such cross-sectoral goals as greater integration of women into LDC economies and more popular participation generally.

• (4) A high-benefit river basin development project, financed jointly with other donors, where AID funds might be essential to get the project started and yet might be small relative to total funds available to the Geographic Bureau concerned.

Accordingly, Missions and Bureaus should examine carefully LDC requests for physical infrastructure financing. Modest-cost projects related to AID's priority objectives can be considered for Agency financing. Higher-cost projects should normally be referred to the IBRD and other multilateral and bilateral donors, although AID might supply some financial and associated technical assistance in joint ventures. Missions should strive to assure that physical infrastructure projects are selected and designed so that, in both their construction and operation, they contribute as fully as feasible to job creation, utilization and upgrading of local materials and skills, institution building generally, enhancement of the environment, and other AID/LDC economic-social-technical concerns (see especially Part IV of this Handbook).

Reference:
1. AIDTO A-744, 11/7/74, and attached paper, both entitled "Generating Employment in Civil Construction: The Choice of Appropriate Technology."

SECTOR POLICIES

III-11: Restricted Areas

AID prohibits or restricts assistance activities in certain areas, usually to conform with FAA legislation but sometimes for other reasons. Among the restricted areas are the following:

1. Abortions

Section 114 of the FAA of 1961, as amended, specifies that development assistance funds shall not be used "to pay for the performance of abortions as a method of family planning or to motivate or coerce any person to practice abortions." PD-56, now filed in AID Handbook 2, Supplement D-4, provides a precise interpretation of this FAA section.

2. Public safety

In accordance with Section 660 of the FAA of 1961, as amended, AID funds shall not be used -- except under Section 481 for international narcotics control -- to provide training, advice, or financial support for police, prisons, or other law enforcement forces for any foreign government or for any program of internal intelligence or surveillance on behalf of any foreign government.

3. Military-use items

In accordance with the legislative distinction between economic and military assistance, and in line with GAO interpretations of 31 USC 628, AID does not furnish economic assistance for the production of military items or provide commodities which are essentially for military use. More specifically, economic assistance funds may not be used to finance (1) military hardware for country military purposes, (2) commercial consumables delivered directly to any military establishment for military purposes, (3) other common use items (e.g., raw materials, components and capital equipment) delivered directly to any military establishment for military purposes, and (4) any articles, regardless of recipient, where the primary purpose is to meet country military requirements. (Items furnished for international narcotics-control purposes under FAA Section 481 are not regarded as furnished for military purposes.) An otherwise ineligible transaction may not be made eligible by passing items through a third party.

4. Competition with U.S. enterprises

Section 620(d) of the FAA of 1961, as amended, stipulates that development loans shall not be made "for construction or operation of any productive enterprise in any country where such enterprise will compete with United States enterprise unless such country has agreed that it will establish appropriate procedures to prevent the exportation for use or consumption in the United States of more than 20 per centum of the annual production of such facility during the life of the loan." The legislative history of this section indicates that the restriction applies only when there is substantial evidence that loans made for the construction or operation of these

productive enterprises will lead to direct competition in the U.S. (not foreign) market prior to repayment of the loan; even then, the loan may be made if a limiting-of-competition agreement can be reached or if the President determines that a waiver of Section 620(d) is in the "national security" interest.

5. Non-food surpluses

The Agency does not normally assist LDCs to increase the production of non-food crops where world surpluses exist and are expected to continue. However, in circumstances where such assistance is justifiable as part of an integrated development program for the rural poor, the Agency will consider providing such aid together with assistance to improve the storage, handling, processing and distribution of these crops.

6. Gambling facilities

It is AID policy not to finance or guarantee investments in either gambling facilities or installations which plan to install them (e.g., hotels, casinos, or tourist accommodations).

7. Weather modification

It is U.S. Government policy not to provide assistance for weather modification owing to the uncertain and potentially unfavorable results of such activities, including real or imagined physical or environmental damage to the host country and its neighbors, social/cultural strains, and political/legal complications. Exceptions can be made only at the highest U.S. Government levels. AID may, however, continue to assist in such activities as helping LDCs to improve their water management and meteorological capabilities and, in general, prevent or mitigate disasters. (For details, see AIDTO 495, 8/19/75.)

8. Other prohibited or restricted activities include the financing of "ineligible commodities" such as luxury goods and unsafe or ineffective products (see AID Handbook 15, Appendix B for details); the support of activitie with a significant religious/proselytizing purpose or content; and a variety of actions controlled by express legislative provisions, such as the use of FAA funds for CIA operations (FAA Section 662), the assisting of Communist countries or military aggressors (FAA Section 620) or assistance to "the government of any country which engages in a consistent pattern of gross violations of internationally recognized human rights, ... unless such assistanc will directly benefit the needy people in such country" (FAA Section 116). For legislative constraints, see also the statutory checklists in AID Handbooks 3 and 4, Appendixes 6C and 3A respectively.

PART IV - CROSS-SECTORAL EMPHASES

CROSS-SECTORAL EMPHASES

IV-2: Income Distribution and Employment

On the presumption that growth, equity, and employment can and should be pursued as coordinate development objectives, it is AID policy to encourage (1) fuller utilization of LDC manpower resources and (2) broader participation of low-income groups in both the process of development and the sharing of its benefits.

Recognizing that continuing LDC economic growth is essential to improving the well-being of their poor and that increasing employment of their currently underutilized labor resources is an important means of promoting growth and achieving a more equitable distribution of income and opportunity, and within the limitation that LDC governments retain central responsibility for dealing with this problem, Missions and Bureaus should, to the extent feasible and appropriate:

1. Encourage LDC's to use their more plentiful (mostly unskilled) manpower in place of scarce capital, by reducing distortions in foreign-exchange and interest rates as well as by revising inappropriate tariff, tax and wage rate policies and foreign-exchange and investment allocation systems. Particularly in this connection, donor training of and advice to LDC students and officials should stress the economic implications of LDC policies and technologies, so that LDC's are better prepared to select those which are more appropriate to their own circumstances.

2. Assist LDC's, particularly in AID's priority sectors, with projects and programs which in their construction and operation are as labor intensive as is compatible with sound economic-social decision-making and which raise the productive capacity of lower-income groups or benefit them in other ways. For example, Missions should try to insure that AID-assisted agriculture projects benefit particularly the small farmer and landless laborer, by means such as cooperatives and credit organizations, the development of efficient technology applicable to small farms, and land reform; that human-resource-development projects increase the knowledge and work capabilities particularly of the unskilled poor and that education and training be more relevant to productive employment; that population/health projects are designed to assure access by the poor; and that AID-assisted or influenced projects strengthen small-scale firms (which tend to be labor intensive) to the fullest extent feasible.

3. Increase support, in appropriate circumstances and especially in rural areas, for LDC public works which are labor intensive in their construction and the later use of which will contribute to development and a more equitable income distribution.

4. Back up the above actions with (a) research designed to increase understanding of the relationship of employment and income distribution to other economic and social factors and to develop more appropriate (i.e., lower-cost, labor-intensive) technology for LDC's, and (b) evaluation of the impact of past and current projects on employment and income distribution -- both to be undertaken jointly with LDC's.

5. Encourage other donors to follow similar practices.

To insure that Missions give greater and more systematic attention to the employment and income-distribution implications of both LDC policies and AID-financed or encouraged projects, Missions and Bureaus should include in each capital/technical assistance project proposal a section which discusses employment and income distribution questions and takes account of which socio-economic groups bear the burden and which receive primary benefit from the project.

References:
1. PD-48
2. PD-52
3. AID Handbook 17 (AID Organization), Chs. 17 & 8.

CROSS-SECTORAL EMPHASES

IV-3: Labor-Manpower

It is AID policy to assist LDC's, both bilaterally and multilaterally, in their self-help efforts to strengthen free labor unions, labor ministries, and other labor-manpower institutions -- with the objective of enhancing the skills, productivity, employment opportunities, compensation, work conditions, freedom, and well-being of working men and women.

AID manpower assistance will continue to be primarily in the context of projects and programs in the priority sectors of agriculture and rural development, population and health, and education and human resources. It is thus important that Missions and Bureaus (1) give due consideration to the role which improved labor-manpower policies, programs, and institutions can play in achieving LDC and AID objectives in these priority sectors and (2) help and encourage LDC governments, institutions, and enterprises to bring about these improvements.

Missions and Bureaus should also (3) encourage an attitude of cooperative solving of labor-manpower problems within LDC's, (4) collaborate with multilateral organizations in the labor-manpower field so as to fulfill relevant ILO, OAS, and UN development resolutions, and (5) continue to encourage and support specific projects which strengthen free labor unions or which establish or improve the capacity of LDC institutions to (e.g.) provide skills-training and employment services, engage in research, or devise a social security system or better labor standards.

In implementing these AID objectives, particularly in matters affecting wages and productivity, Agency efforts must of course be consistent with achieving LDC employment, social justice, and growth objectives.

References:

1. PD-52.
2. OLAB Technical Manuals on "Strengthening Free Labor Unions" and "Labor-Manpower Programs and Institutions".
3. PD-48.
4. AID Policy Handbook, Statement No. IV-2.
5. AID Handbook 17 (AID Organization), Ch. 8.

CROSS-SECTORAL EMPHASES

IV-3: Labor-Manpower

It is AID policy to assist LDC's, both bilaterally and multilaterally, in their self-help efforts to strengthen free labor unions, labor ministries, and other labor-manpower institutions -- with the objective of enhancing the skills, productivity, employment opportunities, compensation, work conditions, freedom, and well-being of working men and women.

AID manpower assistance will continue to be primarily in the context of projects and programs in the priority sectors of agriculture and rural development, population and health, and education and human resources. It is thus important that Missions and Bureaus (1) give due consideration to the role which improved labor-manpower policies, programs, and institutions can play in achieving LDC and AID objectives in these priority sectors and (2) help and encourage LDC governments, institutions, and enterprises to bring about these improvements.

Missions and Bureaus should also (3) encourage an attitude of cooperative solving of labor-manpower problems within LDC's, (4) collaborate with multilateral organizations in the labor-manpower field so as to fulfill relevant ILO, OAS, and UN development resolutions, and (5) continue to encourage and support specific projects which strengthen free labor unions or which establish or improve the capacity of LDC institutions to (e.g.) provide skills-training and employment services, engage in research, or devise a social security system or better labor standards.

In implementing these AID objectives, particularly in matters affecting wages and productivity, Agency efforts must of course be consistent with achieving LDC employment, social justice, and growth objectives.

References:

1. PD-52.
2. OLAB Technical Manuals on "Strengthening Free Labor Unions" and "Labor-Manpower Programs and Institutions".
3. PD-48.
4. AID Policy Handbook, Statement No. IV-2.
5. AID Handbook 17 (AID Organization), Ch. 8.

CROSS-SECTORAL EMPHASES

IV-4: Popular Participation in Development

It is AID policy that its development assistance promote the participation of the people in LDC's, women as well as men, in both the process and benefits of economic-social development. This policy is based on the premise that increased popular participation is not only more equitable but that it can be more productive as well. It applies to all forms of U.S. aid (e.g., capital lending, technical cooperation, investment guarantee programs) and to all sectors of AID activity and concern.

The Agency recognizes that the governmental and social institutions differ in each LDC and need to be more fully understood; that each country must choose its own path and pattern of development consistent with its own needs, values, and capacities; and that U.S. economic assistance can have only a marginal impact. Nonetheless, Missions and Bureaus can and should encourage and support, in AID priority sectors, particularly those projects and programs which are designed to (1) utilize local resources in their planning and decision-making processes, (2) involve, in their implementation, as many of the local persons affected as feasible, (3) benefit especially the lower-income groups in LDC's, and (4) increase the capabilities and opportunities of the people for effective participation in those political processes which are essential to self-government and economic development. Also, taking careful account of indigenous institutional forms and the political-social consequences of development assistance, Missions should (5) use aid, where appropriate, as a means of encouraging the development of private and local governmental institutions in particular in the direction of greater popular involvement.

In carrying out the above policies, Missions and Bureaus should also utilize the services of U.S. non-governmental groups. For example, exchange visits between U.S. counterparts and LDC legislative, executive, religious, labor, and industrial leaders can increase the latter's understanding and support for greater popular participation, particularly if conscious efforts are made to orient the visits (including any training or educational programs) to accomplish this objective.

In short, our development activities aim at a combination of growth and equity. This requires special effort and concern for people as human beings as well as a recognition that economic growth may enrich a few people without substantially improving the lot of many

CROSS-SECTORAL EMPHASES

IV-11: Enviromental Impact

In conforming to the intent and objectives of the National Environmental Policy Act of 1969, and in recognition of the fact that effective long-term development of LDC's (particularly quality of life improvements) require adequate attention to environmental considerations, it is AID policy, in all of its assistance activities, to help developing countries avoid both short-term and long-term damage to the environment and improve it where feasible.

Accordingly, Missions and Bureaus should:

1. Ascertain at the earliest possible stage of project design the likelihood of significant adverse environmental consequences from projects to be assisted; and if such consequences are likely, arrange for a full analysis of the question and incorporation of it in the decision-making process and executing documents prior to project approval and implementation.

2. Make available to LDC's (a) information, guidelines, checklists, instructional materials and technical data on the identification and potential impact of environmental problems, (b) methods for analyzing costs, benefits, and alternative techniques associated with environmental protection, (c) procedures for carrying out impact analyses, and (d) related training as appropriate -- with the aim of helping them develop their own capacity to deal with environmental matters.

3. Help LDC's calculate added costs and benefits in specific projects or activities arising from proposed environmental protection and take account of them in deciding on the level of assistance.

4. Give favorable consideration to assisting environment-improvement projects, within the limits of AID funds and other priorities, particularly where these contribute significantly to priority goals in health and food production.

5. Cooperate with other donors and the UN Environment Programme in particular, in order to identify and help alleviate environmental problems caused or exacerbated by development, including water and air pollution, contamination of the worker and work place, desertification, and irrigation-connected snail-transmitted diseases.

Missions should guard against urging adoption, in AID-assisted projects and programs, of environmental standards, priorities, or solutions designed for the U.S. Instead, analysis, discussion, and negotiation on the handling of environmental problems should be the basis of mutually satisfactory agreements which recognize the unique

CROSS-SECTORAL EMPHASES

IV-4: Popular Participation in Development

It is AID policy that its development assistance promote the participation of the people in LDC's, women as well as men, in both the process and benefits of economic-social development. This policy is based on the premise that increased popular participation is not only more equitable but that it can be more productive as well. It applies to all forms of U.S. aid (e.g., capital lending, technical cooperation, investment guarantee programs) and to all sectors of AID activity and concern.

The Agency recognizes that the governmental and social institutions differ in each LDC and need to be more fully understood; that each country must choose its own path and pattern of development consistent with its own needs, values, and capacities; and that U.S. economic assistance can have only a marginal impact. Nonetheless, Missions and Bureaus can and should encourage and support, in AID priority sectors, particularly those projects and programs which are designed to (1) utilize local resources in their planning and decision-making processes, (2) involve, in their implementation, as many of the local persons affected as feasible, (3) benefit especially the lower-income groups in LDC's, and (4) increase the capabilities and opportunities of the people for effective participation in those political processes which are essential to self-government and economic development. Also, taking careful account of indigenous institutional forms and the political-social consequences of development assistance, Missions should (5) use aid, where appropriate, as a means of encouraging the development of private and local governmental institutions in particular in the direction of greater popular involvement.

In carrying out the above policies, Missions and Bureaus should also utilize the services of U.S. non-governmental groups. For example, exchange visits between U.S. counterparts and LDC legislative, executive, religious, labor, and industrial leaders can increase the latter's understanding and support for greater popular participation, particularly if conscious efforts are made to orient the visits (including any training or educational programs) to accomplish this objective.

In short, our development activities aim at a combination of growth and equity. This requires special effort and concern for people as human beings as well as a recognition that economic growth may enrich a few people without substantially improving the lot of many

unless the policies and technologies chosen are consistent with the resources and needs of the people and their capacity for self-sustaining economic and social progress.

References:
1. AID Policy Handbook, Statements IV-2 and 3.
2. PD-48 and 52.
3. FAA of 1961 as amended, Title IX.
4. Legislative History of FAA (1973).
5. AID Handbook 17 (AID Organization), Ch. 17.

CROSS-SECTORAL EMPHASES

IV-8: Science and Technology

Modern science and technology are the underpinnings of productivity and quality of life generally in the industrialized world. Frequently, however, this technology must be adapted to the economic, social, and technical conditions of LDC's if they are to serve LDC development needs effectively. The scientific and technical competence of the LDC's will also need to be strengthened; and the LDC's economic and social policies may need to be modified so as to encourage appropriate technological choices and the continuing growth of indigenous, innovative capabilities. Otherwise, for example, complex and high-cost modern equipment designed for industrial countries might replace low-cost labor and lead to more unemployment, larger foreign debts, and difficult equipment-maintenance problems in the LDC's. Moreover, the need for LDC's to adopt policies which are more appropriate to their circumstances is becoming more urgent with the growth of population, urbanization, pollution, and unemployment in both rural and urban areas.

AID will continue to stress the importance of science and technology transfers in support of development in its priority areas (see Part III). Equally important in the long run, it is AID policy to help LDC's generally to:

1. Develop national policies and institutions which permit them to make and implement effectively better technological choices particularly in industry, construction, transportation, and agriculture, including such fields as agro-industry, food processing, waste utilization, and science information. As noted in PD-51, "encouraging more effective orientation of LDC university science and engineering programs to development needs" and "strengthening the capabilities of LDC industrial service institutions to assist local industries in selecting, adapting, and using technologies suited to their circumstances" are essential aspects of this AID/LDC effort.

2. Improve their capabilities to assess the location, nature, and magnitude of their natural resources, both renewable and non-renewable, as well as the most effective techniques for utilizing and conserving them, including minerals, forest products, energy, environmental matters, and marine sciences and resources.

3. Increase the cost effectiveness of their public expenditures for such economic infrastructure as energy, transportation, communications, and housing so as to free public funds for other LDC development needs.

Missions and Bureaus are encouraged to initiate science and technology projects/programs when this is consistent with LDC/AID needs and priorities, drawing on current AID/W efforts to identify, mobilize, and coordinate both U.S. and other donor programs of research, innovation, and technical assistance.

References:
1. PD-51.
2. FAA of 1961 as amended, Sec. 106.
3. AID Handbook 17 (AID Organization), Ch. 20.

CROSS-SECTORAL EMPHASES

IV-9: Research and Innovation

It is Agency policy (1) to encourage and support LDC efforts to strengthen their own research and innovative capabilities in both socio-economic and technological areas related to development; (2) to cooperate as fully as feasible in multi-national research, whether world-wide or regional; (3) to build up its in-house and contractor capabilities to assist LDC's in priority research areas and (4) to sponsor and finance research which aims at the discovery and/or application of better means for dealing with the most important development problems facing LDC's.* AID emphasis is on research and pilot projects which can be applied to solving LDC problems in the near future. However, where a major gap exists in the knowledge needed to solve an important LDC problem, and U.S. and other organizations are not performing or supporting the basic research required, AID remains ready to consider financing research aimed at longer-term LDC problems.

Central technical and policy offices are expected to lead Agency efforts (1) to identify problems which are of major concern to many LDC's and where research offers promise of a substantial contribution to economic-social development. (2) to mobilize competent technical and scientific talents for the conduct of (a) appropriate experimental projects to discover and test improved ways of solving problems in LDC's and (b) socio-economic research on priority development-policy problems, (3) to coordinate AID-sponsored research, both internally and with that of other donors, and to help diffuse its results and ensure its application, and (4) to encourage and support the build-up of global networks of mutually supporting research, information, and technical assistance activities in priority subject areas.

Missions and Bureaus are expected, where appropriate and consistent with the LDC's overall development plan and priorities, to:

1. Help in the identification and assessment of LDC research needs, working collaboratively with LDC institutions.

2. Encourage LDC efforts to strengthen the capabilities and desire of local institutions and researchers to engage in research directed toward the solution of priority problems related to ongoing development efforts. AID support might include (inter alia) training, advice, and financing (including development grants); and the efforts might be in the form of separate projects devoted solely to such institution building, or they might be part of other AID projects in such priority areas as food and nutrition, health and population, and education. In considering proposals for support, AID would give priority to those LDC institutions which (1) seek improved relationships with prospective users of research findings

* It is because of its importance to almost all sectors of development that research is categorized under "cross-sectoral emphases" rather than under Part III or V as a sector of or resource for development.

in order to obtain early feedback on problems encountered with new technologies and (2) wish to participate in global problem-solving networks which include advanced bilateral or multilateral institutions working on the same or similar problems.

3. Support LDC research activities focussed on particular LDC development problems with good cost/benefit prospects, with the aims of (a) shedding more light on the nature, magnitude, and/or interrelationships of the economic, social, and technical factors involved, (b) utilizing in innovative ways existing technical, social, and economic knowledge as well as the findings of ongoing research, and (c) developing new knowledge and technology for application to development problems.

4. Cooperate with other donors in the above activities, where feasible and appropriate, and encourage selected LDC institutions to work with the research programs of other countries as well as those of multilateral organizations.

5. Advise AID/W of problems impeding achievement of Agency objectives which might be amenable to research solutions.

Systematic evaluation of all research projects, whether funded centrally or by Missions, is considered crucial--not only because of the need to improve future research projects but also because of the need to insure that the research results are utilized more widely in other LDC's.

References:
1. PD-47
2. AIDTO Circular A-543, 4/15/72.
3. AID Handbook 17 (AID Organization), Chapters 20 and 17.

CROSS-SECTORAL EMPHASES

IV-11: Enviromental Impact

In conforming to the intent and objectives of the National Environmental Policy Act of 1969, and in recognition of the fact that effective long-term development of LDC's (particularly quality of life improvements) require adequate attention to environmental considerations, it is AID policy, in all of its assistance activities, to help developing countries avoid both short-term and long-term damage to the environment and improve it where feasible.

Accordingly, Missions and Bureaus should:

1. Ascertain at the earliest possible stage of project design the likelihood of significant adverse environmental consequences from projects to be assisted; and if such consequences are likely, arrange for a full analysis of the question and incorporation of it in the decision-making process and executing documents prior to project approval and implementation.

2. Make available to LDC's (a) information, guidelines, checklists, instructional materials and technical data on the identification and potential impact of environmental problems, (b) methods for analyzing costs, benefits, and alternative techniques associated with environmental protection, (c) procedures for carrying out impact analyses, and (d) related training as appropriate -- with the aim of helping them develop their own capacity to deal with environmental matters.

3. Help LDC's calculate added costs and benefits in specific projects or activities arising from proposed environmental protection and take account of them in deciding on the level of assistance.

4. Give favorable consideration to assisting environment-improvement projects, within the limits of AID funds and other priorities, particularly where these contribute significantly to priority goals in health and food production.

5. Cooperate with other donors and the UN Environment Programme in particular, in order to identify and help alleviate environmental problems caused or exacerbated by development, including water and air pollution, contamination of the worker and work place, desertification, and irrigation-connected snail-transmitted diseases.

Missions should guard against urging adoption, in AID-assisted projects and programs, of environmental standards, priorities, or solutions designed for the U.S. Instead, analysis, discussion, and negotiation on the handling of environmental problems should be the basis of mutually satisfactory agreements which recognize the unique

social, economic, and physical conditions of each country. However, just as LDC's have final responsibility for their actions on projects, it is an AID decision whether or not to provide the assistance requested. Situations where proposed LDC projects may have significant negative impact on their people's health, or where the effects may transcend national boundaries and affect adjacent countries or the global environment, will require special Agency attention.

References:
1. AIDTO Circ A-731, November 2, 1974.
2. U.S. National Environmental Policy Act of 1969.
3. MC 1214.1.
4. AID Handbook 17 (AID Organization), Chs. 18 (Sec. M) & 20.

PART V - RESOURCE-USE POLICIES

RESOURCE-USE POLICIES

V-1: AID Resources: General

It is AID policy to use all FAA resources as efficiently as possible and to integrate them to the fullest with non-Agency resources in support of LDC and AID over-all or sector goals. This policy applies whether the resources are grants, concessional loans, or guarantees; whether project, sector, or program oriented; whether capital or technical assistance; whether foreign exchange or local currency; whether allocated directly to LDC's or via international agencies or U.S. non-governmental organizations; and whether spent in LDC's, in the U.S., or in third countries. And it can be fully realized only if Missions and Bureaus execute aid agreements which are not only soundly conceived in terms of realistic and measurable goals but also fully understood and supported by LDC recipients.

Project and sector assistance are currently the preferred modes of Agency activity. Both can provide materials, training, advice, and research, but project aid supports a more discrete activity than sector assistance. Aid to a specific number of interrelated activities within a particular LDC sector should be treated as project assistance; and if these activities are separately identifiable and sufficiently large to make separate consideration of them worthwhile, each should be treated as a separate project. If, however, in consideration of certain LDC commitments, the aid is used primarily to increase the total resources devoted to a sector, it should be treated as non-project assistance.

Non-project (program) assistance, formerly used when the LDC's primary need was for U.S. commodities to maintain or increase over-all economic activities and when the LDC's economic policies were judged sound, is now used primarily for emergency (or near emergency) balance-of-payments or budget support, often justified on political/security grounds, or to focus aid on a particular sector requiring commodity inputs (e.g., fertilizers for agriculture).

It is AID policy to focus project and non-project assistance on a development problem, so as to produce measurable lasting improvements in the lives of significant numbers of people, not simply to provide support to LDC's in the form of commodities and advice. Frequently several modes of AID assistance are required for a given problem. To the extent possible all these modes should be programmed under one consolidated set of documents (PID, PRP, and PP), all authorized at the same time and all coordinated by one AID project/program officer.

The question of whether loan or grant assistance is more appropriate for a development problem requires consideration of such factors as (1) the LDC's financial condition, particularly its repayment capacity; (2) the purpose of the financing (e.g., grants are often preferred for pilot or innovative projects and research); (3) the profitability and economic value of the project (if high, there is more justification for loan financing), (4) the cost of the project (if too high, sufficient grant funds are not likely to be available), and (5) the overall U.S. aid strategy for the country. Whether grant or loan, all aid may include technical and capital assistance.

References:
1. PD-57.
2. PD-53.

RESOURCE-USE POLICIES

V-3: Foreign Disaster Assistance

In carrying out its central responsibility for implementing the U.S. policy of assisting victims of foreign disasters, whether natural or man-made, AID:

1. Provides the victims with emergency relief, in coordination with other governments, international agencies, and U.S. and foreign private assistance.

2. Assists in short-term rehabilitation, when such rehabilitation is beyond the capacity of local resources.

3. Participates in foreign disaster preparedness and encourages both other donors and disaster-prone countries (especially LDC's) to do likewise.

4. Considers, under normal AID programming procedures, longer term reconstruction assistance if the social and economic disruption is severe.

All assistance is supplemental to the country's own efforts and is provided only if requested by or acceptable to the government of the stricken country. The decision on the proportion of U.S. Government aid to be channeled through intergovernmental and/or private organizations is made by AID's Foreign Disaster Relief Coordinator, the focal point of U.S. Government foreign disaster relief activities. It is made with the counsel of the Mission in the affected country, the AID and State Bureaus, and other agencies concerned in Washington, the criteria being speed and effectiveness in reaching the victims.

U.S. Missions are required to prepare and have on file a Mission Disaster Plan and to appoint a Mission Disaster Relief Officer, so that they are ready to cooperate fully and immediately with the Chief of Mission and the Foreign Disaster Relief Coordinator when the former determines that a disaster or emergency exists which warrants U.S. Government assistance. After informing the Department and AID/W of their determination that a disaster exists, Chiefs of Mission may, without prior AID clearance, commit up to $25,000 from AID funds for an emergency in the host country.

References:

1. AID Handbook 8.
2. FAA of 1961, as amended, Sec. 639.
3. AID Handbook 17 (AID Organization), Ch. 19.

RESOURCE-USE POLICIES

V-7: Food for Peace

Expanded agricultural production in the developing countries is at this time the only feasible long-run solution to the world food problem. Consequently, U.S. development assistance assigns a high priority to helping LDC's achieve this goal. In the interim, however, to meet the continuing need for U.S. food aid, AID believes that the PL-480 program should have as its priorities: (1) assuring an adequate U.S. response capability in emergency situations; (2) assuring program continuity for high priority Title II projects; (3) the allocation of most Title I food aid to those needy nations facing the greatest food deficits; and (4) providing other Title I programs on the basis of U.S. national interest after establishing the intended recipient's import requirements for PL-480 commodities. It is AID policy, in interagency discussions on the total amounts of food to be made available and the choice of recipients, to emphasize LDC development and humanitarian requirements. Final program decisions, however, are made within the constraints imposed by U.S. foreign policy objectives, the availability of commodities for the program (as determined by USDA in accordance with legislation), and the annual expenditure limitations as determined by the President.

It is AID's goal to utilize all non-AID resources, and particularly U.S. food available under PL-480, as efficiently and carefully as funds made available for AID use under the FAA.* These resources must therefore be integrated as fully as possible with FAA and LDC resources in support of Country and Mission overall or sector goals, with particular care taken to avoid production disincentives in agriculture and other sectors. Thus, Title I food sales, which are essentially similar to program or sector loans, must be justified by Missions and Bureaus on the basis of either a limited resource gap (i.e., balance of payments) analysis or the impact the food sales will have on the agriculture sector directly and on that and other sectors indirectly through the local currency thus made available to the LDC government for development purposes. Title II grants (other than emergency assistance) are to be justified in terms of maternal-child nutritional and health needs, labor-intensive community development projects, and elementary-school lunch programs, with maximum feasible use of U.S. private voluntary agencies.

---

* Note that in FY 1974 the total value of PL-480 commodities shipped (including some non-food but excluding ocean freight) was $845 million, of which Title I sales were $562 million and Title II grants were $283 million. AID economic assistance disbursements in the same year were $1,935 million.

The Country Team is responsible for submitting PL-480 program recommendations and comments to Washington; the AID Mission handles program implementation, including self-help aspects. FFP and PPC prepare, with Geographic Bureau approval, PL-480 budgets and Agency-wide positions on PL-480 programming. The Inter-Agency Staff Committee, chaired by USDA and with membership including State/AID, OMB and Treasury, is responsible for final program approval.

References:
1. PD-34.
2. AID Handbook 9, Ch. 3.
3. PL-480.
4. Statement by Dep. A/AID, J. E. Murphy, 4/17/75, before the Senate Subcommittee on Foreign Agriculture Policy.
5. AID Handbook 17 (AID Organization), Ch. 7.

V-15: Non-U.S. Resources: General

It has always been AID policy to stimulate and encourage a greater flow and more efficient use of non-U.S. resources (including those of LDC's themselves) in the task of development. The need for this policy has never been greater than now, in view of the lower levels of U.S. aid (in both absolute terms and compared with resource flows from other donors) and the increased foreign-exchange requirements of LDC's resulting from petroleum and other price rises. Accordingly, Missions and Bureaus should:

1. Familiarize themselves generally with the resources available, the personalities involved in, and the aid activities of both bilateral and multilateral donors, so that they are prepared (a) to draw the attention of LDC's to the availability of non-U.S. resources for their economic development, particularly where these resources can meet specific LDC needs effectively in terms of quality of equipment and services or such other relevant considerations as costs and speed of delivery, (b) to participate in joint undertakings with LDC's and/or other donors where this can contribute more effectively to development goals, and (c) to counsel U.S. Government representatives to such international organizations as the IBRD, the UNDP, and the DAC.

2. Draw fully on IBRD, LDC, AID, regional and other analyses of LDC problems and opportunities, so as to offer appropriate counsel, if the opportunity should arise, to influence LDC's toward a more effective use of their own resources, keeping in mind the need to maintain a collaborative style particularly in the sensitive area of LDC policies.

3. Participate actively in efforts to coordinate at recipient-country levels the use of AID and other U.S. resources with those of non-U.S. donors and the LDC's themselves, via Consultative Groups and Consortia as well as in-country aid-coordinating groups, so as (a) to make specific aid projects as well as aid generally more effective in achieving agreed-upon socio-economic development objectives and (b) to minimize duplication and possible frictions.

Note that AID has in the past stimulated the IBRD and other multilateral organizations to form new Consortia/Consultative Groups in those cases where an LDC receives (or should receive) substantial financial aid from a number of donors. Some 20 of these now meet

periodically, mostly in Paris under the chairmanship of the IBRD, and the formation of additional groups may turn out to be advisable. Similarly, it is AID policy that UN Resident Representatives be encouraged to arrange with recipient LDC's the organization of local (in-country) coordinating mechanisms, particularly for technical assistance, in which all donor representatives are invited to participate.

References:
1. FAA of 1961, as amended, Sec. 209, 301-3.
2. AID Handbook 17 (AID Organization), Ch. 17.

RESOURCE-USE POLICIES

V-16: Non-U.S. Resources: Multilateral

It has for some time been U. S. policy, in practice and as expressed at the highest levels, to encourage multilateral donors to take the leading roles in development assistance. Thus, the World Bank is now by far the largest single source of development capital (as well as substantial technical assistance). The UNDP is now the largest single source of technical assistance. The regional and subregional development banks, particularly the Inter-American Development Bank, are increasingly important as sources of both capital and technical assistance. And a variety of other multilateral organizations, both regional and worldwide, are substantial contributors in specialized areas.

More specifically, it is AID policy that Bureaus and Missions:

1. Encourage a greater and more efficient flow of capital and technical assistance from these organizations to the LDC's;

2. Finance projects and programs jointly with them, or channel assistance activities through them, where this seems the best way of assisting LDC's, taking care to avoid "back-door" financing of multilateral organizations;

3. Take part in or exercise oversight of the programs of these organizations at all feasible levels at which significant decisions are made which affect program planning and operations -- especially through shared formulation of policies to guide U.S. Executive Directors (e.g., at the IBRD) or U.S. Representatives (e.g., at the UNDP, ECOSOC, the Governing Boards of over 15 specialized UN agencies, and at OAS Councils);

4. Coordinate AID policies, programs and projects with the directors or working-level representatives of multilateral organizations (a) directly with them, at their headquarters or in the field, or (b) in such forums as Consortia/Consultative Groups, OAS Country Reviews, or local (i.e., in-country) coordinating groups where both multilateral and bilateral donors are represented. While the Agency has always encouraged informal consultation by AID units with their counterparts in multilateral organizations, it has recently found it useful to regularize more of these contacts. Thus, the Latin American Bureau schedules joint IBRD-IDB-AID reviews of their respective programs in countries in which they all operate. Most Geographic Bureau Assistant Administrators consult periodically with their counterparts in the IBRD and also the UNDP. And AID and WHO have established procedures for periodic consultation and coordination at both headquarters and field levels as well as technical meetings on specific subjects, which may serve as a model for Agency relationships with other UN specialized agencies.

5. Encourage the recruitment of AID employees by international organizations, so as to strengthen the efficiency and effectiveness of these organizations and at the same time enrich the experience of Agency personnel for future AID assignments.

Reference:

1. AID Handbook 17 (AID Organization), Ch. 17.

V-17: Non-U.S. Resources: Bilateral

The U.S. has been committed for many years to a policy of (1) coordinating its own aid efforts with those of the traditional industrial country donors and (2) sharing with them its expertise and experience in this field. Thus, the U.S. was a principal founder of OECD's Development Assistance Committee (DAC) at a time when the U.S. provided more development assistance than all other bilateral donors combined and when it had by far the largest staff with actual field experience.

The need for more coordination with other bilateral donors has increased as the U.S. share of official development assistance supplied by DAC Members has dropped (currently to about one-third of the total). And this need is being further intensified now that the newly-rich oil countries are accumulating very large resources which could be used to support development programs. Thus the U.S. must encourage greater and more effective resource flows to LDC's, especially from newer donors, if LDC economic development is not to be slowed.*

Missions and Bureaus should, to the extent feasible:

1. Familiarize themselves with the most important current and potential bilateral programs in the countries in which they operate, so that they can participate in joint undertakings with them wherever this is more effective in development terms and/or more acceptable generally to the LDC's and also, if asked, counsel LDC's on the availability and appropriateness of other donor resources.

2. Participate fully in coordination efforts with bilateral donors -- in the capitals, at field levels, in larger groups for specific countries (e.g., Consultative Groups and in-country groups), or at OECD's Development Assistance Committee (DAC) for overall programs -- so as to avoid duplication and increase program effectiveness. At the DAC, located in Paris, the European Economic Commission and 17 traditional country donors, including the U.S., review annually each donor's aid program and policies and meet frequently to exchange information and coordinate their general assistance policies as well as their approaches to specific development problems.

3. Search for means of encouraging the flow of new resources to the LDC's, on terms appropriate to their needs, with full awareness of the need for careful planning and advance consultation with AID/W in the case of new coordination efforts.

*Note that the U.S., with AID participation, is a member of the new Joint Ministerial Council of the Board of Governors of the IBRD and IMF on the Transfer of Real Resources to Developing Countries.

Reference:

1. AID Handbook 17 (AID Organization), Ch. 17.

PART VI - PROGRAMMING AND EVALUATION POLICIES

PROGRAMMING AND EVALUATION POLICIES

VI-5: Program Evaluation

In view of the interdependence of design and evaluation, good project/program design is essential not only to good performance and goal achievement but also to an objective evaluation of that performance. And an objective evaluation of past and current performance, in turn, is essential to improve not only the performance effectiveness and developmental impact of the activity being evaluated but also the planning of new programs and projects in the same country and elsewhere.

Accordingly, it is Agency policy that Missions and Bureaus, working as collaboratively and closely as feasible with LDC's, incorporate evaluative elements into the design of new projects/programs, whether grant or loan and whether technical or capital assistance, so as to facilitate periodic on-going or post-project evaluation. In particular, project proposals should (1) specify explicit interim and end-of-project targets, (2) include project-specific and socio-economic baseline data, (3) define internal causal connections as well as those between project purposes and sectoral or country goals, and (4) describe and analyze those external factors or assumptions outside the scope of the project design which are important to the project's success, indicating as precisely as possible the degree of uncertainty in which the project will operate. In addition, project proposals should review similar experience elsewhere to the extent feasible, provide for collecting progress data, and indicate specific plans for evaluation by senior AID and LDC management.

Missions and Bureaus should insure that evaluations are objective and candid and as searching and penetrating as warranted by the project's size or importance or duration. The objective is not to place blame but rather (1) to ascertain the project's developmental impact and continuing relevance to (possibly changing) country goals, (2) to improve Mission performance and programs, including budget and other routine management decisions, and (3) to contribute to future project/program selection and strategy in other Missions as well as in the one directly affected. In the latter connection, evaluation reports should contain information useful for similar activities planned elsewhere.

Finally, although evaluation is decycled from the budget process, Missions and Bureaus should insure that evaluations are scheduled to permit consideration of findings prior to key program decisions.

References:

1. AIDTO Circular A-603.
2. AID Handbooks 3 and 4 (Project and Nonproject Assistance).
3. AID Handbook 17 (AID Organization), Ch. 17.

AID'S ROLE WITH RESPECT TO NON-AID RESOURCES IN THE TOTAL FOREIGN ASSISTANCE EFFORT PD-37

Our resources in AID - both in staff and money - are not equal to the needs of the developing countries. Therefore we must work harder than ever to mobilize other resources - private, community, and local government.

I am convinced that the attached Policy Determination will enable us to get more mileage from each dollar spent and each direct-hire employee on board.

William S. Gaud

William S. Gaud

DISTRIBUTION:
AID List M, Position 9
AID List B-6, Position 9
AID List B-4, Position 5
AID List C-2

POLICY DETERMINATION

U.S. Agency for International Development

PD-20 **JANUARY 3, 1994**

USAID PROGRAMS AND U.S. JOBS

PD-20
January 3, 1994

USAID

POLICY DETERMINATION

GUIDELINES TO ASSURE USAID PROGRAMS DO NOT RESULT IN THE LOSS OF JOBS IN THE U.S.

I. BACKGROUND

Section 599 of P.L. 102-391 prohibited the use of FY 1993 appropriated funds for financial incentives to U.S. enterprises to relocate abroad, or for establishing or developing export processing zones, if such activities were likely to result in the loss of jobs in the United States. It also prohibited use of funds for assistance which would contribute to violations of internationally recognized workers' rights. Section 547 of P.L. 103-87 continued this prohibition for FY 1994, except that subsection (c) was modified to exempt the informal sector, micro and small-scale enterprises, and smallholder agriculture.

These final Agency guidelines expand the application of sections 599 and 547 to all Agency funds (including local currency generated through foreign assistance activities), regardless of the year appropriated. It is Agency and Administration policy that no assistance be provided if it is likely to result in the loss of jobs in the United States.

The guidelines are divided into six parts: Background, Policy Context, General Principles, and specific guidance for the application of each of the three subsections of the statutory provisions. The guidance incorporates and expands on the statutory requirements. The text of the 1994 legislation is attached as Appendix A. Standard clauses for inclusion in grants, inter-agency agreements, and contracts are attached as Appendix B. Examples of certifications, resolutions, clauses, etc. are attached as Appendix C.

II. POLICY CONTEXT

Section 547 of P.L. 103-87 prohibits the use of appropriated funds for a number of activities related to investment promotion. The associated legislative history recognizes that such prohibitions are made in the context of a consistent postwar policy to support foreign direct investment by U.S. firms based on the link that such investment has with growing economies abroad, more U.S. exports, and more American jobs.

Section 601(a) of the Foreign Assistance Act states the policy of the United States "to encourage the contribution of United States

enterprise toward the economic strength of less developed friendly countries through private trade and investment abroad." Section 601(b) instructs the executive branch to "make arrangements to find, and draw the attention of private enterprise to, opportunities for investment and development in less developed countries and areas."

The mandate contained in Section 601 of the Foreign Assistance Act to encourage private U.S. investment abroad is not unconditional. The legislative history of Section 547 draws a distinction between promoting U.S. foreign investment and persuading U.S. firms to relocate abroad, particularly when such relocation results in a reduction of existing U.S. jobs owing to the replacement of existing U.S. production with production abroad.

This concern is shared by USAID. Administrator Atwood stated in his testimony before the House Committee on Foreign Affairs on May 12, 1993: "We feel very strongly that we should not be exporting American jobs. We ought to be exporting American goods." He laid out a proactive role for USAID in creating demand for American exports and supporting American jobs: "Exports to the developing world have been the largest and fastest growing sector of our GNP. If we can manage to encourage the development of free markets in these areas, then we are going to create opportunities for American businesses to sell their products in these areas of the world."

The Agency is also committed to implementing Agency programs and activities in a manner consistent with internationally recognized worker rights and related U.S. law, regardless of the year in which funds are appropriated. The legislative history of Section 502(a)(4) of the Trade Act of 1974 states that the underlying intent in promoting the internationally recognized rights of workers is to ensure that the broadest sectors of the population benefit from trade and development. The capacity to form free labor unions and to bargain collectively to achieve higher wages and better working conditions is essential for workers in developing countries to attain decent living standards and to overcome hunger. Congress has also expressed concern that "the lack of basic rights for workers in many less developed countries is a powerful inducement for capital flight and overseas production by U.S. industries."

The legislative history accompanying Section 502(a)(4) of the Trade Act of 1974 states that Congress recognizes that workers' rights should be interpreted commensurate with the development level of the particular country. In particular, it recognizes that the prevailing labor standards in the United States and other highly industrialized developed countries may not be appropriate in some developing countries, and paragraphs (d) and

(e) of Section 502(a)(4) permits some flexibility in that regard.

III. GENERAL PRINCIPLES

A. Application. Section 599 applies to activities financed with dollars appropriated in Fiscal Year 1993. Section 547 applies to FY 1994 appropriated funds. As a matter of policy, USAID is extending the application of Section 599 and 547 to all projects financed with appropriated dollars -- prior year funds as well as funds from FY 1993 and FY 1994 forward -- and to all projectized local currency funds, including those generated through P.L. 480 programs.

B. On-going Activities. On-going activities should be reviewed for compliance with these final guidelines. Proscribed activities funded with either FY 1993 or FY 1994 funds must be terminated immediately. Dollar-funded projects from earlier fiscal years, which do not comply either in whole or in part with the restrictions included in Section 547, as defined by this guidance, must be redesigned or terminated within 30 days of the effective date of these guidelines. Exceptions to this termination date may be approved only by the Administrator, and in no case will an extension of activities be permitted beyond 120 days of the effective date of these guidelines. The cost that may result from ensuring compliance with this provision should be taken into account in a Mission's or Bureau's decision of whether to redesign or terminate an on-going activity. On-going local currency activities should also be brought into compliance with these guidelines.

C. Statutory Checklist. Compliance with these guidelines must be verified at the time of project authorization; the statutory checklist has been modified accordingly. Handbook 3, Appendix 5C(2), Assistance Checklist, contains the relevant materials.

D. Grants and Inter-Agency Agreements. Standard clauses incorporating these guidelines are to be included in all HB3, HB13, and Inter-Agency agreements. These standard clauses, which will be incorporated into the appropriate handbooks, are contained in the Appendix B to this guidance. The clauses should also be included in subgrants.

E. Agreements with International Organizations. These guidelines apply to funds transferred to international organizations for implementation of project activities. In most cases, therefore, the standard clauses contained in Appendix B should be included in these agreements. Sometimes this may not be feasible. In such cases, the Mission or Bureau may take other appropriate steps to ensure compliance with the statutory restrictions.

IV. RELOCATION OF U.S. BUSINESSES -- SECTION 547(a)

A. Summary. In order to facilitate application of the statutory provisions and focus attention on those projects which are most in need of scrutiny, this section is broken into five distinct steps.

There is one important change in this five step process from prior guidance: although the statute uses the term "financial incentive," under these final guidelines, the determination of whether an activity is permitted or prohibited under Section 547 no longer depends on that concept, which proved to be difficult to define and apply. Henceforth, any type of assistance, regardless of whether it might be considered "financial assistance," will be considered subject to Section 547 restrictions.

Step one defines two baseline tests which are to be applied at the project design/authorization stage, and which are intended to eliminate broad categories of projects which do not present problems under the guidelines. These tests, framed in terms of questions, are:

1. Is the project, or are components or activities under the project, directed at promoting either foreign or local investment in the recipient country?

2. Could the project reasonably be foreseen to involve the relocation of <u>any</u> U.S. business that would result in a reduction in the number of employees of the business in the U.S.?

If the answer to either of these questions is no, the proposed project is not affected by these guidelines.

If a project is not excluded by either of these baseline tests, the next four steps, which involve greater scrutiny of project activities, must be applied. These steps identify four separate categories of projects/activities within the overall category of problem projects:

Step two identifies activities which USAID/W has already specifically determined to be permitted under the guidelines. These activities may be funded without additional controls being built into the project implementation stage.

Step three identifies other activities that have also already been scrutinized and are considered <u>per se</u> prohibited under the legislation. These activities may not be funded under any circumstances.

Step four provides additional guidance for designing and implementing the projects that remain after steps one through three have been followed. These projects present potential problems under 547(a), but may be funded if adequate controls are built into the implementation stage.

Step five provides guidance for analyzing projects which include a mixture of both activities that are either permissible under the legislation or can be subject to adequate implementation controls, and activities that are prohibited under the statute.

B. Step One: Application of Baseline Tests.

Test Number 1. Is the project, or are components or activities under the project, directed at promoting either foreign or local investment into the recipient country?

The legislative history of 547(a) makes clear that it is not intended to prohibit all activities that could tangentially or indirectly result in U.S. investments that may also involve a relocation overseas, but only those activities consciously directed at promoting investments in the recipient country. In general, USAID's investment promotion activities are well-defined, and these are the projects which merit the highest levels of scrutiny. Other projects may have some effect on foreign investment in the long run, but they are not directed at investment promotion.

For example, most infrastructure projects would not be prohibited under these guidelines, even though the adequacy of infrastructure may be one factor a firm takes into account when deciding to invest or relocate. As another example, a project designed to improve primary health care may create conditions which later may provide some inducement for a U.S. firm to relocate its operations, but since the project itself was not directed at promoting U.S. investments, it would not be prohibited by Section 547(a).

If there is any doubt about whether a project is directed at investment promotion, that doubt should be resolved in favor of a determination that it is.

If the project or activity is not directed in whole or in part at promoting investment, no further analysis is required. If it is, then Test Number 2 should be applied.

Test Number 2: Could the project reasonably be foreseen to involve the relocation of **any** U.S. business that would result in a reduction in the number of employees of the business in the U.S.?

This test is directed at analyzing the potential impact of the project, rather than the activities themselves. The same types of activities may have different impacts in given situations depending on other circumstances. The kinds of factors that should be analyzed in answering this question are: whether the recipient country or region is geographically attractive to U.S. firms; whether existing infrastructure is adequate to support external investment; whether normal investment patterns reflect activity in the country by U.S. firms; and whether the types of firms targeted under the project are likely candidates for relocation. If, in analyzing these and similar factors, the conclusion is reached that the project may result in the relocation of a U.S. business and loss of U.S. jobs, then the project is subject to the more detailed guidance set forth below. If there is no reasonable likelihood that a relocation could take place within the context of the project, then the project is acceptable under the terms of these guidelines and need not be subject to greater scrutiny or controls.

For the purposes of applying this test, drawn directly from the statute, a U.S. business is defined as one which is physically located in the U.S., rather than one which is owned by U.S. citizens. Additionally, the focal point in examining potential relocations is what may happen in the United States, not what form the overseas relocation may take. Regardless of whether the overseas operation involves a foreign subsidiary rather than the U.S. parent, a joint venture with a local firm, establishment of a new overseas enterprise, or an expansion of the U.S. firm's operations, if a loss of jobs in the U.S. is involved, these guidelines are violated. Even in the case of outsourcing and production sharing, where the objective is to preserve U.S. jobs, if the immediate effect would be a loss of some U.S. jobs to an overseas operation, a violation would occur.

If a project is not categorically excluded by one of the above tests, then the project presents a potential problem under the guidelines and the project activities must be examined more carefully, as described below.

C. Steps Two - Five: Analysis of Potential Problem Projects.

Step Two: Permitted Activities. There are some types of activities which, even though they have a commercial or investment orientation, by their nature would be too indirectly linked to any potential relocation to be considered to be prohibited by the statute. These activities may therefore be financed by USAID. Activities which fall into this category are:

-- policy dialogue designed to improve the overall domestic business and economic climate;
-- policy dialogue designed to improve financial and

capital markets;
-- legal, regulatory, and judicial projects, including those explicitly aimed at commercial activities; and
-- dissemination of information regarding the general economic and business climate in a country.

Step Three: Prohibited Activities. Some activities are at the other end of the spectrum and are prohibited regardless of the specific circumstances, because they represent too high a risk of being directly linked to a potential relocation. These activities may not be financed. Activities which fall into this category are:

-- investment promotion missions to the U.S.;
-- media advertising in the U.S. aimed at encouraging relocation of U.S. firms to the host country;
-- training of workers for firms that intend to relocate;
-- support for a U.S. office of an organization whose mission includes promoting investment in the host country; and
-- general budget support for such an organization if it engages in some activities not permitted under the statute.

It should be noted that some activities which are not on this list can easily evolve into them. For example, a trade mission targeted at increasing a country's exports can easily begin engaging in investment promotion activities as well. An organization which focuses on export promotion and trade may incrementally begin to undertake additional activities directed at investment promotion. Missions should pay particular attention to activities they are financing when there is potential for evolution of this sort.

Step Four: Implementation Controls. Many other activities fall into a gray area where they are permitted if they <u>don't</u> lead to a relocation, but would be prohibited if they <u>did</u> lead to a relocation. Examples of such activities are:

-- technical assistance in establishing linkages with U.S. businesses;
-- offices, trade fairs, exhibitions and seminars in the host country;
-- media advertising in the U.S. directed at investment promotion; and
-- credit, guaranties, insurance, research services, studies, travel to the host country, and technical and management assistance offered to firms contemplating or planning investments in the host country.

Such activities may be included in a project if adequate controls

can be built in to guard against relocations taking place. As a first step, the project grant agreement will include the grant clause discussed above, which will alert the implementing agencies to the need to ensure that no violations of these guidelines take place in circumstances under their control. The standard provisions of the grant agreement also include refund rights which should be exercised if the guidelines are violated.

The scope of work for any contractors involved in project implementation should also include a clause directed at these guidelines. The contractor will then be aware that it is responsible for ensuring compliance during the implementation phase. The sample grant clauses included in Appendix B may also be used as contract clauses; however, the Mission may find that a more elaborate clause tailored to the specific project activities is more appropriate for inclusion in a contractor's scope of work. The contractor also should be made aware that the contract clauses containing Section 547-type restrictions need to be passed on to subcontractors.

Finally, the responsible office may want to require that the implementing agency or contractor obtain from any U.S. firm that is a beneficiary of project activities a certification that such firm does not intend to relocate any of its productive operations to the host country. In some cases this may be the only feasible mechanism for ensuring compliance with these guidelines without completely terminating otherwise desirable activities. The need or utility of such a certification will depend on the specific circumstances of the project. An example of such a certification, which should be modified as necessary, is attached as Appendix C.

Step Five: Mixed Permitted-Prohibited. The final category is one in which permitted and prohibited activities are intermixed.

If the permissible activities are clearly distinct and can be segregated from those which do not comply with these guidelines, USAID may fund them. For example, if a host country investment promotion agency carries out discrete programs, some of which are acceptable, USAID may finance the permissible programs if it ensures that the USAID funds are segregated and used only for these activities. Adequate implementation controls should be included, as necessary. A Mission may not provide general budget support to such an agency.

If, on the other hand, the activities are interdependent, USAID may not fund them, even if, when taken in isolation, they would be permitted. For example, a feasibility study which in itself would not violate these guidelines may not be financed if, based on that feasibility study, there is a reasonable likelihood that the host country or other donors would offer incentives to a U.S.

firm to relocate.

V. ASSISTANCE TO EXPORT PROCESSING ZONES -- 547(b)

Paragraph (b) of Section 547 prohibits funding for "establishing or developing" an export processing zone "in which the tax, tariff, labor, environment, and safety laws of that country do not apply." The very nature of an export processing zone generally involves some simplification or reform in local laws, and few activities which USAID would undertake related to export processing zones could be characterized as other than "establishing or developing." Studies and technical assistance for zone design would fall under the prohibition; pre-feasibility studies are one of the few activities which might not, but even these are discouraged, unless required to provide materials for a presidential determination and certification as discussed below.

By its terms, the statute applies not only to designated export processing zones, but also to any "area" subject to the same relief from normal tax, tariff, and labor laws. "Area" means a physically defined, geographic space, including bonded warehouses. Although export processing zones or areas share many features, the essence of such zones or areas is a secure space that is outside the customs territory of the host country. Foreign-made inputs imported into such zones or areas do not ever officially enter the country and are therefore exempt from import duties.

Generally, assistance to export processing zones would involve discrete project activities that can be easily avoided. There may be some cases, however, in which a project's beneficiaries are not fully identified and may potentially include zones or businesses operating in zones. In these cases, as with Section 547(a), the standard clauses that are to be included in all grant agreements will act as the first level of protection against a grantee carrying out prohibited activities. In some cases, it may also be prudent to include either a similar or more detailed clause in the scope of work of contractors implementing project activities, particularly if such contractors would have some discretion in identifying project beneficiaries.

The statute permits an exception to the broad prohibitions of 547(b) if "the President determines and certifies that such assistance is not likely to cause a loss of jobs within the United States." We have interpreted the statutory language of 547(b) expansively signifying concern with <u>any</u> loss of jobs in the United States, whether or not such loss may be offset elsewhere in the U.S. economy by the positive effects of USAID assistance to an export processing zone, or by the positive effects of other USAID interventions. This is a very low

threshold, and we believe that certifications under the statute that job loss is not likely to occur will be extremely rare.

In those limited cases where a certification may be appropriate, the Mission or Bureau making the request will need to provide an in-depth analysis of the factors which would demonstrate that job losses in the United States are unlikely to occur, either as a result of the relocation of U.S. firms to the zone, or as a result of increased competition from foreign firms operating in the zone which could cause U.S. firms to lose business and consequently reduce their operations. These may include such general economic factors as a lack of comparative advantage of the host country (labor costs, infrastructure, availability of transportation, and energy costs, including factors specific to the zone); lack of geographic attractiveness to U.S. investors; and traditional investment and market patterns that mitigate the likelihood of job loss in the U.S. The results of any specific market surveys and feasibility studies that analyze the attractiveness of the zone to U.S. or other investors should also be included. Finally, any analysis available on the effect on specific industries, particularly those which may be declining or import sensitive industries in the U.S., should be part of the request for certification.

Missions or Bureaus requesting a certification should also include a discussion of any particularly controversial issues with respect to the zone that the Administrator should be aware of, even though they may not be relevant to the point of job loss. Such issues may include exemption from normal environmental controls, lower than normal minimum wage standards, and reduced protection of workers' rights.

The authority to make determinations and certifications under the statute has been delegated to the USAID Administrator. Requests should be directed to PPC for initial vetting, in conjunction with the responsible Bureau. PPC will then forward them to the Administrator for final determination. Requests will be considered only on a case-by-case basis; no blanket waivers for a country or region will be granted.

VI. INTERNATIONALLY RECOGNIZED WORKERS RIGHTS -- 547(c)

Section 547(c) differs from previous legislation designed to protect workers' rights, which focused on the degree of protection afforded and progress made at the country level, by focusing instead on project level activities.

The test to be applied under Section 547(c) is whether the project would <u>contribute to the violation</u> of workers' rights. The Agency has been proactive in implementing a consistent policy

of promoting workers' rights, which has included enhancing the capabilities of ministries of labor and local labor organizations.

Because the statute is directed at the project level rather than the country level, that does not mean Missions should not be concerned with failure of a host country's labor laws to comply with Section 502(a)(4) of the 1974 Trade Act. Missions and Bureaus should give particularly close scrutiny to projects involving the labor sector in such a country.

A good source of information on the degree of respect for workers' rights in a particular country is the State Department's annual human rights report. This report is the mechanism by which the Executive Branch complies with the requirement of the GSP Renewal Act of 1984 to report on the status of internationally recognized workers' rights within each beneficiary country. The human rights report may identify particular sectors or industries in a country that are recognized as engaging in serious violations of workers' rights. USAID should pay particular attention to those industries and either avoid projects which could contribute to violations or build adequate controls into the projects.

Additionally, as with the other two provisions of the statute, all grant agreements should include a standard clause requiring compliance by the grantee with Section 547(c). A similar clause should be included in the scope of work of implementing contractors who are carrying out activities in sectors where problems may occur. The standard clause attached in Appendix B, which is the one which will be included in the Handbook 3 standard provisions, is general in nature. It does not specify the rights which are incorporated into Section 547(c) by reference to Section 502(A)(4) of the Trade Act of 1974. There may be some circumstances where the Mission finds it important to include this level of specificity. Appendix A contains the text of Section 502(A)(4), and missions may include this text in grant agreements or contracts when they consider it appropriate to do so.

In some cases, Missions may require that the grantee or contractors obtain certifications of compliance from the ultimate beneficiaries. Under some circumstances, however, this may not be a meaningful mechanism for ensuring compliance with the statute.

Activities involving the informal sector, micro and small-scale enterprise, and smallholder agriculture present a somewhat unique situation in terms of assessing respect for workers' rights. It is clear that the rights enumerated in Sections 502(A)(4)(a)-(e) of the 1974 Trade Act may not be fully enforced with regard to

these sectors in many of the countries in which USAID work. Although individual countries may on the whole be found to be taking steps toward implementing workers' rights, these sectors may be the last to receive the benefits of on-going reforms.

Congress recognized the distinct nature of these sectors when it exempted them from application of the prohibitions contained in Section 547.

PD-20
January 3, 1994

APPENDIX A

TEXT OF LEGISLATION

IMPACT ON JOBS IN THE UNITED STATES

Sec. 547. None of the funds appropriated by this Act may be obligated or expended to provide-

(a) any financial incentive to a business enterprise currently located in the United States for the purpose of inducing such an enterprise to relocate outside the United States if such incentive or inducement is likely to reduce the number of employees of such business enterprise in the United States because United States production is being replaced by such enterprise outside the United States;

(b) assistance for the purpose of establishing or developing in a foreign country any export processing zone or designated area in which the tax, tariff, labor, environment, and safety laws of that country do not apply, in part or in whole, to activities carried out within that zone or area, unless the President determines and certifies that such assistance is not likely to cause a loss of jobs within the United States; or

(c) assistance for any project or activity that contributes to the violation of internationally recognized workers' rights, as defined in Section 502(A)(4) of the Trade Act of 1974, of workers in the recipient country, including any designated zone or area in that country: Provided, That in recognition that the application of this subsection should be commensurate with the level of development of the recipient country and sector, the provisions of this subsection shall not preclude assistance for the informal sector in such country, micro and small-scale enterprise, and smallholder agriculture.

SECTION 502(A)(4) OF THE TRADE ACT OF 1974

For the purposes of this title, the term "internationally recognized workers rights" includes-

(a) the right of association;
(b) the right to organize and bargain collectively;
(c) a prohibition on the use of any form of forced or compulsory labor;
(d) a minimum age for the employment of children; and
(e) acceptable conditions of work with respect to minimum wages, hours of work, and occupational safety and health.

APPENDIX B

STANDARD CLAUSES TO BE INCLUDED IN ALL GRANTS AND INTER-AGENCY AGREEMENTS, AND IN CONTRACTS AS APPROPRIATE:

"No funds or other support provided hereunder may be used in a project or activity reasonably likely to involve the relocation or expansion outside of the United States of an enterprise located in the United States if non-U.S. production in such relocation or expansion replaces some or all of the production of, and reduces the number of employees at, said enterprise in the United States."

"No funds or other support provided hereunder may be used in a project or activity the purpose of which is the establishment or development in a foreign country of any export processing zone or designated area where the labor, environmental, tax, tariff, and safety laws of the country would not apply, without the prior written approval of USAID"

"No funds or other support provided hereunder may be used in an activity which contributes to the violation of internationally recognized rights of workers in the recipient country, including those in any designated zone or area in that country."

PD-20
January 3, 1994

APPENDIX C

EXAMPLES OF CERTIFICATIONS, RESOLUTIONS, CLAUSES, ETC.:

CERTIFICATION

"I have reviewed Section 547 of P.L.103-87 (the FY 1994 Foreign Operations Appropriations Act) and certify that my participation in this [trade mission] [project] [activity] will not result in a reduction in the number of my firm's employees in the United States because my firm is replacing U.S. production with production outside the U.S."

APPENDIX C

SECTION 547 CLAUSE
CURRENT USAID CONTRACT FOR
TRADE IMPLEMENTATION AND POLICY PROGRAM (TIPP)

"Restricted Assistance Activities. The Contractor agrees that, unless otherwise authorized by USAID in writing, no advice, services or assistance of any kind will be provided under this Contract by the Contractor, its employees or subcontractors, which would:

1) Induce a business enterprise in the United States to relocate productive facilities outside the United States; or

2) Assist in the establishment or development of export zones in Indonesia; or

3) Contribute to the violation of internationally recognized workers' rights as defined in Section 502(A)(4) of the Trade Act of 1974.

In the event the Contractor is requested or wishes to provide assistance in any of the areas listed above, or requires clarification from USAID as to whether the provision of advice, services or assistance in any specific instance would be consistent with the limitations set forth above, the Contractor will immediately notify the Contracting Officer, providing a detailed description of the proposed contract activity and the restriction affected. The Contractor will not proceed with the activity unless and until advised by the Contracting Officer that it may do so.

The provisions of this clause are intended to implement Section 547 of P.L. 103-87, the Foreign Operations, Export Financing, and Related Appropriations Act, 1994, and related USAID policy guidance. The Contractor agrees to comply with all policy guidance issued by USAID with regard to Section 547, as from time to time revised and/or supplemented.

The Contractor will ensure that all employees and subcontractors providing services under this contract are made aware of the restrictions set forth in this clause and will include this clause in all subcontracts and other subagreements entered into hereunder."

APPENDIX C
SECTION 547 IMPLEMENTATION AGREEMENT BETWEEN THE ENTERPRISE FUNDS AND THE U.S. GOVERNMENT

To comply with Section 547 of the "Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1994," the Enterprise Funds and the U.S. Agency for International Development agree as follows:

Each Enterprise Fund shall:

1. Add to its Due Diligence process the responsibility for the collection of information as to whether a potential investment would be in violation of Section 547.

2. Amend Article III, Section 2 of each Fund's "Statement of Corporate Policies and Procedures" by adding part (c) so that Section 2 reads in its entirety as follows:

   "2. As a matter of policy, the Corporation shall require that recipients of grants and other forms of assistance from the Corporation certify, as a condition to such assistance, that such funds as are provided by the Corporation not be utilized for:

   a. the manufacture or sale of abortion equipment or the provision of abortion services;

   b. the manufacture or sale of munitions articles or services; and

   c. any action that would be in violation of Section 547 of the "Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1994." The Corporation shall discuss with each recipient the intent of the legislation, the language of the Act itself, and each recipient shall represent to the Corporation at the time the assistance is authorized or before that it will not use the assistance in a manner that would violate Section 547."

3. Use the semi-annual USAID program reviews to provide to USAID written confirmation that the Funds' actions regarding Section 547 are in order for investments authorized by the Funds during such program review period.

These principles will be incorporated in the December 30, 1991, Protocol Agreement between the Enterprise Funds and USAID. The Protocol Agreement, as modified, will then be incorporated by USAID into its Grant Agreements with the Funds.

APPENDIX C

RESOLUTION TO AMEND THE
BULGARIAN-AMERICAN ENTERPRISE FUND
STATEMENT OF CORPORATE POLICIES AND PROCEDURES

RESOLVED, that Article III, Section 2 of the "Bulgarian-American Enterprise Fund Statement of Corporate Policies and Procedures" be amended to read in its entirety as follows:

"2. As a matter of policy, the Corporation shall require that recipients of grants and other forms of assistance from the Corporation certify, as a condition to such assistance, that such funds as are provided by the Corporation not be utilized for:

a. the manufacture or sale of abortion equipment or the provision of abortion services;

b. the manufacture or sale of munitions articles or services; and

c. any action that would be in violation of Section 547 of the "Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1994." The Corporation shall discuss with each recipient the intent of the legislation, the language of the Act itself, and each recipient shall represent to the Corporation at or before the time the assistance is provided that it will not use the assistance in a manner that would violate Section 547."

Terrence J. Brown

January 3, 1994

USAID Policy Papers and Policy Determinations

The following reports have been issued in a series. These documents with an identification code (e.g. PN-AAM-323) may be ordered in microfiche or paper copy. Please direct inquiries regarding orders to:

USAID Document and Information Handling Facility
Suite 1010, 1500 Wilson Boulevard
Arlington, VA 22209

Title-Policy Paper	Date	Fiche
Domestic Water and Sanitation	May 1982	PN-AAM-323
Food and Agricultural Development	May 1982	PN-AAM-322
Nutrition	May 1982	PN-AAM-321
Recurrent Costs	May 1982	PN-AAM-319
Population Assistance	September 1982	PN-AAM-320
Private and Voluntary Organizations	September 1982	PN-AAM-318
Women in Development	October 1982	PN-AAL-777
Pricing Subsidies and Related Policies in Food and Agriculture	November 1982	PN-AAL-373
Approaches to the Policy Dialogue	December 1982	PN-AAM-431
Basic Education and Technical Training	December 1982	PN-AAM-190
Institutional Development	March 1983	PN-AAN-108
Co-Financing	May 1983	PN-AAN-457
Local Organizations in Development	March 1984	PN-AAQ-157
Energy	July 1984	PN-AAQ-160
Urban Development Policy	October 1984	PN-AAQ-158
Shelter	February 1985	PN-AAQ-162
Private Enterprise Development (Revised)	March 1985	PN-AAQ-163
International Disaster Assistance	May 1985	PN-AAQ-164
Cooperative Development	April 1985	PN-AAQ-165
Trade Development	July 1986	PN-AAV-461
Health Assistance (Revised)	December 1986	PN-AAV-462
Environmental and Natural Resources	April 1988	PN-AAV-464
Financial Markets Development	August 1988	PN-AAV-465
Democracy and Governance	November 1991	

Title-Policy Determination	Date	Fiche
PD# 1- Narcotics	August 5, 1982	PN-AAM-443
PD# 2- Mixed Credits	September 29, 1982	PN-AAM-444
PD# 3- Voluntary Sterilization	September 1982	PN-AAM-445
PD# 4- Title XII	October 5, 1982	PN-AAM-446
PD# 8- Participant Training	July 13, 1983	PN-AAP-273
PD# 9- Loan Terms Under PL 480 Title I	September 27, 1983	PN-AAN-753
PD#10- Development Communications	February 17, 1984	PN-AAP-616
PD#11- Using PL 480 Title II Food Aid for Emergency or Refugee Relief	July 26, 1984	PN-AAQ-159
PD#12- Human Rights	September 26, 1984	PN-AAQ-161
PD#13- Land Tenure	May 9, 1986	PN-AAQ-166
PD#14- Implementing USAID Privatization Objectives	June 16, 1986	PN-AAQ-167

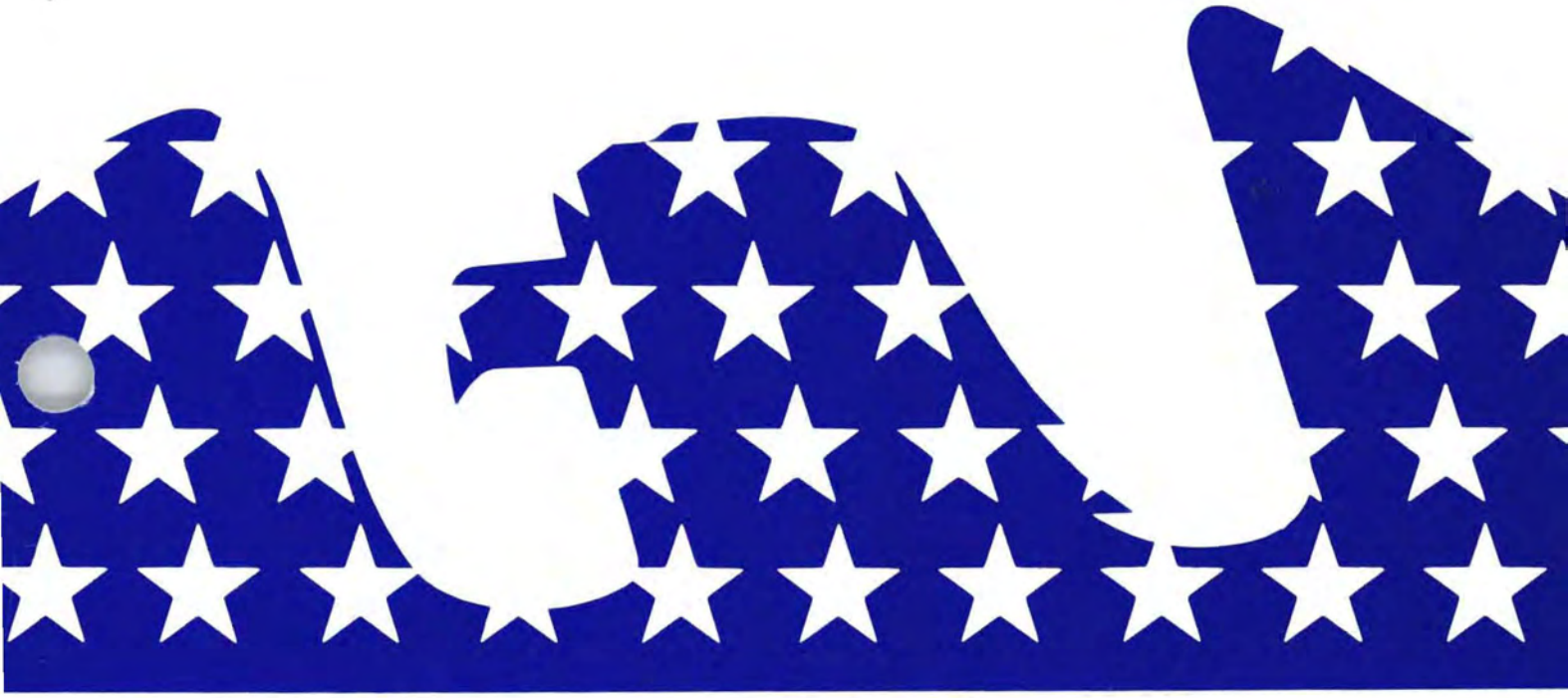
PD#15- Assistance to Support Agricultural Export Development	September 13, 1986	PN-AAV-460
PD#16- Program Financing Arrangements with Independent Organizations	October 9, 1987	PN-AAV-463
PD#17- Microenterprise Development Program Guidelines	October 10, 1988	PN-AAV-466
PD#18- Local Currency	July 30, 1991	PN-AAV-467
PD#19- Definition of Food Security	April 13, 1992	PN-AAV-468
PD#20- USAID Programs and U.S. Jobs	January 3, 1994	PN-AAV-469

POLICY DETERMINATION

Agency for International Development

PD-21 **JULY 18, 1994**

GUIDELINES: ENDOWMENTS FINANCED WITH APPROPRIATED FUNDS



PD-21
July 18, 1994

USAID POLICY DETERMINATION

GUIDELINES: ENDOWMENTS FINANCED WITH APPROPRIATED FUNDS

I. INTRODUCTION

Recent legislative changes greatly expand USAID's ability to fund endowments. Endowments provide another mechanism for achieving USAID's development goals which complements our more traditional assistance forms. Unlike traditional mechanisms which focus on financing goods and services in furtherance of foreign assistance objectives, endowments allow us to support more directly an entity whose purpose is to further such objectives.

However, endowments also present a series of unique difficulties that must be thoroughly assessed before a mission or bureau makes a funding decision. These problems are often exacerbated because of a lack of familiarity with endowments in many developing countries, and because the legal and regulatory environment in such countries may not provide an adequate framework for the establishment and oversight of such funds. In many cases, design of an endowment may also be very labor intensive.

These guidelines are intended to assist missions and bureaus in their analysis and funding of endowments, and to ensure that relevant factors are adequately taken into account. Some of the main issues covered are: the objectives which can be achieved through the use of endowments; characteristics of organizations for which endowments are appropriate; financial management of both the investment fund and program income; application of legislative restrictions; mechanisms and appropriate degree of oversight; and termination of the endowment.

II. BACKGROUND

Prior to 1990, USAID's authority to grant funds for the establishment of endowments was severely restricted. Federal appropriations law generally prohibits a grantee from retaining interest earned on appropriated dollars. As a result, there was no practical means for establishing endowments with dollars appropriated to USAID, or with local currency acquired by the exchange of these dollars.

The only way that endowments could be established with USAID funds before 1990 was with explicit congressional approval. This mechanism was only occasionally used.

The other mechanism for establishing endowments in conjunction with USAID activities was to use host country owned local currency. Because these funds are not appropriated to USAID or owned by USAID, they are not subject to federal appropriations

laws (or most other statutory restrictions on the use of USAID funds). Local currency endowments have become increasing common, particularly over the last decade, supporting programs in education, environmental resource management, and agricultural research.

Legislation enacted as part of the FY 1990 foreign assistance appropriations act took the first step forward in permitting the use of appropriated funds for funding endowments. Section 584 of that act permitted non-governmental organizations (NGOs) to retain interest on, and thus establish endowments with, local currency acquired through the exchange of appropriated dollars. The legislation was directed mainly at transactions involving debt swaps, whereby USAID provides a grant to an NGO to purchase discounted debt of a developing country, which is then redeemed by the host government with local currency funds. Section 584 made possible the retention of interest earned on the local currency funds acquired through debt swaps, and as a by-product, also made possible the establishment of endowments with these funds. The Section 584 authority was continued in fiscal years 1991 and 1992.

In FY 1993 Congress significantly expanded the authority, to permit non-governmental organizations which were contractors or grantees of USAID to retain interest on appropriated dollars retained as dollars as well as those converted into local currency, and to establish endowments with these funds. (Section 567 of the FY 1993 foreign assistance appropriations act.) The authority was extended to apply retroactively to prior year funds as well as FY 1993 funds. Congress reenacted this provision in the FY 1994 appropriations bill as Section 534. (Section 534 of the Foreign Operations, Export Financing, and Related Programs Appropriations Act, 1994; P.L. 103-87.) With this authority, NGO's may now be permitted to establish endowments directly with funds granted to them by USAID, without first having to convert the funds to local currency.

III. SCOPE AND AUTHORITY

A. Purpose of guidelines. The funding of endowments involves a number of budgetary, policy, and legal issues not commonly encountered in more traditional forms of assistance. These guidelines are intended to highlight and provide guidance on these issues in order that endowments may be established in a manner consistent with sound programmatic, budgetary, and financial management practices, and the laws governing the use of appropriated funds.

B. Scope and applicability. These guidelines describe USAID's policies governing the use of grant funds for financing endowments; the organizations eligible to receive endowments; and the various administrative and contractual procedures required in

order to establish, maintain, audit, draw down, evaluate and close an endowment. For the purposes of these guidelines, an endowment is considered to be the capitalization of a fund, independent from USAID, the objective of which is to generate income to maintain activities of a private, non-profit institution that are consistent with the purposes of the Agency's authorizing legislation.

The guidelines apply to all endowments funded with appropriated dollars, including those which have been converted to local currency through debt swaps or normal exchange procedures. The guidelines do not apply to the funding of endowments with host country-owned or NGO-owned local currency. However, many of the issues discussed herein are equally applicable to all endowments, and the guidelines may therefore be useful regardless of the funding source involved.

Endowments are just one of the circumstances in which interest may be retained under the new legislative authority. Separate guidance will be issued on the retention of interest outside the context of endowments.

C. Modifications to guidelines. Modifications to these guidelines may be needed as USAID gains experience with the endowment program. The Bureau for Policy and Program Coordination (PPC) encourages interested parties to identify problems and to suggest needed changes.

IV. DESIGN AND APPROVAL OF ENDOWMENTS

Because the authority to establish endowments is new, the Agency's experience in this area is somewhat limited. U.S. foundations can often be an invaluable source of expertise to assist us in developing activities that involve endowments.

To ensure that the experience being acquired is adequately shared throughout the Agency and its overseas missions, and that this guidance can be updated and refined to reflect innovations in the field, all endowments must be approved in USAID/W at this time. Regional Bureaus will be responsible for approving endowments according to their normal project approval processes. PPC and the Office of General Counsel (GC) should participate in all reviews. PPC will review this policy in two years to determine whether Washington approval continues to be necessary.

In most cases, funds for an endowment for an NGO will be obligated through a grant, and the approval process should therefore follow the procedures applicable to all such grants. However, endowments have a number of characteristics that differ from traditional NGO grant activities, and that raise significant policy issues which should be addressed. The issues set forth

below should be specifically considered during the approval process and documented.

A. Consistency with USAID strategy. A proposal for an endowment must be consistent with the objectives and approved strategies for the country, region, or sector in which the funds are to be expended.

B. Objectives. An endowment should be directed at achieving objectives not attainable through traditional assistance modes. Some possible justifications for endowments are cited below. One or more should be included in the rationale for a proposed endowment, and the bureau or mission should assure itself that such objective(s) are achievable under the circumstances at hand.

1. An endowment may be used to broaden and enhance the funding base of an NGO engaged in activities which have a long-term horizon and where funding by short-term grants or a series of such grants is likely to be insufficient to realize the full program objectives.

2. The financial stability provided by an endowment may insulate the endowed organization from unpredictable government and donor agency budget fluctuations. An endowment may thus enable an NGO to become more independent and self-reliant in identifying and solving environmental, economic, and social development problems.

3. An endowment may allow the recipient organization to attract other funds by increasing donor confidence, thus leveraging the USAID funds.

4. USAID financing of an endowment may be used to encourage the establishment of philanthropic principles in countries where such principles are less well-established.

5. An endowment may allow an activity to be institutionalized and continue beyond USAID's funding, when it otherwise may not have been.

6. An endowment is one mechanism by which USAID may continue development strategies through international or indigenous organizations upon termination of an USAID presence in the country and/or the termination of USAID direct assistance activities.

C. Budgetary impact. In general, the establishment of an endowment entails a much more rapid up front outlay of funds than traditional program activities, and in some cases may involve a relatively large amount of funds. Although the budgetary impact can be lessened somewhat by capitalizing an endowment over more

than one year, it is still greater than if funds were expended over a period of time for the activities themselves.

The bureau or mission granting the funds should determine whether an endowment is more cost effective than multi-year support of the organization through technical assistance and institutional and project support, and whether the benefits to be gained by establishing the endowment outweigh the benefits of the alternative uses of the program funds, which in many cases will have less adverse budgetary implications.

D. Characteristics of the NGO. The following characteristics must be demonstrated by an organization for which an endowment is proposed:

1. In accordance with the statutory provision authorizing endowments, the organization receiving the endowment must be non-governmental. The purpose behind requiring that the organization be "non-governmental" is to ensure that it is independent from the government. Some government involvement is acceptable, as long as the government does not control the organization. For example, the government may be represented on the board of directors of the organization, but only by a minority of the board members.

2. Under the usual circumstances, the organization will also be non-profit.

3. The organization's activities must fall within the purposes for which the USAID funds have been authorized, or the documentation establishing the endowment must limit the use of the USAID funds to such purposes.

4. If the organization is not a registered PVO, it must meet pre-award survey requirements designed to ensure adequate accountability of funds.

5. The organization must have a demonstrated capacity to implement the program which the endowment is to fund, or controls must be built in to ensure that this capacity is developed. In some cases, USAID may want to provide a separate grant to a well-established NGO to help with the institutional development of a beneficiary NGO that does not have a proven track record.

If the beneficiary organization requires a high degree of monitoring and oversight (e.g., it's new or weak), this may mean that an endowment is not an appropriate mechanism for providing assistance to it. In such cases, the mission or bureau should consider providing traditional grant funding for a number of years until the organization has established a track record, and then evaluate whether an endowment makes sense.

E. Recipient financial participation. USAID's current guidelines (PD-16) encourage the largest reasonable and possible financial participation of the recipient in financing a project, establishing a reference point of twenty-five percent of project costs. In some instances, however, especially for newly established NGO's, participation of less than twenty-five percent may still be substantial, given the NGO's resources. It is also possible that no financial participation may be appropriate if the NGO provides a critical and non-substitutable service in achieving bilateral assistance objectives. The USAID official authorizing an endowment will make the final determination of the appropriate level of financial participation.

F. Financial management considerations. Unlike the case of grant expenditures, the financial considerations of endowments must be addressed from two perspectives: the adequacy of controls related to the expenditure of funds by the NGO for program activities, and the adequacy of financial arrangements and controls related to the investment of the endowment fund itself. A number of different arrangements are possible in establishing an endowment, and often these arrangements are driven by these financial considerations. Issues relating to both categories of financial management, and suggestions for mechanisms for building in controls, are set forth below.

1. Program expenditures. Legally, the establishment of an endowment is analogous in many ways to a cash transfer. The purposes of the grant are accomplished at the time the endowment is established; therefore, statutory and regulatory restrictions on the use of funds, such as source/origin, do not apply. (However, USAID may apply some restrictions as a matter of policy. See Section V.C. below.) The converse of this is that USAID may not actively participate in the implementation of program activities.

(a) Bureaus and missions must therefore assure themselves that the beneficiary of the endowment can adequately implement its programs and manage and account for the funds it expends without detailed oversight by USAID.

(b) If the organization is not a registered PVO, a pre-award survey must be performed to ensure adequate accountability of funds.

(c) If the organization is found to have inadequate financial controls in place, or it is being newly created, controls must be built into the program design.

2. The investment fund. An endowment by its nature involves a relatively large amount of appropriated funds, largely outside of USAID's control, which will continue to exist for many years, often beyond the period of USAID oversight. If

the endowment is to succeed, the return generated by the endowment, together with other available resources, must be adequate to support the program of the beneficiary organization, and the possibilities for misuse must be minimized. The arrangements for management of the fund will vary with the size of the fund, the track record of the beneficiary NGO, and whether it is composed of dollars or local currency.

In order to assure that the financial controls over the investment fund are adequate, the following points should be addressed during the program design and approval process:

(a) Country of investment. Legally, there is no restriction on where the funds may be invested. However, because this is a new authority which will be subject to close scrutiny, we are requiring that the funds be invested in financial instruments offered in the U.S. through a U.S.-based financial intermediary. This still allows investments in global offerings. For example, funds may be invested in a mutual fund that includes emerging market or European securities, as long as the mutual fund is offered in the U.S. through a U.S. broker. Investment options in the U.S. markets are sufficiently broad that this requirement should not hamper development of a sound investment strategy for the endowed organization. In fact, even absent this restriction, one could expect that the bulk of funds of an endowed organization looking for long-term stability would be invested in the U.S.

A small amount of funds needed for current local operating expenses will necessarily be held locally, probably in an interest bearing account.

Endowments derived from debt swaps are not subject to this requirement that all long-term investments be in the U.S. These are local currency funds by their nature and thus may be invested locally.

(b) Conflicts of interest. An important concern in the establishment of endowments is conflict of interest. The members of the board of directors, a trustee, or financial manager all may have potential conflicts with respect to either investment or expenditure of the funds. When the funds we grant are required to be invested in the U.S., the problem is substantially diminished (with respect to those funds), but not eliminated. When funds are derived from debt swaps, however, and invested locally, the problem is much greater. The issue of conflict of interest requires careful treatment at the design stage. More detailed guidance on conflict of interest, and sample clauses, are available from PPC, GC, and RLA's.

(c) Management of the funds. Arriving at a mechanism for managing the investment fund entails a fairly complex balancing of USAID's interests, the NGO's interests, and cost.

(i) One option is to establish a trust arrangement whereby control of the investment fund is totally separated from the beneficiary organization. The trustee may be a separate foundation or NGO, a bank, etc. If it seems advantageous under the circumstances, the trustee organization may be specially created in order to manage the endowment.

There are a number of advantages to using a trustee to manage the investment fund:

-- A local NGO that is a beneficiary may appropriately have a board of directors composed entirely, or predominantly, of nationals of that country. With such a board, potential conflicts of interest in investing the funds could be a serious problem, particularly if the funds are local currency derived from a debt swap. It may be prudent and desirable to have international participation in the management of the fund. Separating control of the investments from control of the program activities allows for an infusion of outside influence over the investment function.

-- The board of the beneficiary organization may be composed of people whose characteristics and skills are appropriate for management of the program, but who do not have the background and experience to manage the investment of the endowment fund. Again, having an independent entity manage the fund allows for the selection of those most suited to each task.

-- Separation of the fund from the beneficiary may alleviate the possibility that short-term programmatic pressures could lead to imprudent investments.

-- Finally, if the trustee is either of U.S. nationality or located in the U.S. and serious problems develop in the future, it will usually be easier for USAID to reach the funds. Additionally, the trustee would be regulated by U.S. laws in this case, adding a degree of protection.

The actual degree of independence of the two organizations should be closely examined. For example, is there any overlap on the board of

directors? If the trustee is a bank, is it affiliated with any of the board members of the beneficiary organization?

If a trust arrangement is used, in most cases USAID will grant the funds to the beneficiary NGO, and the beneficiary will execute a trust arrangement with the trustee. However, USAID should require that it approve the trust agreement prior to the signing of the grant or the disbursement of funds. Both the trust agreement and the grant agreement should also specify that the trust agreement may not be amended without USAID approval during the period of USAID oversight. Again, the trust agreement should specify the general parameters of investments allowed and the return expected. USAID will disburse funds directly into the trust account.

If both the trustee and the beneficiary are NGO's, USAID may want to grant the funds directly to the trustee, to be held in trust for the beneficiary. However, we would need to ensure that the appropriate HB13 provisions were passed on by the trustee to the beneficiary.

The disadvantages to using a trust arrangement are:

-- If a suitable trustee does not already exist, creating a new organization could be difficult, time consuming, and expensive.

-- Existing, easily accessible trustees, such as banks, may tend to be extremely conservative in their investment strategies, and not ensure the best return on the funds.

-- Use of a trust arrangement could restrict the NGO's ability to build a capacity for management of long-term assets. A limited track record in this area could frustrate the NGO's efforts to use the USAID funding to leverage contributions from other sources.

(ii) An intermediate arrangement that is common among U.S. organizations is for the beneficiary organization to form a separate finance committee for management of the fund. The committee takes its general direction from the board of directors of the organization, but includes outside members with financial expertise. If such an arrangement is contemplated, it should be specified in the grant agreement. The number and qualifications of the

outside members may also be specified, and USAID should ensure that a satisfactory committee has been formed prior to the disbursement of funds.

(iii) In most cases, at a minimum, a professional financial manager should be retained. In that case, the NGO retains ultimate control of the funds, but enters into a written agreement with a manager for day-to-day investment and accounting services. The contract should specify the general parameters of the types of investments to be permitted, and the amount and timing of income to be disbursed to the organization for its operations. The requirement for such a contract should be included in the grant agreement and the mission should review and approve the contract either prior to the signing of the grant, or prior to the disbursement of funds into the endowment. The grant agreement should also specify that any amendments to the financial management agreement must be approved by USAID during the period of USAID oversight.

(d) Separate account. If the NGO has funds from other sources, the funds contributed by USAID to the endowment, and the return on those funds, should be held in a separate account to facilitate monitoring. In most cases, this should not interfere with having multi-donor contributions to an endowment fund. In fact, many organizations prefer this arrangement, since it provides some incentive to subsequent contributors to add funds that are also identifiably their own, and to which they may also want to attach conditions. However, if a mission or bureau believes that a separate account is not feasible under a particular set of circumstances, they may request an exception to this requirement from PPC.

(e) Types of investments. Although the statutory provision authorizing the retention of interest and establishment of endowments states that the funds may be placed in "interest bearing accounts", we have not interpreted this provision to restrict investments of these funds to savings accounts or similar instruments. Rather, we read this language merely as part of the positive authority Congress was providing to overcome normal prohibitions on retaining "interest" on appropriated funds. As a matter of policy, the investments should be sound and prudent and not include any of a highly speculative nature. The specific investments which will be most beneficial will vary according to the particular circumstances, and may include equity investments.

(f) Life of the endowment. It may not be necessary or desirable in all cases to create an endowment with USAID funds large enough to finance activities in perpetuity, and to permit the use of the investment income only. In some cases, it may be preferable to draw down on the principal to some degree, as well. For example, USAID may finance an organization with the understanding that it will be seeking additional funding from other sources. If the funding materializes as projected, one option may then be to preserve the endowment principal granted by USAID. An alternative approach may be to spend down the USAID funds and retain the new funding as the source of on-going income. If the additional funding does not materialize as planned, it may be preferable for the organization to begin drawing down principal in order to operate at a reasonable level of activity, rather than operate at a level that would have limited impact, even if this means that it may cease to operate altogether in a number of years.

In other cases, USAID may believe that the useful life of the organization is limited, and therefore preservation of the endowment principal is neither necessary nor desirable. Finally, budgetary constraints may limit the size of the endowment and necessitate drawdowns. A word of caution, however: if the funds are drawn down too rapidly, the endowment could appear to be nothing more than an advance of funds, and the failure to apply normal funding controls and restrictions could be called into question. The minimum period over which we would expect the USAID funds to be drawn down is 10-15 years.

(g) Financial plans. In all cases, the financial plans, including the projections for returns and the circumstances under which drawdowns of principal are to be permitted, should be reviewed by USAID prior to the approval of funding for the endowment.

(h) Tax consequences. The creation or funding of endowments may trigger a number of tax consequences -- in the U.S. (both federal and state) as well as in the host country. Of course, the beneficiary NGO has ultimate responsibility for assessing its tax liabilities. Nevertheless, tax issues should be thoroughly explored prior to the approval of an endowment, since they affect financial projections. A separate information package on U.S. tax issues has been prepared for internal guidance and is available from GC or PPC. Two of the most salient points, exempt status and deductibility of contributions, are briefly discussed below.

Income from investments in the U.S. will generally be subject to federal taxes and taxed at the corporate rate

unless the NGO has been recognized as a charitable organization under Section 501(c)(3) of the U.S. Internal Revenue Code. (A separate exemption, unrelated to 501(c)(3) status, is applicable to interest income from U.S. bank accounts.) Foreign organizations can acquire exempt status by filing Form 1023. The IRS generally takes a minimum of three months to process the application. In its review, the IRS emphasizes financial management controls and accountability measures, so a thorough analysis of many of the issues identified in this guidance will help to assure 501(c)(3) status for the organization.

In general, contributions by a U.S. citizen to a foreign organization are not tax deductible, nor are contributions to a U.S. organization that is acting as a mere conduit for funds for a foreign organization. There are circumstances under which a U.S. organization can channel funds to a foreign organization without jeopardizing the deductibility of the funds, but the rules are fairly complex and need to be followed closely.

G. Legal-regulatory environment. In many developing countries, endowments are not a familiar funding arrangement. The host country laws and regulations may not be appropriate, therefore, for establishing endowments, at least in some forms. To overcome gaps in the law, the charter or by-laws of the organizations may have to include items not normally found in these documents. Local legal counsel should be consulted early in the process. Missions should recognize, however, that if endowments are not common in a country, even finding local counsel who can provide reliable advice could be problematic. The mission may need to contract outside consultants in order to gain a full understanding of the local legal and tax issues involved.

V. OBLIGATION OF FUNDS

A. Grant agreement. As stated above, obligation of funds will normally be through a grant agreement. Although there are substantial differences between our normal grant-funded activities and endowments, we are still granting the funds to the beneficiary organization, and imposing certain restrictions on the use of the funds, all of which must be incorporated into the grant agreement, either directly or by reference. Nevertheless, even though the grant agreement is the basic obligation document, it must be modified substantially in a manner similar to the modifications we make to government-to-government grant agreements for cash transfers. A model agreement will be developed in the near future.

B. Use of funds. The grant agreement should state any restrictions on the use of funds, particularly if the organization is not to be permitted to use the funds for all of

the purposes for which it has been organized, or which are permitted under its charter.

C. Restrictions on funds. A normal grant agreement contains a panoply of restrictions on the use of the funds, most of which are statutorily imposed. Since endowments are created in order to provide the organization with a stable source of income, the primary purpose for which the funds are to be used is accomplished at the time the endowment is funded, although we may retain a subsidiary interest in how the funds are later used, as well. An endowment is therefore similar to a cash transfer, and normal statutory restrictions do not apply as a matter of law. However, we have determined that the following restrictions should be applied as a matter of policy:

1. Source/origin. Because USAID oversight of endowments will be somewhat limited; the organizations receiving endowments will often have other funding sources for their operations, separation of which from USAID funding could be extremely burdensome; and in most cases the income from the USAID funds will be spent rather than those funds themselves, USAID will not impose any flat source/origin requirements. However, beneficiary organizations should be encouraged to make a good faith effort to follow the general parameters of our source/origin rules, recognizing that the source of the funds is the U.S. Government. The grant agreement should contain a clause to this effect. Compliance with this good faith effort will not be monitored. Missions should be aware that source/origin is always a sensitive issue, and failure of the organization to make such a good faith effort could possibly jeopardize continuation of our endowment authority.

2. Family planning activities. None of the funds made available through an endowment, including investment income, may be used --

(1) to coerce any person to practice abortion; or

(2) to pay for the performance of involuntary sterilizations or to coerce or provide any financial incentive to any person to undergo sterilization.

D. Conditions precedent. The grant agreement should state that, prior to the disbursement of funds, the following must be reviewed and approved by the mission:

1. the financial plan, which includes a realistic projection of income from the endowment; and

2. the arrangements for management of the endowment fund, which should include an executed trust agreement or financial

management contract if they are to be used, or formation of a finance committee.

E. Covenants. The grant agreement should include the following covenants:

1. a covenant that the trust agreement, finance committee, or financial management contract cannot be changed during the period of USAID oversight without the approval of USAID; and

2. a covenant requiring that if either the NGO or the endowment are dissolved at any time (even after the period of USAID oversight), any funds remaining in the endowment must be returned to the U.S. Treasury as miscellaneous receipts, unless USAID agrees otherwise.

F. Monitoring by USAID. The grant agreement should establish the period of USAID oversight, and the level of monitoring that will be performed during that period. In general, the endowment and use of funds should be monitored for a minimum of five years and a maximum of ten. Further details on monitoring are included below.

G. Termination. The grant agreement should include the normal rights to terminate at USAID's option if funds are improperly used, to apply during the period of USAID oversight. Additionally, the grant agreement should specify that failure to provide a scheduled audit report to USAID, or serious adverse audit findings, will constitute default under the agreement and can be considered grounds for termination. The grant agreement should also provide that if the grant is terminated, any funds remaining in the endowment must be refunded to USAID.

VI. MONITORING AND OVERSIGHT

A. Monitoring by USAID. The degree of monitoring by USAID that is desirable and feasible will be influenced to some degree by the specific circumstances surrounding the endowment. If the organization has a good track record, and we are funding the endowment as part of a decision to terminate direct USAID activities in the country, limited oversight by USAID might be all that is needed or even feasible. On the other hand, if the organization is new and we are maintaining a presence in the country, more oversight for a longer period of time might be appropriate.

In any case, the oversight that is permitted will be limited to some degree by the nature of the transaction. In arriving at the legal determination that normal statutory restrictions need not be applied to the funding of an endowment, we are relying on the rationale that the purpose of the assistance is achieved at the time the endowment is funded. If USAID maintains too high a

level of involvement in the subsequent project activities, this logic will be undermined, and it could be concluded that a normal grant agreement was the more appropriate assistance vehicle. No clear line can be drawn between what is the right level of involvement and oversight and what is too much. However, the following examples can be used as a guide:

1. The participation of a USAID employee on the board of directors of the organization or the trust (if the trustee also has some substantive oversight role in addition to having responsibility for the funds) is permissible only if it is in an ex-officio (i.e., officially representing USAID) non-voting capacity.

2. Requiring that USAID approve the first board of directors is permissible, but approving replacements after that is not. (The by-laws should build in a replacement mechanism which gives USAID confidence that the replacements will be acceptable without USAID oversight.)

3. Retaining the right to approve subgrants made by the NGO is not permissible.

4. Requiring submission of the NGO's annual report, or an annual report specifically prepared for USAID, is permissible and usually desirable.

B. Monitoring after the Period of USAID Oversight. Missions and bureaus financing endowments also need to assure themselves that adequate arrangements are in place to ensure monitoring of the endowment by others (e.g., through publication of annual reports and audits and distribution to the broad NGO community) after the period of USAID oversight ends. Appropriate provisions should be included in the grant agreement and/or trust agreement. This issue should be explicitly addressed during project design and approval.

C. Audits. An annual audit during the period of USAID oversight, following the normal A-133 audit procedures, is required in all cases. The report should cover both the status of the principal and the earnings. The grant agreement should specify that failure to provide a scheduled audit report to USAID, or serious adverse audit findings, will constitute default under the agreement and be considered grounds for termination of the agreement and refund of the funds remaining in the endowment. Additionally, the endowment should be included in the mission's audit universe, in accordance with Audit Management Resolution Program, in order to ensure that it is tracked and monitored, even though there will not be any disbursements from USAID during most of the oversight years.

VII. MULTI-DONOR ENDOWMENTS

Endowments involving more than one donor may require some deviations from the above guidance. In such cases, specific additional guidance should be sought from PPC and GC.

VIII. CONSULTATIONS

Endowments can involve very complex structures and agreements, and may be affected by both local and U.S. laws and tax regulations. If the amounts involved are large, the potential for abuse or misuse of funds increases, particularly since many of the normal USAID controls cannot be applied. Additionally, the staff resources needed to establish an endowment may be greater than anticipated. Although USAID has gained a considerable amount of experience with local currency endowments, we do not have extensive experience creating endowments with appropriated dollars. Furthermore, dollar endowments are likely to be subject to a higher level of scrutiny by Congress and other outside organizations than that which is given to local currency endowments. It is therefore advisable for a mission or bureau that is contemplating funding an endowment to seek appropriate advice from local and U.S. legal counsel, as well as PPC and GC, as the first step in the process.

6/6/94

Terrence J. Brown
Assistant to the Administrator
Bureau For Policy and
Program Coordination

USAID POLICY PAPERS AND POLICY DETERMINIATIONS

The following reports have been issued in a series. These documents with an identification code (e.g. PN-AAM-323) may be ordered in microfiche or paper copy. Please direct inquiries regarding orders to:

A.I.D. Development Information Services Clearinghouse
1500 Wilson Boulevard, Suite 1010
Arlington, VA 22209-2404

Title-Policy Paper	DATE	DOCID
Domestic Water and Sanitation	May 1982	PN-AAM-323
Food and Agricultural Development	May 1982	PN-AAM-322
Nutrition	May 1982	PN-AAM-321
Recurrent Costs	May 1982	PN-AAM-319
Population Assistance	September 1982	PN-AAM-320
Private and Voluntary Organizations	September 1982	PN-AAM-318
Women in Development	October 1982	PN-AAL-777
Pricing, Subsidies and Related Policies in Food and Agriculture	November 1982	PN-AAN-373
Approaches to the Policy Dialogue	December 1982	PN-AAM-431
Basic Education and Technical Training	December 1982	PN-AAM-190
Institutional Development	March 1983	PN-AAN-108
Co-Financing	May 1983	PN-AAN-457
Local Organizations in Development	March 1984	PN-AAQ-157
Energy	July 1984	PN-AAQ-160
Urban Development Policy	October 1984	PN-AAQ-158
Shelter	February 1985	PN-AAQ-162
Private Enterprise Development (Revised)	March 1985	PN-AAQ-163
International Disaster Assistance	May 1985	PN-AAQ-164
Cooperative Development	April 1985	PN-AAQ-165
Trade Development	July 1986	PN-AAV-461
Health Assistance (Revised)	December 1986	PN-AAV-462
Environmental and Natural Resources	April 1988	PN-AAV-464
Financial Markets Development	August 1988	PN-AAV-465
Democracy and Governance	November 1991	PN-ABL-224

Title-Policy Determination	Date	Fiche
PD# 1- Narcotics	August 5, 1982	PN-AAM-443
PD# 2- Mixed Credits	September 29, 1982	PN-AAM-444
PD# 3- Voluntary Sterilization	September 1982	PN-AAM-445
PD# 4- Title XII	October 5, 1982	PN-AAM-446
PD# 8- Participant Training	July 13, 1983	PN-AAP-273

PD# 9- Loan Terms Under PL 480 Title I	September 27, 1983	PN-AAN-753
PD# 10-Development Communications	February 17, 1984	PN-AAP-616
PD# 11-Using PL 480 Title II Food Aid for Emergency or Refugee Relief	July 26, 1984	PN-AAQ-159
PD# 12- Human Rights	September 26, 1984	PN-AAQ-161
PD# 13- Land Tenure	May 9, 1986	PN-AAQ-166
PD# 14- Implementing USAID Privation Objectives	June 16, 1986	PN-AAQ-167
PD# 15- Assistance to Support Agricultural Export Development	September 13, 1986	PN-AAV-460
PD# 16- Program Financing Arrangements with Independent Organizations	October 9, 1987	PN-AAV-463
PD# 17- Microenterprise Development Program Guidelines	October 10, 1988	PN-AAV-466
PD# 18- Local Currency	July 30, 1991	PN-AAV-467
PD# 19- Definition of Food Security	April 13, 1992	PN-AAV-468
PD# 20- USAID Programs and U.S. Jobs	January 3, 1994	PN-AAV-469
PD# 21- Endowments Financed with Appropriated Funds Guidelines	July 18, 1994	PN-AAV-470

POLICY DETERMINATIONS

Sup A to HB 1
(TM 1:27)

PD-37
February 10, 1967

AID'S ROLE WITH RESPECT TO NON-AID RESOURCES IN THE TOTAL FOREIGN ASSISTANCE EFFORT

A. Background

AID is just one part of the total foreign assistance effort. It has always recognized the importance of other free world and multilateral aid donors. It must now pay increased attention to the valuable resources available from U.S. non-Federal aid donors. These include the business community, voluntary agencies, the universities, community groups, foundations, unions, farm organizations, cooperatives, and state and local governments.

AID furthers the total foreign assistance effort to developing countries through three means:

1. It assists developing countries to coordinate diverse aid-donors, encouraging such donors to provide assistance and identifying, where necessary, suitable opportunities for assistance by U.S. non-Federal aid donors.

2. It finances - or provides financial incentives for - the provision of skills or resources to developing countries by U.S. entities other than AID.

3. It uses its own personnel to assist developing countries.

B. General Policy

1. AID as a Catalyst. AID must act as a catalyst to stimulate others to provide assistance to the developing nations. In all fields and all assisted countries, AID must, therefore, be fully aware of the total range of potential aid donors, whether U.S. non-Federal, multilateral, or foreign.

2. AID's Role in Coordination. AID should assist developing countries to coordinate the use of all resources available for development - whether indigenous, AID-provided, or non-AID. AID is directed by statute to coordinate its efforts with those of private and other public entities providing resources from the United States. It must do so vigorously, but with full respect for the independence and ultimate autonomy of private and non-Federal aid donors.

3. AID as a Channel. AID is not staffed to provide, through its own direct-hire personnel, all the required technical assistance which it is capable of financing. Therefore other sources of personnel must be tapped.

Rather than directly carrying out all of its own programs, AID must increasingly become a channel through which American resources and skills - wherever located - can be identified, focused, and transmitted to the less developed countries of the world. Through contracts and interagency agreements, AID must, by law as well as policy, draw upon the technical resources of governmental and private institutions to the fullest extent practicable.

C. Specific Policy Regarding Coordination and Catalytic Activities

1. Pre-Condition. Before agreeing to finance a technical assistance activity, AID will make a diligent effort to ascertain that no other suitable aid donor is willing to finance the activity.

2. Identification of Projects. Missions will seek to identify, to countries and available potential donors, specific new projects - whether or not suitable for AID financing - which are to the cooperating countries' advantage and suitable for private U.S. sponsorship. They will then, as requested, assist cooperating countries to enlist the support of such sponsors and, in addition, will inform AID/Washington of such projects to permit further solicitation efforts in the United States.

3. Coordination. Missions and Bureaus will assist cooperating countries, as requested, in coordinating non-Federal U.S. aid donors. They will seek to encourage sponsorship of projects which have maximum social or economic impact and to discourage duplicative or low priority activities. They will, as requested by sponsors, assist in the resolution of operating problems and advise as to local conditions and difficulties.

4. Private Investment. Missions and Bureaus will continue to be alert to opportunities suitable for U.S. private investment and will take all appropriate measures to encourage such investment when it would further development objectives. The Office of Development Finance and Private Enterprise should be called upon to assist in this effort, where appropriate.

D. Specific Policy Regarding the Implementation of AID-financed Activities

1. Order of Preference. Where other factors are equal, means of obtaining skilled personnel will be used in the following order of preference:

a. by contract with non-governmental organizations.

b. by participating agency agreement (or contract) with other federal, state, or local government agencies.

c. by direct-hire.

2. Use of Direct-Hire. It is AID policy to restrict to a minimum, consistent with other legal and policy requirements, the use of direct-hire personnel. This policy is consistent with the needs to: (a) shift as many projects as possible from grant to loan financing; (b) foster an increased assumption by competent borrowers and grantees of implementing responsibility for AID-financed projects; (c) facilitate, through concentration, the elimination of marginal activities and the relocation of technicians devoted to such activities, and (d) eliminate all but the smallest possible contingent of AID personnel, using such personnel primarily for policy, managerial, technical supervisory, and coordinating functions.

3. Choice Between Government and Private Instrumentalities. In choosing between other government agencies and the private community as sources of needed skills, it is AID policy, other factors being equal, to favor the private community. This policy is designed to make even the AID-financed portion of the total foreign assistance effort less of a purely governmental endeavor. It will broaden the base of contact between the United States and aid recipients.

Where a United States firm or non-governmental institution is placed under contract for an overseas project, a relationship is created which has the potential -- after cessation of AID financing -- of being independently extended or renewed for the mutual benefit of both parties and in furtherance of AID's broad objectives. This potential for "by-product assistance" does not exist when the job is accomplished by government personnel. Nor does it often exist when single individuals are placed under contract.

It is also AID policy, therefore, to seek, wherever possible, to tap the private community for needed skills by placing firms or institutions rather than single individuals under contract. This policy requires AID to contract for such skills on a project by project rather than an expert by expert basis, to the maximum extent practicable.

4. Criteria. The policies stated immediately above should be applied in light of the criteria set forth in the attachment to this Policy Determination.

E. Implementation

1. All Missions and all units in AID/Washington are instructed to apply these policies in every appropriate instance.

2. Staff offices must intensify their efforts to become conversant with the location, capability, and quality of resources throughout the United States which are potentially available for the total assistance effort. Missions must intensify their efforts within

their respective countries to become conversant with the activities of all other aid donors and to assist the countries in coordinating them.

3. The Office of Management Planning must, in consultation with other offices, design agency-wide procedures to assure maximum possible compliance with these policies.

I shall from time to time request special reports of progress towards the full implementation of these policies.

William S. Gaud

William S. Gaud

JCPRichardson:A/MP:1/26/67

Attachment

Guidelines Governing the Choice Between Direct, Contract, and Participating Agency Hire to Implement AID-Financed Activities

The following guidelines are to be taken into account in reflecting -- through specific choices between direct, contract, and participating agency hire -- the policies stated in Section D of the foregoing Policy Determination. The guidelines are intended as an aid to analysis. They do not purport to be exhaustive.

I. Legal Restrictions

Many functions, for legal or compelling policy reasons, can only be performed by direct-hire personnel. They include:

A. Negotiating with host countries in behalf of the United States.

B. Making policy, planning, budgeting, and programming decisions which determine the allocation of resources available to AID.

C. Evaluating and overseeing the execution of functions assigned (through contract or interagency agreement) to other government agencies or the private community.

D. Locating, judging the competence of, selecting, and negotiating with external sources of needed skills.

E. Performance of essentially internal functions such as personnel administration, agency management, and Congressional presentation.

II. Administrative Considerations

Despite the policy preferences which have been established, it may occasionally be desirable, for reasons such as those listed below, to perform given tasks or functions through AID direct-hire personnel even though it is not legally necessary to do so. Such reasons might include:

A. The acute need for speed, in instances where the needed personnel are processed, cleared, and immediately available from the ranks of AID's direct-hire corps.

B. The non-existence of personnel in other government agencies or the private community who possess the requisite expertise. This situation is most likely when the needed skill consists, in addition to purely technical skill, of ability to (1) adapt American skills and techniques to foreign conditions, (2) impart possessed skills to others of a different culture or educational level or (3) create institutions for the retention or dissemination of such skills.

C. The possibility of a prohibitive cost differential between direct-hire and other skills. Before conceding any such differential, it will be necessary to consider the indirect costs of direct-hire (such as overhead expense, retirement benefits, etc.) as well as the significant, though intangible, benefits to AID of creating potential, through a contract with the private American community, for "by-product assistance." Also, there will be situations in which it is necessary to pay more than direct-hire salary scales will permit in order to procure the level and type of talent required.

D. The possible loss of control that might result from having a project (or function) implemented by personnel who are not direct-hire. Such a loss is by no means to be considered inevitable, for it is not necessary to perform a function in order to control the manner in which it is performed. Normally, AID should control project implementation through significant leverage points rather than through an overly intimate involvement in all the details of execution.

III. Other Factors

In addition to the stated policy preference in favor of the private community over participating agencies of government, the following criteria are among those to be considered in choosing between the two sources:

A. Where the participating agency would use AID funds to hire personnel into its own ranks from the non-government community, AID should consider whether it might be preferable to obtain the needed skills directly by contract in order to create otherwise absent potential for "by-product assistance." This consideration should be measured against the benefits that might accrue from the unique backstopping capacities and institutional environment existing in the participating agency. Generally, it will be more advantageous to obtain single experts from participating agencies and to obtain skilled personnel for the implementation of whole projects from the private community.

GUIDELINES ON RESEARCH PD-47

The attached Policy Determination, "Guidelines on Strengthening the Innovative and Research Thrust of AID Programs," has been approved by the Administrator as Agency policy. Together with Attachment A --Section VIII of the FY 1974 Development Assistance Planning Guidelines (AIDTO CIRCULAR A-543), a comprehensive statement of A.I.D.'s research objectives and the means of pursuing them is provided.

Thomas M. Arndt
Executive Secretary

DISTRIBUTION:
A.I.D. List M, Position 9
A.I.D. List B-6, Position 9
A.I.D. List B-4, Position 5
A.I.D. List C-2

Sup A to HB 1
PD-47 (TM 1:27)
September 13, 1972

Guidelines on Strengthening the Innovative and Research Thrust of AID Programs

Policy

The problems of development are changing and many are becoming more acute. In some cases basic knowledge is inadequate, in some technology is inappropriate, and in some institutional and policy frameworks are outdated. These circumstances call for increasing AID focus on innovation and research. The twin aim should be to help LDC's find better answers to their most important development problems while helping them hasten the development of their own capabilities to find such answers.

The basic policy guidance for stronger Agency innovation and research are provided in the Administrator's January 24 memorandum on "Reform of the U.S. Economic Assistance Program" and the April 15 Development Assistance Planning Guidance for FY 1974 (AIDTO CIRCULAR A-543). This paper amplifies that guidance.

AID does not seek innovative activities such as research and pilot projects for their own sake. Rather it seeks increased use of such activities as important tools in advancing development purposes. The extent and nature of opportunities to do so will vary greatly among countries and subject fields.

Inter-Relationship of Country, Regional and Interregional Planning

The interrelationship of country, regional, and interregional research programs is important. Interregional activities directed centrally by AID/W are intended to build quality Agency response capabilities to LDC assistance needs in terms of both personnel and knowledge in priority areas. Therefore, central program strategies need to reflect the global pattern of country level and regional concerns -- both current and longer term. At the same time, country and regional (as well as interregional) strategies should endeavor to concentrate activities where the U.S. has the strongest actual or potential response capabilities.

Because of the variety of programming and funding formats for the Agency's research activities, central supervision of the total program by the Administrator requires special staff management. The Technical Assistance Bureau will be responsible for keeping the Administrator informed on all research progress and problems,

whether TAB or other central office-funded (including population research) or regionally or country-funded. TAB also will assemble the composite package which will provide the basis for the Administrator's annual review of the research program, discussed below.

Role of Central Technical Offices

AID's central technical offices should lead in developing the Agency's innovative thrust because such approaches are meant to have worldwide application and use relatively scarce and specialized human resources. It is a complex matter to identify and bring together the best technical and scientific capabilities in appropriate experimental designs to discover and test better ways of doing things in LDC's. A high degree of central management is appropriate for many types of research and innovative activities in order to provide the specialized review and monitoring needed for such activities, to avoid needless duplication and to facilitate interregional transfer of experience. Other aspects, such as pilot testing in the field, usually require central guidance to achieve coordination with related efforts elsewhere. However, the value of interregional activities fostering innovation will depend on the Agency's ability to identify research activities of sufficient importance to the LDC's to encourage their involvement in developing local applications and in contributing to the findings that have multi-country applications.

Country Level Efforts

There are a number of ways in which missions can strengthen the innovative content of AID activities at the country level and the contribution of those activities to global progress toward solving LDC problems. Missions can:

-- Support projects, including training, to strengthen the capabilities of promising country institutions to do research on priority country problems, with emphasis on adaptive research, and on encouragement to researchers to relate their efforts closely to operating country programs.

-- Support research activities which attack particular country problems, where expert appraisal suggests good cost/return prospects.

-- Use of their good offices, and appropriate financial support to help selected LDC institutions build linkages on high priority LDC problems (involving joint research, technical or training help, and/or information exchange) with international and other national research programs. Individual LDC efforts can be made much more productive by this reinforcement from outside and can, in turn, contribute to the global attack on the major LDC problems.

-- Finance projects to test new ways of coping with priority development problems; in so doing, country efforts should be tied to broader research and testing activities in other countries, where this is feasible, so as to gain maximum benefit of experience in designing, guiding and evaluating pilot projects.

-- Encourage LDC government financial allocations to support high priority local research activities. Incentive grants may be an appropriate tool for encouraging promising programs.

Networks

The Agency central technical offices are responsible for supporting the build-up of global networks of mutually supporting research, information and technical assistance activities in priority subject areas. Networks are being encouraged to achieve "critical massing" of resources and efforts for breakthroughs on the important LDC problems because:

- research can be expensive in the use of scarce talent and money, and the resources needed to achieve significant breakthroughs often exceed by far what individual LDC's or even individual donors can muster;

- knowledge building on common problems can proceed at widely separated locations in mutually reinforcing fashion, if supported by suitable coordination and information exchange;

- the great bulk of research facilities and capabilities exists in the developed countries, especially the U.S., whereas extensive LDC involvement ususally is indispensable for effective work on their problems.

Network building is most advanced in agricultural research but it is being developed in other fields where feasible.

The central technical offices will provide guidance and assistance to Missions in identifying potentially productive country tie-ins to these networks.

Identifying Global Priorities

Priorities for research projects, 211(d) grants and central technical assistance support projects will be developed from statements of what the global priority development problems are within broad sectors and how they relate to other agency activities and to activities of other assistance organizations. These global sector statements will be built from information contained in field submissions as well as from central assessment of future needs. It is expected that a rough first version of these global statements will be completed by December 31, 1972 and that there will be periodic revisions as needed. These statements will be reviewed at the AID/W senior technical and management level and by the Administrator. Meanwhile, the Key Problem Area papers of the Technical Assistance Bureau and similar efforts by other central technical offices provide an interim basis for establishing priorities for interregional projects (as well as for some related regional projects.) Descriptions of Key Problem Area work to date are available to Missions, as are materials on research and development activities and central service contracts in other areas of global program concern. These indicate where the Agency has or is building good response capabilities.

Project Design and Management for Optimum Payoff

Success of research, 211(d) and other innovative project activities depends not only on their addressing priority problems for improving the lives of LDC peoples, but on a number of design and mangement factors that focus on obtaining maximum useable results. Thus, AID must stress:

-- initial assessment and periodic review of the relative value of anticipated results and the cost of the research;

-- expert assessment of the design, methodology and management of research projects;

-- active expansion of the use of research findings and 211 (d) capabilities.

Budgeting for Research and Related Activities

The global sector statements (or Key Problem Area analyses until such time as the global sector statements have been worked out) will provide the analytical base for research, 211(d) and other technical assistance budget decisions. Research included in the Regional Bureaus' and PHA's annual program submissions as well as research and related activities included in TAB's program submission will be reviewed as a package during the Administrator's annual program review process and examined for compatibility with global problem priorities.

The annual allocation of central research funds among activity fields should reflect (a) the relative priority of research gaps, taking account of other Agency and non-Agency related activities, (b) the funding requirements for on-going projects and (c) the scope of good research opportunities in each global problem area. The 211(d) allocation will be based on assessment of the most important gaps in U. S. capabilities for working in priority problem areas. In all cases the quality of individual project proposals will be a critical factor in determining the success of the Agency's innovative efforts. To allow for adjustment in response to project reviews, the annual pre-allocations among activity fields will be indicative planning estimates only, to indicate desired directions of program emphasis, rather than firm allotments.

Project Review

Research proposals, reflecting the priority noted above, will be submitted by the sponsoring Bureau for review successively by the allottee Bureau (if different from the sponsoring Bureau), the inter-Bureau Research and Institutional Grants Committee (RIGC) and the Agency's external Research Advisory Committee (RAC). The findings and recommendations of these committees will be advisory to the Assistant Administrator of the allottee Bureau, who will decide whether to put the projects forward, together with his recommendation on disposal of any substantial issues raised by RIGC or RAC, for the required approval by the Administrator.

This applies to all central or interregionally-funded research, including population research which is funded separately from other central research. This review process applies also to regionally

or country-funded research activities of sufficient importance or appropriate type to warrant such review. TAB will work with Regional Bureaus in establishing appropriate criteria for this process and will submit such proposed criteria for review by the Administrator.

Issues arising in the project review process and proposed variation from these guidelines may be considered by the Project Approval Committee.

Approved: John A. Hannah
John A. Hannah
Administrator, A.I.D.

Date: 9-13-72

EXCERPT FROM
DEVELOPMENT ASSISTANCE PLANNING GUIDANCE - FY 1974
(AIDTO CIRCULAR A-543, 4/15/72)

"VIII. Research, Innovation, and Development

"1. The concept of concentrating on priority problems whose solution is crucial for development also involves greater integration or links between A.I.D. central research efforts, 211(d) grants, pilot research projects, and operational programs in the field. The guiding principles are as follows:

-- A.I.D. has a limited amount of research funds which requires selectivity, and therefore the majority of A.I.D.'s research funds will be concentrated on applied research and on pilot projects integrated with priority development problems. To the maximum extent feasible, research will be conducted in the LDCs and will involve their institutions and personnel so as to relate more effectively to the social and economic setting that surrounds the problem and to create the LDC capacity to carry on the work.

-- A.I.D.'s research efforts will be concerned with innovative application of technology, sector/sub-sector analytical methodology, and new forms of institutional development and delivery systems as well as innovation in the development process and policy.

-- Research efforts in the LDCs will be linked, wherever possible, to similar efforts in the U.S., in other countries and to international research institutes, e.g. IRRI and IITA. This will provide a research network linking the LDCs to the developed world, and will provide a "critical mass" of research effort that will help to obtain significant results from the comparatively limited resources the LDCs can apply to research.

-- more emphasis will be placed on systematic evaluation of A.I.D.-financed research efforts in order to get more pay-out and utilization in developing countries.

"2. A clear cut example of the potential beneficial linkage between research and operational programs is A.I.D.'s effort in the management of tropical soil and water resources. A.I.D. has provided central research and Section 211(d) grants to highly qualified U.S. universities to conduct some specific research and to expand their response capability in tropical soils and water work. In addition, A.I.D. is participating in a multi-donor effort involving research technicians from both the developed and underdeveloped countries in support of international research institutes

concerned with tropical agriculture and soils in Ibadan, Nigeria (IITA) and in Cali, Colombia (CIAT). Increasing efforts are being made to include economic studies and inputs as well as technical considerations in efforts such as these. These A.I.D.-financed U.S. and international research efforts in tropical agriculture are increasingly being tied into LDC local research and production programs.

"3. We encourage you to build research elements into your development assistance programs and FY 1974 budget submissions. We look to Missions to recommend priority problem areas that need additional research efforts to help insure successful implementation of operational programs and LDC research efforts. The identification of opportunities to support research and innovative activities at the country level will be more productive if they are tied into emerging regional or international networks involving the U.S. and other donors. Additional expert resources may also be available for country-specific problems at reduced incremental costs and/or time which, in turn, may have significant regional or worldwide ramifications.

"4. Consideration should be given to the special resources of knowledge and people created by the Agency's central programs for research and 211(d) institutional grants. The research program was described in a document entitled "The A.I.D. Research Program, 1962-71: Project Objectives and Results," distributed on 5/7/71 by AIDTO Circular A-972. A similar publication on 211(d) institutions will be distributed shortly. We also seek Mission recommendations with regard to how existing central research and 211(d) grants can be made more relevant to country programs."

POLICY DETERMINATION

INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT

File as: AID HANDBOOK	TRANS. MEMO NO.	EFFECTIVE DATE	PAGE NO.
1, Sup A	1:27	October 2, 1972	

EMPLOYMENT AND INCOME DISTRIBUTION OBJECTIVES FOR A.I.D. PROGRAMS AND POLICIES

PD-48

The attached Policy Determination, "Employment and Income Distribution Objectives for A.I.D. Programs and Policies," has been approved by the Administrator as Agency policy. The measures outlined in the Policy Determination are elements in a continuing process of examining ways in which employment and income distribution can be taken into systematic and sustained account to coordinate broader development objectives with growth.

Implementation of the Agency approach to employment and income distribution calls for both specific new actions and for more systematic and continuing emphasis on these considerations in the way the Agency conducts its on-going activities. Specific new actions include the development of economic policy guidance (item 1) by PPC/PDA; the development of sectoral and project guidance (item 2) by task forces composed of staff from PPC, TAB, PHA, and the regional bureau and staff offices; reoriented training of LDC administrators and technicians (#4) primarily by OIT; evaluation (#8) by PPC/PE; research (#9) by PPC/PDA, TAB, the bureaus and the Missions; and the orientation and training of A.I.D. staff (#10) by SER/PM. Responsibility for more systematic and continuing emphasis on employment and income distribution as called for in connection with human resource development (#3), public works (#5), agriculture (#6), and industry (#7) falls primarily on the regional bureaus and Missions as does implementation, within the guidelines to be developed, of approaches to economic planning (#1) and sector/program/project formulation and appraisal (#2).

Thomas M. Arndt
Executive Secretary

DISTRIBUTION:
A.I.D. List M, Position 9
A.I.D. List B-6, Position 9
A.I.D. List B-4, Position 5
A.I.D. List C-2

Address questions about this policy determination to: PPC/PDA

POLICY DETERMINATION

EMPLOYMENT AND INCOME DISTRIBUTION OBJECTIVES FOR A.I.D. PROGRAMS AND POLICIES

Background of the Problem

Despite creditable aggregate growth performance over the past two decades, substantial segments of the population in LDCs are not sharing proportionately in the benefits of growth. This unequal participation in the benefits of development is manifested in two particularly conspicuous -- and related -- respects: (1) persistently high underemployment (or low productivity employment) and (in some countries) unemployment, and (2) highly unequal income distribution.

In addition to the human misery they entail, inadequate employment opportunities and highly unequal income distribution have at least two important implications: first, the waste inherent in the under-utilization of human resources, the most abundant resource of most developing countries, retards the development process; and, second, the frustrations generated by perceived unequal participation in the benefits of development, and especially by open unemployment, constitute a potential source of disaffection and unrest which could undermine the development process. Meaningful development involves broad popular participation in the development process and in its benefits, including progress toward meeting the basic needs of people, both their material needs for food, health, shelter and security and their less readily measured but also important concerns for social justice and human dignity.

Three important causes of the present situation are (1) the population explosion of the 1950's and 1960's which is now being reflected in labor force growth rates of 2 to 3% in most developing countries; (2) the transfer of technology developed by and for industrialized countries and therefore often inappropriate for countries characterized by relative scarcity of capital and abundance of labor, a process which is encouraged by policies which distort factor prices by undervaluing capital and overvaluing labor; and (3) an institutional structure (e.g., in credit, land tenure, education, agricultural extension, etc.) which tends to favor well-established

enterprises and interest groups and to provide inferior access for small operators in agriculture and industry.

Issues

Donor agencies, including A.I.D., inevitably affect employment and income distribution in many ways, notably (1) the types of technological and capital transfer which they finance; (2) the orientations of the LDC institutions the development of which they support; (3) the effect of these transfers on what the developing countries do with their own resources (i.e., the demonstration effect); (4) the training in developed countries which they provide for LDC administrators and technicians; and (5) the general planning advice they give to LDC governments.

In addition, the employment problem in particular reemphasizes the critical need to reduce population growth rates. The efforts of A.I.D. and other donors to help LDCs reduce fertility should, in the long run, have a major impact on the number of entrants to the labor force and thus on employment.

A.I.D., along with other donors and LDC governments, has recently become increasingly concerned about employment and income distribution and has adopted a number of measures to take these issues into account. It is necessary, however, for A.I.D. to give more systematic attention to the employment and income distribution implications of all of the programs, projects, and policies it supports so that, at a minimum, these may contribute to an alleviation of these pressing problems. At the same time it should be recognized that central responsibility for dealing with employment and income distribution falls to the LDC governments and that the role of A.I.D. is marginal and should conform to the collaborative style.

This emphasis on employment and income distribution does not mean exclusion of other essential elements of the development process or indiscriminate support for any approach which promises to increase employment or reduce income inequality regardless of other consequences and of costs; continuing growth remains essential. The important point is that development must be considered within a conceptual framework which includes these two aspects. An approach to the development of a set of policies and programs which will promote growth, employment, and equity as coordinate objectives is outlined below.

Implementation

The following measures will affect a number of Agency activities. They are intended as elements in a continuous process of examining ways in which employment impact and benefit distribution can be taken into account in a systematic and sustained way. It should be recognized, however, that there are no easy answers or panaceas for employment and income distribution problems; the purpose of this Policy Determination is not to prescribe answers but rather to call attention to the need to give adequate consideration to these problems.

1. Economic Planning Guidance

Employment and income distribution should be taken into account in economic planning discussions. To facilitate this process, guidance will be developed for the use of A.I.D. officials and consultants who participate in consultative group meetings or in other ways are involved in the discussion of general economic policy. The primary emphasis will be on the ways in which employment can be adversely affected by distortions in exchange and interest rates, tariff, tax and wage policies as well as foreign exchange and investment allocation systems and other economic policies. The purpose is to indicate to LDC governments the benefits of adopting policies and practices which contribute to the establishment of factor prices more closely reflecting factor availabilities. Such measures are desirable in any case and should be adopted even if there were no employment and equity problems. They would improve resource allocation and therefore support rapid growth. The crucial longer-term importance for labor force growth of measures to reduce fertility should also be indicated.

2. Sector Program and Project Guidance

Capital and technical assistance project proposals will be required to include a section explaining what attention was given to employment and income distribution considerations. Missions will be expected to address these questions in the formulation and appraisal of capital and technical assistance programs and projects. (If no consideration was given, an explanation should be provided of why such consideration was omitted.) Proposals will be reviewed with an eye to how these issues are treated.

In order to facilitate the integration of employment and income distribution considerations at the sector, program, and project levels, a set of interrelated critical questions will be developed for each important sector (with special questions for important subsectors). The questions will be designed to explore how different socio-economic groups are affected -- both favorably and adversely -- in terms of their access to employment and to resources and opportunities -- and the consequences thereof for income distribution. Attention will also be directed to analysis of the conditions which must be established and the types of policy and institutional change required for programs and projects intended to reach segments of the population which have not previously participated significantly in the development process. In collaboration with host country governments, explicit consideration should be given to technical and institutional alternatives of a proposal with different employment and income distribution implications.

When factor prices are distorted, shadow rates, especially for foreign exchange, capital, and labor, should be considered in the design and appraisal of proposals. Agency guidance in the use of shadow prices will be developed.

3. The Development of Human Resources

The potential of human resource development programs in health, nutrition, education, training, and family planning to create a more employable and productive labor force, raise social mobility,and expand the opportunities open to the poor should be fully exploited. In its continuing support for such programs A.I.D. must exercise care and selectivity, however, to assure that they in fact benefit the poor and thus exercise an equalizing effect rather than benefit predominantly the already privileged and thus further skew the distribution of income. This calls for careful analysis of the benefit incidence of human resource development programs. To support this effort research will be undertaken to explore what socio-economic groups benefit from different types of human resources development programs. Education and training must be made relevant to productive employment.

4. The Training of LDC Administrators and Technicians

The foreign training provided for LDC administrators, engineers, economists, educators, and other experts should be oriented to the conditions of developing countries, with special attention to the employment and income implications of public policies (such as those outlined under item 1 above) and of technology. Administrators and technicians brought to the U.S. for training are exposed to

techniques and approaches which are functional for capital-rich labor-scarce economies but often dysfunctional for the capital-scarce labor-surplus developing world. As a major supporter of such training, A.I.D. should arrange for the development of materials emphasizing the creative adaptation to LDC conditions of techniques learned in the U.S. and for their introduction into training programs. The potential of third country training programs which include attention to the adaptation of technology to LDC conditions should be explored.

5. Labor-Intensive Public Works

Consideration should be given to expanded A.I.D. support for public works which lend themselves to labor-intensive methods (such as the construction of farm to market roads, drainage, irrigation, terracing and conservation, housing, etc.) by food assistance and other means. Such programs can contribute to the creation of useful infrastructure as well as provide employment. It is important to identify and distinguish between the immediate employment benefits and the longer-run use benefits, which may accrue to the wealthy. For this and other reasons more serious and systematic analysis of their socio-economic impact and administrative arrangements is required to improve their productivity and make their impact more equitable.

6. Agriculture

In A.I.D.'s extensive involvement in programs in the agriculture sector, increased emphasis should be placed on problems of employment and income distribution, in particular on problems of the small farmer and landless laborer. Relevant programs and policies A.I.D. should consider supporting in appropriate circumstances include such things as small farmer credit and cooperatives; land reform and land tenure (including cadastral surveys); the development of efficient technology applicable to small farms; and removal of subsidies or imposition of taxes on labor-displacing equipment. For many members of this target group development necessarily means the increasing importance over time of urbanization and non-agricultural pursuits. The close interdependence of the rural and urban sectors cannot be overlooked in seeking to deal with the difficult problems of small farmers and landless laborers.

7. Industry

Although A.I.D. is not heavily involved in industry sector programs, where it is so involved emphasis should be given to support of programs and policies which make for increased employment and improved income distribution. Elements in this approach include generally favoring labor intensive technologies in industry where feasible and encouraging small scale firms (which tend to be labor intensive) through elimination of economic policies which discriminate against them, development and dissemination of appropriate technology, facilitation of subcontracting arrangements, and strengthening credit and other types of institutional support (e.g., technical advice, marketing, etc.) geared to the special needs of small producers. Where appropriate, export promotion activities should be linked to employment considerations since frequently the comparative advantage of LDCs in exporting manufactured products is in labor-intensive industries.

8. Evaluation

A.I.D. will initiate a process for evaluating on a regular basis its projects in terms of their benefit incidence, including selected completed projects as well as current ones. A select number of past projects should be evaluated for their benefit incidence, especially employment and access to resources and opportunities. Whenever possible, provision should be made for local social scientists to participate fully in the design and implementation of the evaluations.

9. Research

In order to develop improved understanding of the nature and dimensions of the employment and income distribution problems in LDCs and of the ways in which they are affected by different types of policies, A.I.D. will, in collaboration with international and national institutions, support improvement of the concepts and the measurement of employment and income distribution in LDCs. In its own research strategy A.I.D. will give special priority to research undertakings designed to increase understanding of employment and income distribution

in relation to other economic and social parameters and lead to conclusions about measures which could be utilized by LDC governments and donor agencies. Full participation of LDC institutions and scholars in such research will be encouraged. A.I.D. missions are encouraged to stimulate and support LDC research in this area.

10. Organization of A.I.D. and Orientation of A.I.D. Staff

The primary responsibility for incorporating employment and income distribution considerations into A.I.D. activities must rest with the Missions because of their greater familiarity with the specifics of country situations, their continuing dialogues with LDC governments, and their role in conceiving and developing programs and projects in collaboration with local institutions. The AID/W regional bureaus also have a major role to play as they review the proposals submitted by Missions. Missions and bureaus will make their own arrangements to assure that these functions are adequately performed. The Bureau for Program and Policy Coordination will be responsible for overall guidance and for developing the Economic Guidance and relevant evaluation; it will, in collaboration with other bureaus and staff offices, play a major role in developing sector/program/project guidance; and it will assist other bureaus, where appropriate, to implement their respective responsibilities under this determination. PPC and the Technical Assistance Bureau will continue to be jointly interested in centrally funded research on these problems. TAB can also provide significant technical support in a number of technical areas, notably agriculture, industry, and human resource development.

Successful implementation of an employment-expanding and income-equalizing thrust clearly requires widespread understanding by A.I.D. staff of the nature of these problems and of the various instruments available for dealing with them. Training to enhance staff sensitivities and capabilities in this area will be undertaken by SER/PM in collaboration with PPC.

11. Expression of Views on Employment and Income Distribution

A.I.D. should put forward these views on employment and income distribution when dealing with other U.S. Government agencies, private organizations, multilateral and bilateral donors,

and, in appropriate collaborative style, with the governments of LDCs. A.I.D. officials participating in meetings with other donors should call attention to employment and income distribution considerations when these are relevant to discussions either at the policy level or at the level of particular project activities.

Approved: John A. Hannah
JOHN A. HANNAH
Administrator

Date: October 2, 1972

January 12, 1973

PD-50

A.I.D. AND THE RELATIVELY LESS DEVELOPED COUNTRIES

At the UNCTAD III meeting in Santiago the United States and other developed countries made a commitment to undertake special measures for the least developed countries. The attached Policy Determination reflects A.I.D.'s response under that commitment.

DISTRIBUTION:
A.I.D. List M, Position 9
A.I.D. List B-6, Position 9
A.I.D. List B-4, Position 5
A.I.D. List C-2

Sup A to HB 1

PD-50 (TM 1:27)
January 12, 1973

POLICY DETERMINATION

A.I.D. AND THE RELATIVELY LESS DEVELOPED COUNTRIES

A. The Least Developed Countries

Explicit concern for the situation of the least developed nations arose at the second UNCTAD in New Delhi. This concern grew until at the third UNCTAD, these nations - defined by criteria of per capita income, structure of GNP and literacy - became the subject of a unanimous resolution agreeing on special measures for their assistance.

The least developed countries represent less than ten percent of the total population of the developing countries, and consequently the greater part of total assistance flows will continue to be directed to other countries. But the justification for special measures for this group of countries is compelling: their poverty, the critical nature of the problems they face, the fact that they have not been able to benefit greatly from existing programs and measures designed to assist the developing countries in general and are lagging further behind. For developmental, humanitarian, moral, political and economic considerations, the U.S. strongly supported the resolution to make a special effort to assist this group of countries.

The development of policies and approaches for special measures of assistance to the least developed countries shall be part of A.I.D.'s assistance strategy. Appropriate steps shall be taken through program submissions to the OMB, in Congressional presentations, and in general public education and information to emphasize this goal.

B. Supporting the Multilateral Approach

We desire to assist the least developed countries within a multilateral framework and through an international effort. Particularly because of the extreme shortage of skilled manpower and the extremely limited institutional capacity of these countries, it becomes even more necessary for donors to cooperate fully in the effort, and for the existing mechanisms of coordination to be rapidly expanded. This objective can be achieved by giving positive and specific support to expand and upgrade the capacity and competence of the UN assistance organizations. An example of such an innovative approach is the mounting of regional, multinational, interdisciplinary advisory teams - by ECOSOC - to cooperate with

all aid-giving agencies and directly assist the least developed countries to expand their capacity for development planning and programming, and increase the flow of foreign assistance.

Positive steps will be taken to increase cooperation and coordination of the assistance effort to these countries, with special attention to -

a) the UNDP on technical assistance matters, especially through the promotion of appropriate joint activities;

b) the IBRD group and regional development banks on capital development matters;

c) the DAC on donor policy problems, especially to achieve improvements in terms, tying, and debt burden issues;

d) other donors in individual country and regional aid situations.

A.I.D. will undertake to second technical officers to the UNDP, for assignment to their priority programs in the least developed.

A.I.D. shall consider support of regional development advisory teams - UNDAT's - for placement in Africa. This offer may include, where appropriate, professional A.I.D. and other U.S. technical experts.

C. Agency Assistance Policies and Practices

The major, common bottleneck of the least developed countries, is their very limited capacity to develop plans and allocate resources, to prepare projects and programs for capital and technical assistance, to organize and administer their development. At the same time, the social and economic framework of most of these societies prevents any effective mobilization of savings and other resources. Responding to the progress made in the more advanced of the developing countries, and the changing foreign assistance situation, we have developed new policies and procedures which place greater responsibility upon the recipient countries. However, some of these changes may not be appropriate for the least developed and may impose strains upon their limited ability and capacity to benefit from foreign assistance.

The Agency will give further consideration to guidelines and policy determinations aimed at obtaining greater effectiveness in aid

giving and to accelerating the flow of development assistance for these countries. Such new approaches for consideration include -

a) the substitution of grant for loan funding, especially for joint technical/capital projects;

b) relaxation of requirements for local cost financing;

c) the financing of recurrent expenditures;

d) untying of assistance, both goods and personnel services;

e) greater flexibility on requirements for counterpart personnel, for administrative and contracting procedures, and for meeting local support needs of technical assistance personnel.

D. Research and Evaluation

In spite of our expanding awareness and understanding of the problems and needs of the least developed countries, much of this knowledge derives from the personal experiences of individual technicians. There is a great need for systématic analysis of the development and assistance experience, of adaptive research to relate development policies, practices, strategies and tools to the special circumstances of the least developed countries. While present indications are that the least developed benefit little from measures to expand trade, existing analysis based on empirical data, especially for the African countries, is inadequate for policy purposes. In the field of education, only a beginning has been made towards the development of education systems and strategies relevant to the conditions and requirements of the least developed.

Much of our existing knowledge of agriculture, disease, transportation, housing and the technologies that spring therefrom, is based upon research and investigations of physical, economic, and social conditions different from those common to the developing countries, and little of the research on developing countries has focused on the special problems of the least developed. Major underlying physical, environmental, and resource conditions or constraints (e.g., the encroachment of arid lands in the sub-Sahara regions) need to be tackled systematically and scientifically.

Priority shall be given to the development of a program of research and evaluation by this Agency, and in cooperation with similar research organizations and LDC institutions in the developing

countries, oriented towards the needs of the least developed countries. In addition, special efforts will be made to link the least developed countries with existing or emerging international research networks.

E. The Role of Non-Government Organizations

Many private, non-profit organizations are active in the least developed countries, each with its own objectives, interests, field of endeavor. Many are eager to expand their outreach, to develop new areas and new programs. Some of their activities parallel and strongly supplement the development efforts of recipient countries and donor governments. Innovative efforts should be made by A.I.D. to more effectively tap this wealth of private efforts, and experience, without, however, changing their own goals and approaches.

Within A.I.D. there should be close cooperation between the regional bureaus and PHA to develop a program that will direct these organizations toward giving assistance to the least developed countries in priority development assistance areas.

F. Interim A.I.D. Actions

The Regional Bureaus have the responsibility for program development and project planning for the least developed countries and should take further steps to implement the new measures directed towards these countries. Recognizing, however, the limitations on U.S. assistance resources, and the need to further distinguish between the different least developed countries, a special effort should be made to identify individual country situations most appropriate for further program development along the lines described above.

An additional effort shall also be made to identify other innovative approaches, on a country or regional basis, which will offer opportunity for more effective use of U.S. and other assistance in the least developed. Such effort should be based upon:

1) analysis of priority needs and constraints to development, both for individual countries and groups of countries possibly sharing common problems;

2) identification of host countries' interests, capacities, and self-help efforts;

3) review of multilateral and regional assistance programs and activities, and possible U.S. participation in them (as the preferred U.S. assistance approach);

4) possible development of limited additional input in the form of direct assistance projects which capitalize upon special U.S. expertise and experience, attack critical and basic development problems, and which would stimulate other donor interest and action.

Approved: John A. Hannah
John A. Hannah

1-12-73
Date

PD-51

GUIDANCE STATEMENT ON SELECTED ASPECTS OF SCIENCE AND TECHNOLOGY

This Policy Determination describes an A.I.D. program to assist developing countries with selected aspects of technological transfer and adaptation. It focuses on --

.. Helping LDCs develop national policies and institutions that will permit better technological choices, particularly in industry.

.. Natural resources assessment and management.

.. Reducing public investment costs.

DISTRIBUTION:
A.I.D. List M, Position 9
A.I.D. List B-6, Position 9
A.I.D. List B-4, Position 5
A.I.D. List C-2

Sup A to HB 1
(TM 1:27)
PD-51
January 12, 1973

GUIDANCE STATEMENT ON SELECTED ASPECTS OF SCIENCE AND TECHNOLOGY

Introduction

This statement describes an AID program to assist developing countries with selected aspects of the problem of technological transfer and adaptation. It focuses on: (a) helping LDCs develop national policies and institutions which permit developing countries to make better technological choices, particularly in industry; (b) natural resources assessment and management; and (c) reducing public investment costs.

This program is designed as a supplement to AID's priority programs in Agriculture, Population and Health, Education, etc. The statement does not define AID's science and technology strategy in these priority areas. This will be addressed separately, but by focusing on the general problem of improving LDC abilities to make technological choices, this program is relevant to AID efforts in agriculture, population and other priority fields. Moreover, many of the technologies considered have multiple applications in these fields.

Background

Experience has demonstrated that comparatively little U. S. technology can be transferred to LDCs without significant adaptation. The LDCs are aware of the need for technologies which fit their factor endowments and absorptive capacities. Stress is being placed on innovation to develop more appropriate technologies and on devising policies and institutions which permit developing countries to make better technological choices.

The problem of technological choice is growing in significance as unemployment and urbanization increase in the developing countries. Urban populations will increase by about 50 percent in the 1970s. At the start of the decade, they were 54 percent of the population in Latin America, 38 percent in East Asia, 22 percent in Africa, and 14 percent in South Asia. As these shifts proceed, the need for policies and technologies which increase productive employment in the urban industrial and service sectors as well as in the rural sector will grow.

AID's use of U. S. science and technology has generally followed the main lines of its program. Extensive use has been made of American science and technology in agriculture, health, and family planning. Substantial programs of research and development in these areas have been launched by the Agency. Similarly, AID has drawn on U. S. talent in the social

sciences and on engineering firms concerned with construction of economic infrastructure. However, relatively limited use has been made of U. S. capabilities in other biological and engineering sciences and in the physical sciences.

It is essential for AID to continue to strengthen the application of science and technology in its major programs.

But it is also important for AID to have a small program focused on the general problem of technological choice -- how LDCs can best adapt and utilize foreign technologies and encourage indigenous technological development. AID should also take advantage of selected opportunities for application of U. S. scientific and technological strengths outside its main areas of concentration.

This statement describes an AID program to assist LDCs with selected aspects of technological transfer and adaptation. The selection of activities reflects almost three years of Agency experimentation and analysis, as well as widespread consultations within AID and with many experts and development administrators of the developing countries, U. S. institutions, and other assistance agencies. Experience in these areas is still quite limited, and the focus of efforts will be kept under periodic review and amended as experience suggests.

Concentration Areas

The first emphasis of this science and technology program will be on policy and institutional development -- helping LDCs build their capabilities for using science and technology more effectively in support of development. There will also be smaller programs in natural resource assessment and management, and reducing public investment costs. AID will support LDC initiatives where they are strongly supported locally.

(1) Science and Technology Institutional Development: AID will focus on helping the LDCs in three areas:

-- Developing institutions for formulating national science and technology policies, priorities, and organizational responsibilities and for implementing decisions in this field.

-- Encouraging more effective orientation of LDC university science and engineering programs to development needs.

BEST AVAILABLE COPY

-- Strengthening the capabilities of LDC industrial service institutions to assist local industries in selecting, adapting, and using technologies suited to their circumstances, with special attention to support of small-scale industry.

This program reflects a need for national institutions that are effective in pursuing two related purposes. One purpose is to stimulate the efficient development of scientific and technological capabilities which meet national development requirements. The other purpose is to stimulate more effective use of existing scientific and technological capabilities in support of economic and social development.

While selection of technologies is largely a matter for private entrepreneurs, LDC technological institutions can play an important role through their influence on macro-economic policies of the Government, advice to entrepreneurs on availability of alternative technologies, and supporting services to industry. Included in these services is the network of industrial research, extension, and standards institutes throughout the LDCs. Generally, AID will sponsor collaboration between U. S. and LDC technological institutes that work with private industry. Particular attention will be paid to stimulating commercially viable small scale industry, which tends to use more labor and less capital per unit of output.

(2) Other Programs: In addition to science and technology infrastructure, AID will also undertake two smaller activities under this program.

(a) Natural Resource Assessment and Management: Improved LDC capabilities for assessing the location and nature of their natural resources and for determining how these resources can best be developed is of great importance for development. This includes extractive resources such as minerals and clays and the renewable resources of water, soil, and forests. Attention will be given to faster, cheaper, and more effective techniques for identifying and appraising natural resources, as well as to improved techniques for managing natural resource development such as integrated land use planning, conservation of renewable resources, and pollution abatement and control. Particular attention will be paid to opportunities to advance knowledge of means for environmental protection.

BEST AVAILABLE COPY

AID's role in this field will be one of an agent or broker between the developing countries and U. S. experts, such as the organizations involved in the Earth Resources Technology Satellite (ERTS) program, and will avoid politically sensitive areas of commercial contracting to develop these resources.

(b) Reducing Public Investment Costs: AID will also explore, on a selective basis, technological innovations that can greatly reduce the costs of economic infrastructure activities that are heavy users of LDC public funds, such as public works, housing, transportation, communications, and energy development. Success here could release public revenues that could be applied to other development needs. Priority will be given to those activities which relate directly to the quality of life for the mass of the population such as water and sewage for low-income areas, low-income housing, and rural development.

Program Leadership

The Office of Science and Technology in the Technical Assistance Bureau (TAB/OST), in collaboration with the Office of Engineering and other central offices as appropriate, is responsible for Agency policy guidance and technical leadership in the areas identified above. It will:

-- identify and help mobilize the technical inputs needed for appropriate analysis, design, and implementation of Regional and Mission projects in these sub-sectors and for closely related types of science and technology activity;

-- coordinate and focus the use of Agency resources in research, institutional grants, and pilot programs to identify and establish innovative approaches to major problems impeding LDC development in these sub-sectors, manage the interregional components of such composite efforts, and provide technical advisory services to Regions and Missions on desirable linkages and content for related activities in their programs;

-- mobilize, in collaboration with the Regional Bureaus, sufficient consultants and contractors from the most qualified elements of the U. S. science and technology community, to provide the services needed by the Agency in this sphere of activity; and

-- provide technical liaison with interested international organizations and assist Regional Bureaus in providing such liaison for regional organizations, seeking more effective use of U. S. talent and experience by these organizations.

TAB/OST will give full consideration to Mission and Regional Bureau views regarding the timing and content of proposed field visits under this activity. Recognizing that limitations on Missions' staffing frequently make it difficult for them to arrange, participate in, monitor, or guide such contacts, the central staff and its intermediaries are expected to make their own arrangements for consultation when necessary. Missions are to be kept fully informed of proposed visits, asked to provide any advice they wish regarding the timing and content of the visit and to participate if they desire, and informed of the outcomes of consultations. Care is needed to assure that such visits are not used to distort LDC priorities or stimulate LDC requests for assistance that cannot be accommodated within the budget projections of the Mission, Regional Bureau, or Technical Assistance Bureau.

Approved: John A. Hannah
John A. Hannah

1-12-73
Date

Policy Determination on Labor-Manpower
(Administrator's Transmittal Message)

1. I have approved the attached Policy Determination on Labor-Manpower. The central responsibility for alleviating problems of skill shortages, low worker productivity and inadequate employment opportunities, and for enhancing the quality of life for working men and women falls to the LDC's themselves, but in a manner consistent with its collaborative style, AID should try to be helpful in seeking solutions to these developmental problems.

2. Although AID has a significant interest in the labor-manpower institutions and policy development, this does not necessarily mean that Missions are expected to mount such bilateral projects. This and several other points were brought out during the clearance process. Some Bureaus asked that particular attention should be called to the following: (It is intended to spell these points out in greater detail in the two labor-manpower handbooks now being written.)

A. The office of Labor Affairs with limited central funds will continue high priority selective programs in the labor-manpower area.

B. AID field Missions in mounting their development assistance programs--e.g., in agriculture, nutrition, education, health, family planning--should address the goals and objectives outlined in the Policy Determination. Paragraph II.E.7. provides, however, that the primary responsibility for incorporating labor-manpower considerations into AID activities rests with the Missions and Regional Bureaus.

C. Paragraphs II.E.2. and II.E.3. state that AID labor-manpower development assistance should give priority attention to the AID sectors of major concern and to support of the Policy Determination on Employment and Income Distribution. In terms of such sectors as agriculture, health, and education, II.E.1. calls for due consideration

of labor-manpower inputs and outputs in the development of the pertinent sector analyses and strategies. For example, where skill shortages are holding back the attainment of output goals, a skills training input should be considered. As another example, in some cases a family planning goal can be advanced by means of a labor union-sponsored education program or with the involvement of a women's bureau.

D. The policy itself and II.E.5. and 6. point out that AID should be supportive of the international--e.g., International Labor Organization (ILO)--and regional--e.g., Organization of American States (OAS)--efforts in the labor-manpower area. Many of the activities can be carried out beneficially by the relevant multilateral institutions.

E. However, in the case of Section 601 of the FAA stating that "it is declared to be the policy of the United States...to strengthen free labor unions," the Regional Bureaus and Missions, through ongoing substantial contracts with the American Institute for Free Labor Development (AIFLD), the African-American Labor Center (AALC), and the Asian-American Free Labor Institute (AAFLI), will continue to be supportive of the goals and policies contained in the Policy Determination.

F. With respect to free labor unions and increased participation by workers in the economic and social development process, the following provisions of the Policy Determination are especially relevant:

- I., Policy, states, "It is AID policy to assist, bilaterally and multilaterally, less developed countries in their self-help efforts to strengthen the capabilities of labor unions...for enhancing the... freedom and welfare of working men and women."

- II.C., Welfare and Freedom of Workers, states, "In providing development assistance, AID should encourage...the development of strong, independent, responsible and democratic organizations of workers...(and) the involvement of working men and women in the development process...such as...consultation (by relevant governmental institutions) with the representatives of the men and women affected by the measures to be taken, and in particular representatives of free employers' and workers' organizations."

- II.D., Labor-Manpower Institutions, provides that AID's development assistance should assist the people of the LDC's in their efforts to build the institutions, such as free and responsible labor unions, which will meet the aspirations of workers and their families for a better life, with freedom.

- II.E.4., covering U.S. Labor-Manpower Development Assistance, stresses that AID personnel should recognize that the preferred mode of labor-manpower development assistance is joint problem-solving with the recipient country and that "in this connection, shall also seek the views of employers' and workers' organizations in the country or area of the assignment."

G. It should be noted that the Policy Determination is concerned with the problems and aspirations of the rural labor force as well as those in urban areas. For example, in some developing countries, there are viable labor unions of plantation workers, campesinos, and employees of ministries of agriculture or rural development. Other LDC's have established a farm placement service within the overall national employment service. As two final examples, LDC labor and price statistics institutions often collect and disseminate employment, wage, and unemployment data for rural workers and, often standard minimum wage legislation has to be adjusted to take into consideration special factors associated with farm labor.

Attachment:
Policy Determination on Labor-Manpower

(Initially disseminated as AIDTO CIRCULAR A-499, May 2, 1973.)

DISTRIBUTION:
AID List M, Position 24
AID List B-6, Position 24
AID List B-4, Position 5
AID List C-2

Policy Determination on Labor-Manpower

I. Policy

It is AID policy to assist, bilaterally and multilaterally, less developed countries in their self-help efforts to strengthen the capabilities of labor unions, labor ministries, and other labor-manpower institutions for enhancing the skills and utilization, employment opportunities, productivity, freedom, and welfare of working men and women.

II. Principles

The following basic principles apply to this Policy. For pertinent operating principles and procedures, reference should be made to handbooks on (a) strengthening free labor unions, and (b) labor-manpower programs and institutions. These fundamental principles are interrelated and, when properly applied, can be mutually reinforcing and often synergetic.

A. General

1. The ultimate objective of development assistance under this policy is sustained improvement in the well-being of the individual worker and his family.

2. The basic principles should take due account of the stage and level of economic and social development of the country concerned, and should be pursued by methods that are appropriate to national conditions and practices.

a. This proviso is particularly important in view of the critical problem of unemployment and underemployment in developing countries. Policies and programs designed primarily to promote the welfare of wage and salary workers may, if pursued too vigorously, be inimical to the promotion of job creation for the entire labor force. In many developing countries wage earners constitute a relatively small proportion of the entire working-age population.

b. Important complementary approaches to expand productive employment for the entire working-age population include policies, programs, and institutions on the labor-demand side to create new employment opportunities and on the labor-supply side to enhance the employability of the labor force through manpower and human resource development programs.

B. Manpower Development and Utilization

Enhancement of the occupational skills of members of the labor force and their productive employment in industry, agriculture, and commerce are essential to economic growth and a reduction of the incidence of poverty. In providing development assistance, AID should encourage:

1. On-the-job and employing establishment-related training, retraining, and skills upgrading in public and private services and undertakings, including understanding and observance of labor legislation, the background and reasons for free labor unions and their role in economic and social development, and the methods of consultation and cooperation between management and workers, particularly in regard to the introduction of technological change, productivity measures, and redundancy.

2. Workers, management, and their associations to make a positive contribution at the work place, public and private, to industrial relations, with stress on means for resolving worker grievances, the idea and practice of negotiations, consultation and collaboration in labor relations, the opening of communications between workers, management and government, and improving working conditions.

3. The recipient nation to declare and pursue, as a major goal, an active policy designed to promote full, productive, and freely chosen employment, with a view to stimulating economic growth and development, raising levels of living, meeting manpower requirements, and overcoming unemployment and underemployment.

4. The best possible organization of the labor (employment) market, including recruitment and placement, employment counseling, labor market information, and job development, as an integral part of the national program for the achievement and maintenance of full employment.

5. The appraisal and modification of policies and programs relating to human resources development, fiscal and trade policies, and those policies affecting the cost and supply of capital in the light of their effect on the productive employment and welfare of working men and women.

C. Welfare and Freedom of Workers

Economic growth is not the end purpose of development, but rather is one of the means for attaining development objectives. A major such objective is to meet the aspirations of workers and their families for a better life, with dignity and freedom, and to help spread the benefits of economic progress among the wage and salary components of the labor force. In providing development assistance, AID should encourage:

1. The development of strong, independent, responsible, and democratic organizations of workers, which can engage in collective bargaining and perform other useful functions in the improvement of the economic and social life of their members.

2. Conformity with the basic aims of the ILO Conventions on the use of forced or compulsory labor and freedom of association and collective bargaining.

3. Freedom of choice of manpower training and employment and the fullest possible opportunity for each worker to qualify for and to use his skills and endowments in a job for which he is well suited.

4. The point of view that wage policies fulfill several purposes: (a) they often provide opportunities to use the incentive effect of increased income to support increased productivity; (b) they can facilitate the transfer of skilled labor from the less efficient to the more efficient industries; (c) they influence the advancement of skill improvement; (d) they may improve the quality of life for workers and their families; (e) they affect the internal market for goods and services; (f) they should seek to be consistent with the promotion of better income distribution and employment opportunities for the total population; and (g) they are part of overall development policies and hence subject to such constraints as guidelines on productivity, growth, and cost of living.

5. The understanding that the regulation of minimum wages is an essential element of social and economic policy, since it insures a fairer wage for underpaid workers and for those who are unable to negotiate equitable remuneration, realizing that standard minimum wage legislation cannot be universally effective in the traditional sector and that modern sector minimum wages should bear some reasonable relationship to rural family incomes, to the effect on rural-urban migration and urban unemployment, and to the need for job creation in the industrial sector.

6. Social security as an instrument of genuine social policy and a more just distribution of the national income, since the wage earner and his family are almost wholly dependent on the income from his employment and income maintenance programs are main instruments for dealing with problems of work-related injury, involuntary unemployment, sickness, invalidity, old age, and death of the breadwinner, realizing that social security and other instruments for enhancing worker welfare should also take due account of the health of the economy, methods of financing social security, and such other national goals as employment and income-earning opportunities among other groups in the labor force.

7. The development and enforcement of the country's legal provisions relating to conditions of work, such as provisions relating to hours, wages, safety, health and welfare, the employment of children and young persons, and other connected matters consistent with local circumstances.

8. Inclusion in overall development programs of the basic aims and standards of the ILO Convention on child labor and on social policy.

9. The involvement of working men and women in the development process through their participation in relevant private and governmental activities and institutions, such as the formulation and implementation of manpower, employment, social security, labor standards, industrial relations, and skills training policies and programs in consultation, at all stages, with the representatives of the men and women affected by the measures to be taken, and in particular representatives of free employers' and workers' organizations and the accessibility of the machinery for implementing these policies and programs to those whom they are intended to serve.

D. Labor-Manpower Institutions

In providing development assistance, AID should assist the people of the less developed countries in their efforts to build the economic, political, and social institutions which will meet the aspirations of workers and their families for a better life, with freedom. These institutions include:

1. Free Labor Unions

Free and responsible labor unions, enjoying the right to engage in collective bargaining, can have an important role in the process of modernization and the social and economic development of the less developed countries. For example, by acting as forums for the exchange of information and instruments for attitudinal change on vital development issues, such as bringing to the fore difficult questions of social welfare and equitable distribution of income, seeking to improve the conditions under which the commitment of labor to industry takes place, and helping advance population and family planning goals, labor unions may strengthen the forces in a society which are impelling it to modernize.

2. Ministries of Labor

Ministries of labor are a part of the social conscience of the government; they are the public agencies that can mobilize, prepare, and promote the well-being of working men and women. It is essential that the ministers of labor play an active role at the national and international level in order to achieve more rapidly and effectively social and economic development objectives. There can be no effective development unless the legitimate rights of working men and women are recognized and

their aspirations are expressed in terms of concrete achievements involving such factors as wages, employment, working conditions, and social security. In all these tasks, the ministries of labor have a vital role to play. They bear particular responsibility for seeking those solutions to problems of social and economic development which will not place the greater burden on the weakest and most disadvantaged members of society.

3. Labor Statistics and Research Institutions

The planning, implementation, and evaluation of sound labor-manpower policies and programs have been hampered in most developing countries by the absence of an institutional capability to produce reliable, current labor-manpower statistics and to engage in efforts to improve their labor force, wage, price, hours, and productivity research and statistics in order to, among other objectives, formulate realistic quantitative targets for employment, to measure the trend in real earnings and productivity, and to provide needed insights directed at the amelioration of work-related problems of the labor force.

4. Industrial Relations

Institutions able to contribute to constructive industrial relations need to be strengthened. The creation of permanent machinery to establish regular relations between employers' and workers' organizations and to give them the character of fruitful cooperation consistent with their respective contributions to national development should be encouraged. In particular, an effective system of cooperation and consultation should be established between the State and employers' and workers' organizations with regard to questions of social policy and labor legislation.

5. Labor Standards

Institutions able to contribute to constructive labor standards also need to be strengthened. Labor legislation should be accompanied by an effective system of inspection that would guarantee compliance and enable the workers to share in the benefits of economic development.

6. Employment Services

Effective employment services are required to assist workers in finding suitable employment, and employers in finding the best qualified workers, and to disseminate information on labor needs and employment opportunities.

7. Skills Training

The skills training, particularly on-the-job, capabilities of government, employers, labor unions, and professional societies should be strengthened, so that increased training and job opportunities are available to all workers, organized and unorganized, in both rural and urban areas, and especially to the unemployed, underemployed, and inadequately trained employed workers.

8. Social Security

The success of social security programs requires efficient administration. Steps should be taken to insure that the workers and their families covered by social security legislation are really covered in practice.

9. U.S. Employers

The labor-manpower policies and practices of U.S. firms with overseas operations can have an important effect on U.S. and recipient-country development interests. Steps should be encouraged for these firms to establish good industrial relations, manpower training, and fair labor standards policies and practices in conformity with international standards and local legislation.

10. Universities

Institutions of higher education should be encouraged to add to their curricula courses on labor-manpower economics, labor and price statistics, labor-management relations and collective bargaining, social security, manpower and employment development, utilization and welfare, and other subjects within the framework of social and economic development.

11. Advisory Committees

Worker participation in development efforts should be advanced by the establishment of committees, on which labor along with other interested groups are represented, as advisory bodies to national and local public agencies concerned with policy and programs in such areas as manpower and employment development, labor legislation, social security, and overall development policies affecting the welfare of working men and women.

12. Women's Bureaus

Developing countries should be encouraged to advance the status of working women by establishing viable women's bureaus and to strengthen them where they exist.

E. U.S. Labor-Manpower Development Assistance

Within the frame of reference of AID Policy Determinations on overall development assistance, AID direct-hire, PASA, and contract personnel, in carrying out the above policy and basic principles, as appropriate, should:

1. In sector analyses and strategies, give due consideration to the role of labor-manpower policies, programs, institutions, and attitudes related to the formation, allocation, utilization, incentives, statistics, and welfare of working men and women required to achieve sector objectives.

2. Encourage, as appropriate, the identified country labor-manpower institutions to give priority attention to members of the labor force affecting the following sectors: health and family planning, agriculture and food production, and education.

3. Give special attention to relating labor-manpower development assistance programs to the Policy Determination on Employment and Income Distribution (PD-48).

4. Recognize that the preferred mode of labor-manpower development assistance is joint problem-solving with the recipient country; in this connection, shall also seek the views of employers' and workers' organizations in the country or area of their assignment and communicate to these organizations copies of available reports.

5. Seek to implement the relevant provisions of the International Development Strategy for the Second United Nations' Development Decade, the resolutions establishing the ILO's World Employment Program and its regional manpower-employment components, the OAS's resolutions, particularly those passed by the Inter-American Conferences of Ministers of Labor on the Alliance for Progress, and officially U.S.-supported resolutions adopted by other multilateral organizations such as the World Bank Group and the Organization for Economic Cooperation and Development.

6. Collaborate with the above international and regional organizations toward the end of participating actively in joint programming, consultative groups and consortia, and of making available to them American experience and expertise in the solution of developing country problems in the fields of labor, manpower, employment, and worker welfare.

7. The primary responsibility for incorporating labor-manpower considerations into AID activities must rest with the Missions because of their greater familiarity with the specifics of country situations, their continuing dialogues with host governments, and their role in conceiving and developing programs and projects in collaboration with local institutions. The Regional Bureaus also have a major role to play

as they review the proposals submitted by Missions. Missions and Bureaus will make their own arrangements to assure that the functions are adequately performed. The Office of Labor Affairs will be responsible for overall technical guidance, and, in collaboration with the Bureau for Program and Policy Coordination and the Bureau for Technical Assistance, will be responsible for developing the Economic and Social Guidance and relevant evaluation and centrally funded research in the labor-manpower area; will, in collaboration with other Bureaus and independent Offices, play a major role in developing sector/program/project guidance; and will assist other Bureaus and Offices, where appropriate, to implement their respective responsibilities under this Determination.

8. AID, in its recruitment, inservice training, details, and assignments, should include labor-manpower professionals, such as labor economists and labor-manpower officers.

III. Legal or Administrative Antecedents

FAA Sections 102, 201, 207, 211, 251, 281, 291, and 601; M.O. 204.7 and M.O.'s 1612.40; State Department Policies.

Approved: John A. Hannah
JOHN A. HANNAH
Administrator

Date: 4-30-73

GUIDANCE STATEMENT ON URBAN DEVELOPMENT

The Administrator has signed the attached statement on AID's policies in the field of urban development (Attachment A). The policy statement is based on a staff paper entitled "Urban Growth and Development as a Component of Agency Policy and Programs," which is also attached. (See Attachment B.)

This paper is part of a series of policy papers which are under preparation, as stated in AID Circular A-50 (1/16/73).

Attachments:
A--Guidance Statement on Urban Development
B--Urban Growth and Development as a Component of Agency Policy and Programs

Attachment A to
PD-54

GUIDANCE STATEMENT ON URBAN DEVELOPMENT

Introduction

The Administrator's Advisory Council recently has discussed urban development program policy. This was based on staff papers developed through a long process of consultations, study, and analysis, involving field surveys in 19 developing countries and both informal and organized discussions with a large number of LDC personnel, U.S. experts, Agency personnel, and involved persons from developed countries and other assistance agencies. *

This statement provides interim guidance for Agency action in this field. It recognizes the development opportunities found in urban development, the need to give more systematic recognition to urban development as an integral part of national development, and the need to gain increased understanding of the complexities of urban problems, all with due regard to Agency program priorities. The guidance will need continuing reexamination over the next few years, as we learn more about needs and opportunities for focusing on the expanding urban dimensions of LDC development.

Background

AID has made sizeable investments in urban development, particularly in Latin America. While our knowledge of urban development processes is limited, it is growing. Meanwhile, competing demands for funds in agriculture, education, population, health, nutrition, and other fields are putting a heavy strain on Agency resources. Tight budget prospects deepen this problem.

Nevertheless, we must recognize certain facts.

- A large and growing proportion of LDC people are in urban areas. This situation often makes it easier to reach them effectively in pursuit of priority development goals such as employment, health, education, and family planning. Urbanization is a major dimension of development, affecting both rural and urban areas, that can not be separated out or ignored by LDC's as they strive for better lives for their peoples.

- The developing countries, AID, and other donors continue to make heavy investments in urban areas, without an adequate knowledge

---

* The findings of this reconnaissance and study process are contained in Attachment B.

base or analytical guidance on the effects of alternative investments and policies, in the urban context, on their array of development goals. These investments will rise rapidly, regardless of the involvement of AID capital assistance.

- There may well be an increasing number of situations in which LDC's are particularly interested in AID assistance in urban contexts. LDC's correctly see the United States as having relevant technical talents.

A further factor is that some other major assistance agencies have also been rethinking their role in this field. They have recognized the foregoing facts and the desirability of collaborative efforts.

Program Conclusions

Weighing these needs and opportunities along with the constraints on AID's pursuit of additional urban development activities at this time leads to the following conclusions:

(1) As a major development agency, AID needs to keep abreast of the urban dimensions of the development process in LDC's and to look ahead to the implications of their growing urbanization for LDC development programs and policies. Thus, we should continue to build on the good start already made in establishing our base of understanding.

(2) Country programs should continue to provide capital and technical assistance and investment guarantees for urban development, selectively, where cooperating country interest and support is strong and where the activities are comparatively potent means of improving the quality of life. This would include pursuit of opportunities to advance priority Agency goals by developing population, health, nutrition, and education programs aimed at the urban poor. In order to get the best results from these and other development efforts, we should support efforts to improve the systematic analysis of their interaction with the other factors affecting urbanization.

(3) As Agency resources permit, a modest set of R&D and interregional services activities should be supported to:

. increase the awareness and understanding of LDC decision-makers on urban problems;

. improve the quantity, quality, and accessibility of information available to LDC's on urban development;

expand the availability of skilled manpower in LDC's to guide the process of urban development.

R&D efforts should to the maximum extent possible take into account the need of LDC's for pragmatic practical solutions to pressing urban problems. The efforts should be geared to the solution of these immediate problems and have a high transfer value.

(4) We should encourage other assistance organizations to become more active in this field, as feasible, including private voluntary organizations. For this purpose and to strengthen the impact of AID's other efforts, we should foster building of collaborative networks of R&D and experience sharing among LDC organizations working on urban development and selected U.S. and third-country organizations best able to contribute to their efforts.

Action Responsibilities

The division of responsibilities within AID applying to urban development should continue, as described in the attached Tables (Attachment B).

Approved: John A. Hannah
John A. Hannah
6-15-73
Date

TABLE OF CONTENTS

INTRODUCTION.....1 - 5
The Perception of Urbanization 3
Recent Developments 4

PROBLEMS OF URBAN DEVELOPMENT IN DEVELOPING COUNTRIES.....5 - 7
Focus Defined 6
Functional Problems 6
Problems of the System 7

APPROACHES AND RESOURCES FOR URBAN DEVELOPMENT
IN DEVELOPING COUNTRIES.....7 - 9
Institutional Resources 8

AGENCY EXPERIENCE IN URBAN DEVELOPMENT.....9 - 18
Technical Assistance 10
Capital Assistance 11
Housing Investment Guaranty Programs 16
Current Activities 16
Organizational Setting 17

URBAN DEVELOPMENT PROGRAMS OF OTHER DONORS.....18 - 22
Multilateral Assistance 18
Bilateral Assistance 19
The Stockholm Conference 20
Collaboration and Cooperation 20

ISSUES AND RECOMMENDATIONS.....23 - 28
Enhancing Current Efforts 23
New Points of Intervention 24

ANNEXES

I. The Problems of Urban Development I-1 - 37

II. Approaches and Resources for Urban Development II-1 - 32

III. Activities for the New Points of Intervention III-1 - 12

(The detailed Annexes are not being distributed with this Policy Determination but are available on request from the Office of Urban Development, Bureau for Technical Assistance.)

Sup A to HB 1 (TM 1:27)

Attachment B to
PD-54

URBAN GROWTH AND DEVELOPMENT

AS A COMPONENT OF AGENCY POLICY AND PROGRAMS

February 12, 1973

Office of Urban Development
Bureau for Technical Assistance
AGENCY FOR INTERNATIONAL DEVELOPMENT
U.S. Department of State
Washington, D.C. 20523

Attachment B to
PD-54

URBAN GROWTH AND DEVELOPMENT

AS A COMPONENT OF AGENCY POLICY AND PROGRAM

Introduction

Global urban population has quadrupled during the last 50 years. The urban population of developed regions has increased by a factor of 2.75 compared with 6.75 for the less developed regions. Current U.N. projections indicate total population of the less developed regions from 1920-2000 will quadruple, while the urban population will grow by a factor of 20. The variations in level of urban population growth between geographic regions is considerable as Table I illustrates.

Variations between countries within regions also are significant; for example, in Africa, Ethiopia is 7% urban while Nigeria is 23%, and Morocco is 35% urban.

About one-half of the rapid urban growth stems from the unprecedented rural to urban migration during the post World War II period. This phenomenon is the consequence of the industralization/ modernization process taking place in most LDC's and shows no signs of abating.

The other half of the rapid urban growth has resulted from the factors related to a worldwide population explosion. The urban population base was already large and the high rates of increase produced even larger growth rates.

Such urban growth was not projected by demographers. Much about the process is not known and little attention has been given to its relationship to national development even though the urban growth has exerted large demands on limited resources of LDC's.

Table I

Urban Population Growth Rates by Region, 1950-1970
(Percent)

	Urban Portion of National Population			Urban Growth Rate	
	1950	1960	1970	1950-60	1960-70
World	28	33	34	3.4	3.2
Latin America	40	47	54	4.6	4.4
Africa	13	18	22	4.7	4.7
South Asia	12	13	14	3.3	4.4
East Asia	19	29	38	5.5	4.1

Source: FOCUS ON URBAN DEVELOPMENT: PERCEPTIONS, PROBLEMS, APPROACHES, NEEDS -- A Potential Role for U.S. Technical Assistance. A monograph prepared by the Office of Urban Development, Bureau for Technical Assistance (TA/UD), Agency for International Development (Washington, D.C., April 1972), pp. 205-209.

Urban development can be viewed as a process encompassing the physical growth of the city, the concentration, stimulation, and amount of economic activity, the attitudes of its inhabitants, the adaptation of its institutions, and the relationship of the urban center to the region and the nation. To the extent a city's vital functions fail or its developmental potential is impared, its positive impact on regional or national development will be lessened.

The city's linkages with a region, with other cities, and with the national economy determine the influence it exerts beyond its own boundaries. The magnitude of the city's influence depends on many factors which in turn are subject to control and direction by national policies and influence the allocation of resources.

Urbanization has usually been considered mainly in terms of the individual problems which accompany it; e.g., inadequate housing, lack of water and sewerage, unemployment, congestion, environmental degradation and social dislocation. However, this perception is limited; the very nature, problems, and advantages of urbanization are so complex that they demand careful and considerable attention. The perception of the process must be understood in its broadest terms and not in its separate parts. An attack on the separate parts of the urban problem leads to fragmented and spasmodic solutions. For example, resources allocated to build houses alone will not meet the needs and demands of the people who live in the houses.

The Perception of Urban Development

Although there are some disagreements on terms, urban development can usefully be perceived as a sector. A sector has been defined flexibly for AID programming purposes as a set of activities that are "either sufficiently homogeneous or closely enough interrelated and linked to warrant special identification and treatment in analysis and in the allocation of resources."1/ Sector analysis, defined as "a study of the principal factors governing development of the sector for the purpose of identifying manageable, integrated projects and policies with payoff," can be applied to urban development and provide methodology to perceive and plan program options for the broadly defined urban sector.1/ Thus, it is convenient to use the sector terminology to refer to activities specifically focusing on the urbanization process, even though urbanization considerations are a dimension of most other sectors in which AID is active.

The United States has been slow to respond to the phenomenon of its own urban growth. Scholars too have been slow to recognize and examine the implications of urbanization. With few notable exceptions, social scientists and physical planners have not anticipated the urban problems that exist in both advanced and developing countries. Only in recent years has the urban issue appeared with any regularity and depth in the development literature and the state-of-the-art is still in its infancy. Within this atmosphere, U.S. urban initiatives in foreign assistance efforts have been inconsistent and sporadic.

A further major contributing factor for the lack of focus on urban development in AID's efforts was its preoccupation with rural

1/ AIDTO Circ. A-1583

interests in developing countries. This was not necessarily an irrational concentration. During the 1950's and 60's the concern with major food shortages in many LDC's made it necessary to direct much of the Agency's assistance to the areas responsible for increasing food production. This need still exists.

Recent Developments

Meanwhile, there has been a movement in the developing countries to establish their own urban priorities and policy requirements. References to urban problems and urban strategies have been noted for the first time in the latest 5-year development plans of a number of countries.

The Agency reform program has established goals of reducing poverty and unemployment, improving income distribution, and controlling populatio All can be influenced significantly by policies which reflect the urban dimensions of development, thereby exploiting the special features of concentration and accessibility in cities. For example:

Poverty - A major facet of the urbanization process is integration of the rural poor who have migrated to the city and into the modern sector. This process has been and can be influenced positively.

The urban poor are a more accessible target group for specific policies and programs than the rural poor.

The urban poor, especially recent migrants, often possess characteristics essential to development. They came to the city under conditions of risk, seeking opportunity and change.

Unemployment - New employment is a principal product of the city. The dimensions and nature of urban unemployment are ascertainable. The close proximity of a tangible problem and potential solutions is an asset to be exploited.

Population - Urban populations are younger and hence more fertile as a group than rural populations. They also are less conservative, more susceptible to rising expectations, more literate and educated, and subjected to lower death rates than rural populations. They are an obvious, concentrated, and accessible target for intensive population study and programming.

Income Distribution - Guiding the development of cities can help bring about a more even regional income distribution. The stimulation of selected cities to help develop and integrate lagging and/or isolated regions is just one example.

Rural Development - Urban centers, large and small, influence the course of development in rural areas. They stimulate crop diversification, increased productivity, and commercialization of Agriculture by providing cash markets for agricultural goods. They provide a source of agricultural inputs for agricultural improvement and a source of supply of other agricultural commodities that permits geographic agricultural specialization. Urban centers can absorb some of the surplus rural population which in turn stimulates rural-urban exchanges--the flow of ideas, money, and goods. All of these attributes can be exploited more effectively if integrated into conscious policy.

During the past 2 years, several international donor agencies--e.g., the Ford Foundation, International Bank for Reconstruction and Development, and AID--have been rethinking their previous efforts in urban development, seeking new directions, and assessing the problems and resources for solving them. In response to the Agency's concern for policy and program guidance, the Office of Urban Development of the Bureau for Technical Assistance (TA/UD) has been engaged in a deliberate, "bottom up" process of identifying urban problems in developing countries, the approaches and resources employed to address the problems in these and other countries, and a possible role for external assistance. Many descriptive and analytical documents and working papers have been prepared, the major one being a widely circulated monograph entitled "Focus on Urban Development: Perceptions, Problems, Approaches, and Needs--A Potential Role for U.S. Foreign Assistance."

The process has involved a literature review, field surveys and visits in 19 developing countries, consultations with a host of U.S. experts, government officials, and Agency personnel, consultations with other donors, and an Agency Urban Development Workshop involving U.S. AID and AID/W representatives. The considered judgments of nearly 500 knowledgeable people in developing and developed countries have helped to select and to develop the content of this paper and the proposed Agency policy guidelines that will follow.

PROBLEMS OF URBAN DEVELOPMENT IN DEVELOPING COUNTRIES

A consideration of urban development often begins with a discussion of major problems. Urban problems have not been amenable to solution

through the sporadic and disjointed approaches which have been employed in the United States and elsewhere. Therefore, a lack of success has led to frustration, discouragement, disillusionment, and a curtailment of effort.

The following delineation of urban problems is an attempt to present their characteristics as they are perceived and manifested in developing countries. The purpose is not to reinforce the negative perception of the urban situation. On the contrary, it is hoped that succeeding sections of the paper will reveal ways in which urban problems are being addressed and might be approached more effectively. (A more detailed description of urban problems is in the Annex.)

Focus Defined

The notion that the city plays a positive role in regional and national development was reinforced repeatedly during the various phases of the TA/UD study. Despite positive evidence, the relationships between urban and national development often are misunderstood. More information is required at all levels, especially at leadership levels.

The focus of the TA/UD study was not the city per se. The concern was more with the day-to-day functioning of the city and its linkages to overall national development. The city is seen as absorbing, organizing, and employing resources (inputs) which improve conditions within the city and enhance the city's developmental impact on its region or nation. The city is seen also as producing goods and services (outputs) for regional and national development.

Two distinct and interacting categories of problems were revealed--namely, problems of the condition and day-to-day functioning of the urban environment and problems of the system of inputs for national urban development.

Functional Problems

Included in the set of day-to-day operational problems are rapid urban growth, attitudes and perceptions of recent arrivals, employment, housing, infrastructural facilities and services, and pollution. Of this first category, the most fundamental is the universal problem of rapid urban growth which can intensify all of the other problems within the urban environment.

The problems of the condition and day-to-day functioning of the urban environment are most acute in the larger cities. These problems have developed at such a rate and on such a scale that they are out of reach of existing resources and short-run solutions. This is true especially of urban unemployment, housing, and infrastructure. These problems are discussed further in the Annex.

Problems of the System

At the heart of the second category of problems are the nine major factors in the urban development process -- namely, perception and leadership, national urban development policy, legal framework, institutions, manpower, information (including research), planning, financial resources, and administrative capacity. These factors appeared to be the principal ones in the system of elements for national urban development.

Further analysis indicated that some of the problems of urban development are a function of the internal weaknesses and inadequacies of these factors or their absence altogether. The analysis revealed also that these factors seldom were comprehended as being interdependent when applied to urban development. The need for their coordination, orchestration, and integration through urban and national development policies was not perceived, generally speaking.

The problem of trying to deal with all nine factors led to a recognition that the linkages between them were not of equal strength or importance. Some of the factors are greater constraints in the urban development process than others. For example, perception and leadership, manpower, and information are the principal determinants, affecting all of the others, and of these the perception and leadership factor is the most serious constraint. At the other extreme, planning is the most conspicuous example of an input which is heavily dependent on or constrained by the others.

The fact that these nine factors are parts of a system suggests that piecemeal or narrowly conceived approaches to urban development will be much less effective than approaches that reflect serious consideration of the system and its linkages and interdependencies. (Additional information on this area can be found in Annex I, summarized in the table at the end on "Suggested Linkages Among the Factors in Urban Development.")

APPROACHES AND RESOURCES FOR URBAN DEVELOPMENT IN DEVELOPING COUNTRIES

Some constructive work is underway in the developing countries and elsewhere to meet pressing urban development needs, despite a general sluggishness on the part of many governments and international aid agencies to include urban assistance activities in their developmental framework. Many innovative approaches are being tried and standard mechanisms are being applied successfully, sometimes in imaginative ways.

There is also a small group of well qualified, perceptive, dedicated, and hard-working professionals in many developing countries. They are responsible for many of the positive results in urban development efforts and they constitute a valuable and vital human resource for planning, designing, and implementing future activities.

Urban problems have been perceived in terms of specific physical needs such as housing, water, sewerage, transport, and power. As a result this approach represents the major way urban problems have been dealt with and the way in which the bulk of resources have been allocated. The approach has been characterized by a failure to coordinate projects and programs addressed individually to these physical needs.

Urban planning also has been approached in several ways. The predominant physical planning with its narrowly perceived approach has been mentioned above. There are a few instances of integrated, multidisciplinary approaches to metropolitan planning. Most of the important new developments are taking place at the national and regional levels where most of the skilled manpower and some of the major constraints to an improvement of planning at the local level are located. (A fuller description of these approached is in the Annex.)

Institutional Resources

The quality and quantity of available resources for urban development vary from country to country and at the national, subnational, and municipal levels of government. If it achieves recognition at the national government level, urban development usually is coupled with and is subordinate to housing. Little is known about the place of urban development in subnational structures. These are special development corporations at the regional or state level which usually are responsible for developing a satellite town, a new town, or a growth center in a regional or area development scheme.

There are many planning and housing and urban development departments at the municipal level of government. Special authorities also are used for public service and metropolitan development programs.

The proliferation of department and special authorities at several levels of government is accompanied by weak coordinating mechanisms, if they exist at all.

With few exceptions the most available and least used of non-governmental resources in the developing countries are the universities. On the one hand political leaders and bureaucrats are reluctant to exploit these resources; on the other hand, university officials and professors resist becoming involved. The gap is being bridged in some countries; however, the universities do not yet provide much training for urban development specialists.

Other nongovernmental resources, very thin in developing countries, include municipal associations, professional societies, and church councils. Independent research efforts, seminars, and conferences provide additional resources, some of which are supported by bilateral and international assistance.

AGENCY EXPERIENCE IN URBAN DEVELOPMENT

Urban and urban-related activities are not new to the Agency. An analysis of AID and predecessor agency involvement in this field from FY 1949 through FY 1971 indicates 154 technical assistance and 115 capital assistance grant and loan projects which addressed urban development problems in some form. In addition, there have been 640 capital assistance projects whose effect on urban development is believed to have been considerable. The nature of urban development in cutting across other sectors is such that many of the Agency's investments in both capital and technical assistance impact on urban centers and influence urban development, either directly or indirectly.

Underlying this rather broad spectrum of involvement is the fact that most of this activity has been ad hoc in nature. No framework has been provided or employed to take stock of the urban impact of these projects. Project activities generally have reflected sub-sectoral considerations, such as housing, various physical facilities and services, and public administration. No clear linkages are evident between projects.

In 1965 some attempt was made to address this shortcoming. The U.S. Urban Development Committee of the International Cooperation Year made a number of recommendations to the President concerning international urban problems. They were, in part, the basis for establishing the United Nations Center for Housing, Building, and Planning, and adoption of fledgling urban development guidelines within AID in 1966. (See M.O. 1612.83.1 - Urban Development and Housing Policy.) The guidelines gave recognition to investment in housing as a function of national economic development, to urban centers as loci of progress and stability, and to planning as a necessary precursor of assistance

to urban development. As a policy and operational guidelines for the Agency, however, they had relatively little impact except in the Latin American region, traditionally in the vanguard of Agency initiatives in urban development.

Technical Assistance

The Agency's low level of commitment overall is suggested by the fact that only 1.5% of total investments in technical assistance activities over the period examined (1949-1971) were in areas broadly defined as addressing urban development. Of this, more than 60% of the Agency's urban technical assistance investments have been made in Latin America (see Table II). Table III indicates the broad categories of activities considered, and shows the Agency's preoccupation with housing and planning. Urban education is also a dominant theme, but less meaningfully in this context as it includes all technical assistance projects explicitly directed at the improvement of educational institutions or facilities in urban areas.

Table II

Total AID Technical Assistance Urban Development Projects, 1949 - 1971: Expenditure by Region

Region	No. of Countries	No. of Projects	Expenditures ($000)	Expenditures % of Total
Latin America	18	74	$40,385	60.6
Africa	11	25	10,080	15.1
Near East/S. Asia	11	29	9,561	14.3
East Asia	6	21	4,740	7.1
Nonregional	-	5	1,904	2.9
Total	46	154	$66,670	100.0

Table III

Total AID Technical Assistance Urban Development Projects, 1949 - 1971: Expenditure by Project Category

Category	Expenditures ($000)	% Total
Urban Education	$16,447	24.7
Housing	13,747	20.6
Planning	9,206	13.8
Urban/Community Development	6,965	10.5
Urban Transport	5,086	7.6
Urban Services	4,483	6.7
Municipal Administration	2,573	3.9
Other	8,163	12.2
Total	$66,670	100.0

Sources: Stephen W. Cooley, A.I.D. TECHNICAL ASSISTANCE FOR URBAN DEVELOPMENT: A Study of Agency Experience, 1949-1970 (Washington, D.C., June 1971), pp. 4 and 21; and Mariko Fukuda, A.I.D. TECHNICAL ASSISTANCE FOR URBAN DEVELOPMENT: Experience and Trends During Fiscal Year 1971 (Washington, D.C., November 1972), pp. 2 and 10. These reports were prepared for the Office of Urban Development, Bureau for Technical Assistance, Agency for International Development.

Capital Assistance

A review of AID capital assistance projects reveals a substantial Agency investment influencing the urbanization and urban development processes. More than $407 million have been allocated to 115 grant and loan projects during the period of FY 1949 through FY 1971. Most of this investment has gone into housing and project support for housing exclusive of the Housing Investment Guaranty loans, potable

water systems, and environmental sanitation. Only a small fraction was used for intercity highways and urban transit and traffic engineering. The breakdown is given in Table IV.

The capital assistance expenditures for urban development follow the pattern noted earlier for technical assistance -- namely, that 69% of the total Agency urban capital assistance investments have been made in Latin America (Table VII).

It is much more difficult to identify and assess the impact of other capital assistance projects on urban development. It would appear, however, that more than 640 projects costing nearly $4 billion have had varying and significant influence. Table V summarizes total Agency data on power and communications, highway, railway, manufacturing and processing, and other categories, all of which in this analysis are assumed to have an impact on cities. The expenditures of Tables IV and V represent 67.5% of the total Agency expenditures and obligations in capital assistance during FY 1949 through FY 1971. The comparable amount for technical assistance is only 1.5%. Illustrative of this imbalance is the NESA Region which has obligated more than $1.8 billion for capital projects influencing urban development (Table VI) and less than $10.0 million for technical assistance in this area (Table VII).

Table VI gives a regional presentation of the totals in Table V. Table VII shows the combined capital and technical assistance figures for urban development projects by region.

Table IV

AID Capital Assistance Grants and Loans for Urban Development, FY 1949 - FY 1971: Total Number of Projects and Expenditures and Obligations by Category*

Category	Number of Projects	Expenditures and Obligations ($000)	% of Total
Housing	46	205,333	50.2
Urban Potable Water	13	79,457	20.0
Environmental Sanitation	44	77,764	19.0
Intercity Highways	8	28,892	7.0
Project Support for Housing	2	13,698	3.3
Urban Transit and Traffic Engineering	2	2,306	0.5
Total	115	407,450	100.0

Source: Compiled by Eric Chetwynd from "Capital Assistance Completed Projects (W 253)," Office of the Controller (Washington, D.C., Agency for International Development, June 30, 1971).

*These figures and those in subsequent tables combine expenditures (taken from W 253 report of "Capital Assistance Completed Projects") and obligations (taken from W 253 report of ongoing "Capital Assistance Projects"). Figures for Viet-Nam are not included because of the special nature of many of the capital projects undertaken there.

Table V

AID Capital Assistance Grants and Loans Influencing Urban Development, FY 1949 - FY 1971: Total Number of Projects and Expenditures and Obligations by Category

Category	No. of Projects	Expenditures and Obligations ($000)	% of Total
Power and Communications	169	1,416,421	35.6
Highways	132	754,998	19.0
Railways	51	588,371	14.8
Manufacturing and Processing	125	505,509	12.7
Development Banking and Investment Credit	59	312,945	7.9
Air Transport	59	170,732	4.3
Port Facilities and Harbor Improvement	21	81,224	2.0
Engineering and Construction	19	82,648	2.0
Communications	13	67,544	1.7
Total	647	3,980,386	100.0

Source: Chetwynd, ibid.

Table VI

AID Capital Assistance Grants and Loans Influencing Urban Development During FY 1949 - FY 1971: Number of Projects and Expenditures and Obligations by Region

Region	No. of Projects	Expenditures and Obligations ($000)	% of Total
Near East and South Asia	180	1,853,212	46.6
Latin America	130	825,663	20.7
East Asia	212	783,089	19.7
Africa*	125	518,422	13.0
Total	647	3,980,386	100.0

*Includes Europe (Iceland, Spain, and Yugoslavia)

Source: Chetwynd, ibid.

Table VII

Total AID Capital and Technical Assistance Urban Development Projects, 1949 - 1971: Amount by Region

Region	No. Projects			Amount ($000)		
	Cap.	Tech.	Total	Capital	Technical	Total
Latin America	58	74	132	284,141	40,385	324,526
Africa*	30	25	55	86,419	10,080	96,499
Near East/S. Asia	9	29	38	18,574	9,561	28,135
East Asia	18	21	39	18,316	4,740	23,056
Nonregional	-	5	5	--	1,904	1,904
Total	115	154	269	407,450	66,670	474,120

*For capital assistance, Africa and Europe (Iceland, Spain, and Yugoslavia).

Source: Chetwynd, ibid. and Cooley, and Fukuda, op. cit.

Housing Investment Guaranty Program

AID capital investment in housing through the Housing Investment Guaranty (HIG) program has been substantial. The program was started in the Latin America Bureau and initiated by Congress in 1963 with guaranty authority of $10 million. Since then the program has become global and the authority expanded to $780 million, of which some $472 million has been committed ($50 million to Africa, $85 million to Asia, and $337 million to Latin America). The focus has been on long-term housing credit, housing demonstration projects, and support to local housing investment and savings institutions.

The HIG program is being studied currently by an Agency task force in an attempt to integrate it more closely with the Agency's overall developmental objectives. The effort will culminate in a proposed Agency shelter strategy. Housing is such an integral component of urban development that the Agency should make every effort to insure coordination of its urban development and shelter strategies.

Current Activities

With increased international interest in urban development, AID's programming has begun recently to take a more positive and integrated approach in this field. Once again the initiatives have been concentrated almost exclusively in Latin America. The most notable example is the Colombia Urban Sector Loan. This loan, now in its second phase, provides for a $67 million input into the Colombian Government's urban/regional sector development program, an effort which is national in scope and is keyed directly to achievement of major national development objectives, such as regional integration (economic and demographic decentralization), employment generation, and income distribution. The Mission has been involved heavily in the Colombian urban/regional sector analysis, a pioneering effort for the Agency.

Similar themes have emerged in recent small loans and technical assistance projects for Ecuador, Paraguay, Panama, and Honduras. The emphasis is on stimulation of secondary or interior cities (poles of development) in order to retard migration to major centers and to promote hinterland development. In Bolivia the focus is on development of a newly created National Urban Development Service.

Other Missions, such as Brazil and Kenya, are giving serious consideration to potential initiatives in urban development. Guatemala

is an example of a Mission experimenting with development of new sources of employment and provision of social services for rural-urban migrants. In Viet-Nam, the U.S. AID Mission's new Thu Thiem development project is an example of innovation in planning for comprehensive urban area development.

A new trend is reflected in these recent activities, although their number is still modest and their geographic distribution unbalanced. Most are pioneering efforts and the need for recognition and guidance by Agency policy has been expressed frequently by those responsible for them.

Organizational Setting

There is no current organizational focal point for urban development in the Agency; there are several Bureaus and Offices with responsibilities in this area.

The Office of Housing in the Bureau for Program and Management Services (SER/H) is responsible for administering the large HIG program. In addition, it provides services for other housing needs requested by the Regional Bureaus.

The Office of Engineering (SER/ENGR) established a small urban planning unit in 1971 to review and help coordinate separate infrastructural and building projects in urban centers. Policy guidelines are being explored. In addition, that unit has initiated a pilot study of labor-intensive construction technologies for housing and supporting infrastructure.

The Office of Science and Technology (OST) of the Bureau for Technical Assistance (TA) has been developing resources for technical applications of science and technology to some aspects of urban development, particularly industry. This is an element of OST's 211(d) grants to Cornell and M.I.T. Low cost construction material R&D is also underway.

In the Regional Bureaus, Latin America and Supporting Assistance have backstop units in urban development. Latin America Bureau's Housing, Industry and Urban Development Division is situated in the Office of Development Resources. It is responsible for technical and operational backstopping of urban development programs in the region. The focus of the unit has been on institutional development for housing finance, pilot projects for low-income housing, urban planning,

and more recently on urban sector backstopping and innovations in urban development programming. Many of the Latin America field Missions have specific units or offices designated to handle urban development and housing affairs, including the Regional Offices in Guatemala and Argentina.

The Bureau for Supporting Assistance (SA) has a backstop officer for urban, environmental, and aviation affairs in its Office of Capital and Commercial Development, who services Viet-Nam and the other SA countries. U.S. AID/Viet-Nam is the only Mission outside Latin America with a special unit for urban development affairs; it is now the responsibility of CORDS.

The principal Agency overview of urban development has been provided by the two-man Office of Urban Development (TA/UD), augmented by short-term use of some supplemental resources. Since late 1970, it has carried out a comprehensive reconnaissance and analysis of worldwide urban development situations and LDC needs, of resources actually and potentially available throughout the world to address these needs, and of views on how best to proceed in the field. It has also responded to Bureau and Mission requests for technical backstopping. It has worked with the aforementioned units in the Agency in a sector analysis of urban development and in developing proposed policy and program guidelines. There also has been considerable communication among these Agency units and coordination with other donors during the past 2 years, in light of the recent heightened interest in urban development on the part of several donors.

URBAN DEVELOPMENT PROGRAMS OF OTHER DONORS

Only in recent years has the attention of international aid agencies been drawn to urban development. Hence, their contributions to solving urban problems in developing countries have tended to be occasional, scattered, and piecemeal. A brief overview is provided by Table VIII.

Multilateral Assistance

The United Nations Development Program (UNDP) has the greatest commitment in this area in terms of number of projects and countries assisted. There are currently more than 80 active projects in 60 different developing countries. In addition, the United Nations is supporting some regional training and research centers and the major research project on regional development and growth poles by the United Nations Research Institute for Social Development in Geneva. The U.N. Center for Housing, Building, and Planning is the U.N. focal point for urban programs.

The IBRD published its Urbanization Sector Working Paper in June 1972 -- the culmination of approximately 2 years of analysis. Among other findings it was discovered that already $13 billion (or 75%) of bank lending to developing countries has been "directly urban-related" -- that is, mainly for electric supply and interurban transport. The Bank has identified urban transportation, land use, and housing as the three emphases in its program for 1972-1976, consisting of $700 million for some 40 projects in nearly 30 different cities. In research, the Bank will concentrate on matters of operational significance related to the activities above.

The OAS has a relatively active new urban program in Latin America. Its policy for technical assistance to urban development has three emphasis; in order of priority they are: promotion and development of national urban development strategies, assistance to local level metropolitan planning and administration, and overcoming bottlenecks in the construction industry. Six multidisciplinary regional urban development field teams are stationed permanently at various points throughout Latin America to implement this strategy and to service the region.

The Inter-American Development Bank (IDB) has been concerned with urbanization in Latin America since the inception of the Bank's operations in 1960. Experimenting with various means of integrating and combining capital and technical assistance has resulted in several organizational and policy changes, the latest of which was begun only recently. Traditionally, the IDB has invested about 20% of its loans (approximately $900 million) in water, sewerage, and housing. In addition, IDB has sponsored and cosponsored conferences and workshops.

Bilateral Assistance

Bilateral technical assistance is not of great consequence in urban development, with the exception of what is given by the United States in Latin America, Japan in Asia, and France and Great Britain in Africa. Japan's current involvement is limited mainly to master plan development for specific urban physical facilities. France and Great Britain are involved principally in town and regional planning in their former colonies. Other countries involved in one or more projects are the Netherlands, Denmark, and Sweden (primarily housing research and training), and West Germany (city and regional planning and transportation studies).

The Ford Foundation is nearing publication of an internal study which is similar to the ones which the IBRD and AID have just completed. The Foundation's traditional and occasional involvement in this field has been support of selected research and small pilot projects, some institutional support, fellowships for training abroad, and a number of independent studies. The one exception is the Foundation's substantial and continuing involvement with the Calcutta Planning Project and the Calcutta Metropolitan Planning Organization.

The Peace Corps has had an extensive technical assistance involvement worldwide with more than 300 volunteers working in various aspects of municipal development. It is not known how much these programs have been affected by the recent and significant organizational changes.

The substantial capital assistance for investments in or influencing urban areas is dominated by major donors. According to crude U.N. figures for 1968-1969, the United States, France, and the United Kingdon (in that order) contributed almost all of the total of more than $300 million committed for bilateral programs in housing, building, and planning.

The Stockholm Conference

The recently concluded United Nations Conference on the Human Environment declared that "a point has been reached in history when we must shape our actions throughout the world with a more prudent care for their environmental consequences..." The Conference went on to recommend that "all development assistance agencies...give high priority to requests of governments for assistance in the planning of human settlements..."

Collaboration and Cooperation

The foregoing inventory, while incomplete, indicates that important programmatic changes are taking place and external assistance for urban development is increasing. The emphasis seems to be on the need for better utilization of the substantial capital assistance resources which already are being employed, rather than additional capital resources. There is much evidence also of the need and the opportunity for collaboration and cooperation to bring harmony to policies and investments in this field.

During their recent studies of urban development, the representatives of the various donor agencies maintained close contact,

especially those who were engaged in similar studies. The exchange of information and critiquing of one another's findings have become well established. In fact, some of this interagency exchange has been organized informally; occasional meetings are called by the U.N. Center for Housing, Building, and Planning for interested donors.

Most aid donors have acknowledged the need for additional assistance in and innovative approaches to the problem areas of perception and and leadership, manpower, and information and stressed the desirability of greater cooperation and coordination among donors. More specifically, the U.N. Center for Housing, Building, and Planning has expressed a desire to collaborate in research efforts. IBRD officials recognize the need for additional technical assistance to support their more capital assistance-oriented efforts in housing, land-use, and transportation. The OAS is seeking ways of using more creatively and effectively its resources for urban development, including its six regional field teams, in cooperation with other resources. Ford Foundation officials also have expressed a desire to combine the strengths of that organization with those of other aid agencies to advance the state-of-the-art and to strengthen and make more accessible the limited pool of expertise in urban development.

These agencies not only have had experience in this field, but also all of them quite recently have taken a fresh look at what they should be doing to address more effectively the urban aspects of national development. It would seem that this combination of factors (experience, timing, and desire) provides a very special opportunity for a high degree of meaningful cooperation and coordination at the policy; program, and project levels.

Table VIII

International Assistance for Urban Development:
By Donor and Project Category

Category	UNDP	IBRD	OAS	IDB	Corps	Fndn	France	UK	Japan	Other
Capital Assistance										
1. Housing		X		X			X	X		
2. Water				X			X	X		
3. Sewerage				X			X	X		
4. Transportation		X					X	X		
5. Power		X					X	X		
Technical Assistance										
1. Instit. Building			X			X				
2. Training	X		X			X				X
3. Info/Research	X		X	X	X	X				X
4. Planning	X	X	X		X		X	X	X	X
5. Administration	X		X		X					
6. Surveys	X									
7. Bldg. Industry			X							
8. Housing	X		X	X						

Source: FOCUS ON URBAN DEVELOPMENT..., op. cit., pp. 156-159.

Attachment B to
PD-54

ISSUES AND RECOMMENDATIONS

On the basis of the foregoing analysis of the problems of rapid urban growth and development, the Agency's experience in dealing with them, and other approaches and resources which are being applied to addressing these problems, the Agency should:

(1) Give official recognition to urban development as an integral part of national development and subsequent wide publication of such a policy decision.

(2) Examine current Agency capital and technical aid efforts related to urban development to emphasize the Agency's new sectoral approach to development assistance.

(3) Focus on three problem areas -- perception and leadership, information, and manpower -- in order to give direction to the implementation of the new policy on urban development; in so doing, it should complement what the Agency, other donors, and the developing countries are doing already in this field.

(4) Seek to increase, largely through centrally funded research and development efforts, knowledge about the urban development process.

(5) Commit sufficient resources to support efforts which are designed to improve Agency and developing country capability to exploit the development potential in the processes of urbanization and urban development.

Enhancing Current Efforts

Agency programming is a process initiated in the field, usually with the benefit of AID/W policy direction and support. Substantial activities are supported already by some of the Latin America Missions while urban development problems and opportunities are still at a very low threshold of perception in many of the countries receiving AID assistance. The primary objective of the recommended policy direction and of the specific activities proposed for its implementation is improvement of field Mission programs and of AID/W support to them. More specifically, they are designed to assist Missions in dealing with cooperating-country needs and proposals in urban development by

(1) supporting and enhancing ongoing activities, (2) encouraging consideration of meaningful projects in countries where urban development activities and problems are coming to the fore, and (3) providing accessibility to information and a framework for analyzing and monitoring activities in those countries not yet ready for explicit urban-development programming.

Principal requirements in programs sponsored by Missions and Regional Bureaus in urban development are timely access to qualified outside expertise, access to information on operational and state-of-the-art problems, knowledge of U.S. and LDC institutions with expertise in these areas, and mechanisms for understanding the problems under consideration. There is also a need for the skills and approaches required for country analysis of urban development in a sectoral context. Above all, there is need for Agency backing and guidance for initiation of these new activities. All of these requirements are addressed in the policy, priorities, and activities being proposed.

Providing these and related urban development services will strengthen the capabilities of Agency central technical offices to provide support in their fields of specialization. For example, their operational and backstopping responsibilities will be strengthened by a concerted Agency policy in urban development and specific activities geared to operating on perception and leadership, manpower, and information as defined in this paper. Projects which examine the U.S. experience in urban development, Agency investments impacting on urban development, and land-use approaches will be particularly valuable to the operational activities of the Office of Housing and the general backstopping responsibilities of the Office of Engineering. The Office of Population, heretofore not mentioned in this context, will be aided by those elements of the proposed program that would support study, and promote recognition, of the variety of consequences for urban centers of rapid population growth and migration and the spatial distribution of population.

The most telling effect of the proposed policy and activities, if implemented, would be to orchestrate and bring more focus to Agency activities in urban development, thus exploiting more fully the role of the city in national development and contributing to the achievement of Agency objectives.

New Points of Intervention

In addition to supporting ongoing and new efforts at the level of country Missions and Regional Bureaus, it is recommended that the

Agency focus on the three factors in the urban development process having the most influence, not only on the functions of the urban environment, but also on the linkages in national development. They are: perception and leadership, manpower, and information. (See "Problems of the System," p. 9, ff.)

It is recognized that the degree of constraint varies from country to country. For example, in some countries perception and leadership at the national level no longer poses the major obstacle; in others, it should be the starting point for country and Mission programming. Nevertheless, according to the analysis, these three factors are serious constraints in the urban development process in many developing countries.

The most serious constraint is perception and leadership. This refers to perceptions and attitudes on the part of leaders and resource allocators at all levels in developing countries. It includes sensitivity to urban problems, awareness of the city as a complex subsystem within the national environment, understanding of the essential interactions between the city and its hinterland (metropolitan or region) and other cities, and a comprehension of the vital role of leadership in addressing the problems of urban development.

Manpower, the second problem area, refers to a cadre of skilled professionals and paraprofessionals in developing countries which understands the basic factors and linkages in urban development and the role of the several professions and disciplines (such as planning, law, administration, finance, and others).

The third problem area, information, is the substance from which other factors (especially the two factors mentioned above) derive much of their sustenance. It includes basic information on urban conditions, problems, and resources in developing countries, access to the literature (case studies and comparative analyses as well as conventional wisdom) and to the results of practical experience and technological breakthroughs, and the institutional capacity to use what is available and to produce and share additional data.

For these new points of intervention there will be activities involving research and development. The starting points are:

(a) An introspective analysis of relevant aspects of the Agency's experience to determine if appropriate sector analysis and project guidelines can be developed to take into account and exploit the urban impact of AID activities. This is recommended as a topic for an early Spring review.

(b) An analytical accounting of U.S. domestic experience in urban development with relevance for developing countries. The purpose is to help sensitize decision-makers in LDC's to the positive and negative aspects of the U.S. experience and to the range of policy options open to them.

(c) Development research on practical and adaptable approaches to land use analysis and planning -- a basic element in the planning process and a powerful tool in urban development.

(d) Promotion of a U.S. consortium of research, manpower, and information resources for international urban development through linked 211(d) grants to several institutions. These in turn would be linked with leading LDC institutions in joint research, training, and other colloborative activities, with heavy emphasis on practical problem solving. This consortium will become an important and leading U.S. node of a now infant international network of urban development resources.

(e) Fostering of institutional capacity in developing countries for sector analysis and problem solving in urban development. This activity will focus on specific urban development institutions in developing countries to promote their growth and strengthen network linkages.

(f) Helping to overcome the lack of established channels for systematic development and exchange of experience, information, and research in urban development by promoting an international consultative mechanism for network development.

Initial concentration on the three new areas -- perception and leadership, manpower, and information -- necessarily requires long-term developmental activities. However, they must be complemented and sustained by other activities which in the shortrun will address pressing operational problems. The new activities outlined above contain elements of both approaches. (More details of these activities are in Annex III.)

The proposed activities also have a very close identification with the new programming approaches which are part of the Agency reform. A collaborative, "bottom up" style has been used in the very formulation of the activities and is emphasized in the proposed steps of implementation. The suggested division of labor in AID (Table IX) seeks to reflect and to project this style. The location and use of a broader range of resources, including American private groups, have only to be continued and expanded from a substantial beginning during the sector analysis.

All of the activities are designed to contribute significantly to the development of a network of information, institutions, and other resources which can be used to seek solutions to urban-development problems. A broad international network is envisioned, and there have been already some encouraging attempts among donor organizations to find ways of sharing development assistance responsibilities and coordinating assistance efforts in urban development.

Attachment B to
PD-54 (TM 1:27)

Table IX

Suggested Division of Labor in AID/W for Urban Development*

Regional Bureaus	Office of Engineering	Office of Housing	Office of Population	P P C	T A Bureau
1. Backstopping existing programs. 2. Sector analysis in cooperation with central resources offices. 3. Program planning. 4. Development of linkages with other program efforts.	1. Engineering and construction aspects of development. 2. Feasibility studies and project review. 3. Recruitment of engineering and construction resources on request.	1. Administration of Housing Investment Guaranty Program. 2. Financing other housing and related urban infrastructure. 3. Technical assistance in housing and shelter sector analysis. 4. Recruitment of housing and housing finance resources on request.	1. Implementation of population policy. 2. Demographic research. 3. Migration studies.	1. Guidance for sector analysis. 2. Coordination of urban development activities with new areas of Agency concern such as employment and income distribution. 3. Management of efforts to develop analytical guidelines on the urban impact of Agency investments.	1. Leadership in developing awareness and an integrative focus in the Agency. 2. Leadership in urban development research, including sector analysis methodology. 3. Development of resource capability via a. in-house training and recruitment, b. talent banking, c. centers of excellence, d. developing-country institutions. 4. Technical assistance backstopping for sector analysis and project design. 5. Overall Agency relations and representation with international agencies and timely liaison with appropriate units in the Agency.

*NOTE: This breakdown is intended to be illustrative, not comprehensive or exclusive. Several of the listed responsibilities are shared by more than one Agency unit. Underlying the Agency's policy and program for urban development is a conscious effort to relate them operationally to other Agency policies and programs, and to involve appropriate units within and outside the Agency in their implementation. For example, the areas of concentration are related closely to key problem areas, such as multipurpose health-delivery systems, environmental sanitation, local-action capability, management of operational services, nonformal education, and tailoring and diffusion of industrial technologies to fit developing-country needs. They also are linked closely with the new emphasis on employment and equitable distribution of income.

SHELTER PROGRAM OBJECTIVES

AID's goal in the shelter sector is to assist LDCs develop the institutional, technological, and financial capacity to provide shelter under reasonable conditions for all levels of society, with emphasis on government actions to meet the needs of the poor. The Housing Guaranty Authority provides for substantial resource transfers to developing nations. The magnitude of the resources made available through the world's largest international housing program calls for its full integration and coordination with other AID development objectives and programs. Reasonable shelter is an essential element in the improvement of the quality of life for the poorest majority.

Given the unique characteristics of AID's Housing Guaranty Authority, it should be the preferred resource used to assist LDCs meet their housing needs; however, development loan and development grant resources may and should be utilized selectively when they will contribute to AID's shelter objectives. All shelter projects, irrespective of the source of financing, should be programmed as an integral element of AID annual country programming.

AID's shelter activities will give the highest priority to undertakings submitted by host governments which clearly lead to the improvement in the lives of the poorest of their people. To the extent possible, AID shelter resources -- grant, loans and guaranties -- will be invested in projects either directly benefitting low income groups (i.e., the poorer half of a given country or city urban population), or indirectly benefitting such groups through the development of national housing policy and housing institutions. Because of policy and practical constraints within some developing countries, it is not feasible to shift all housing guaranty investment resources immediately into direct financing of projects for poor families. However, an increased proportion of housing guaranty financing will be used for projects that directly benefit low income groups.

A priority objective of AID's shelter strategy is to help the LDCs develop their capabilities for analyzing their housing requirements and developing plans and policies that meet these requirements. By assisting LDCs formulate a rational housing policy which addresses the needs of all citizens, AID will encourage increased attention to the needs of the poor. As an integral part of negotiation for AID assistance, the Agency will discuss with the LDC its general housing strategy and alternative means of improving the living conditions of poor people.

AID programs will also assist developing countries in creating and strengthening the necessary institutional framework to implement their shelter policies. Given the magnitude of the need and the relatively small amount of resources available, AID assistance should have a strong multiplier effect. By building shelter finance institutions capable of replication on a large scale and encouraging technical and financial innovations, the effect of small resource allocations will be substantial.

AID shelter assistance will be used to encourage maximum use of unutilized resources (e.g., institutions which mobilize idle savings, encourage self-help housing, and optimize the use of unemployed labor), while minimizing the drain on scarce resources (e.g., existing savings or imports).

AID will help the developing countries examine alternative interest rate policies. Artificially low interest rates may reduce the flow of private capital into home financing,and exacerbate the scarcity of housing investment funds for lower income groups; whereas, rent payments may reflect returns on capital far in excess of prevailing interest rates (e.g., from 30% to 100% per annum). Public resources are generally inadequate to provide interest subsidies to a substantial number of poor people, and for such families, at non-subsidized rates, their monthly outlays for a home would be less than their current rental payments. Although charged with political sensitivities, interest rate policy is an important subject for an LDC/AID dialogue.

AID will assist LDCs in meeting the minimum shelter requirements of poor families with the limited resources available by:

-- Advising on the establishment of housing standards that assure the minimum requirements of health and safety and enable the construction of shelters that the poor can afford.

-- Supporting the "sites and services" approach, which provides poor families with homesites in new tracts of urbanized land with basic supporting infrastructure services on which to build a shelter with their own labor.

-- Providing technical assistance in order to develop viable institutions to mobilize savings and provide small credits to families for financing acquisition of their homesites, purchase of building materials, or construction of a core house.

-- Assisting the developing countries to adapt new housing materials and construction technology to reduce costs or improve the performance of low-cost housing, using United States research and technical capacity that is applicable to LDCs.

In discussions with LDCs, AID will give careful attention to the effect of home finance institutions on aggregate savings. AID will encourage projects that provide incentives for families to save more than they otherwise would, and that contribute to the development of capital markets and monetization of household savings.

These criteria will apply to projects for reconstruction of housing destroyed in a national disaster to the extent possible, and wind or earthquake resistant features will be incorporated into replacement housing, whenever feasible.

Subject to competing research needs, AID may fund from grant, loan, or guaranty fee income research on shelter sector policy and technological problems of current concern to developing countries. Priority will be accorded to research with worldwide application.

COOPERATION WITH OTHER ORGANIZATIONS

AID will encourage an interchange of experience and information among those domestic and international organizations concerned with the shelter sector in LDCs, with particular emphasis on housing policy, institutional development, and the problems of meeting low income shelter requirements.

AID is prepared to consider supplementing the housing activities of the World Bank or other donors with its own resources when requested by the host country.

PROGRAMMING SHELTER ACTIVITIES

AID assistance to developing countries in the shelter sector will respond to the social and developmental priorities of individual applicants.

The identification of shelter needs, the design of projects and programs will be fully integrated with AID's country programming. The Housing Guaranty Program will be fully incorporated into the AID budget review process, the justifications to OMB, and the Congressional Presentation.

Development grant and loan funds available under Section 106 of the Foreign Assistance Act of 1973 may be used in support of direct financing of housing for low income families. SER/H will work closely with the Central and Regional Bureaus and Missions to identify opportunities for the use of development loans and grants and to assist in the design of projects. The Bureaus will allocate a portion of Section 106 funds and propose projects where one or more of the following criteria are satisfied. The grant or loan will:

-- Enhance the effectiveness of housing guaranty funds in reaching low income families.

-- Enable technical advisory services to help LDC governments formulate national housing policies that respond to the needs of low income families.

-- Assist in the design of projects that will directly finance low-cost housing.

-- Facilitate the acceptance by borrowers of the concept of non-subsidized low-cost housing.

-- Develop models and demonstration of low-cost housing and financial institution-building responsive to the needs of low income groups.

COUNTRY ELIGIBILITY FOR HOUSING GUARANTY LOANS

Housing guaranty investments are a useful means of transferring private U.S. resources to developing countries which are able to service an increasing volume of foreign loans at prevailing market interest rates, but are experiencing difficulty gaining access as newcomers to the long-term private capital markets. The housing guaranty loan is especially well-suited to the needs of countries in which concessional loans are being phased out.

A prerequisite for authority to begin negotiation of a housing guaranty loan is a determination by the country Mission (or Embassy) and the region concerned that the housing guaranty loan will contribute to social and developmental objectives of the borrower. This determination should be obtained at the "Approval-In-Principle" or IRR stage. High income developing countries which are rapidly accumulating reserves and already have ready access to the long-term private capital markets are generally not eligible for housing guaranty loans, except when the Regional Bureau determines that special considerations otherwise justify a guaranty. Very low per capita income countries (including the least developed countries) which will continue to require concessional aid for an indeterminate period are generally not suited for housing guaranty loans, unless compelling circumstances justify.

The eligibility of countries for housing investment guaranty loans will be determined on a case-by-case basis at the time a request for HIG assistance is received and will be based upon an analysis of the country balance of payments prospects, debt servicing capability, and development investment needs.

PD-55 (Revised)
October 22, 1974

As in the past, AID will, in the future, consider sympathetically requests for assistance for shelter reconstruction following national disasters (i.e., an earthquake or flood).

John E. Murphy
Acting Administrator

10/22/74
Date

POLICY DETERMINATION

INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT

File as: AID HANDBOOK | TRANS. MEMO NO. | EFFECTIVE DATE | PAGE NO.

1, Sup A | 1:27 | September 16, 1974

PD-61

REQUESTING ACCELERATED REPAYMENT ON AID LOANS

On September 16, 1974, the Deputy Administrator signed the attached statement which sets forth AID policy toward the requesting of accelerated repayment of AID loans from former recipients. This policy directive concludes that a request by the USG for accelerated repayment of AID loans would arise in those cases where a former AID recipient met the following criteria: an extremely strong foreign exchange position, a high per capita income level, and a debt owed AID of significant quantity. In those cases where analysis by the Bureau for Program and Policy Coordination indicates that a country has met these criteria, PPC in conjunction with the Office of the General Counsel and the appropriate regional bureau will propose the type of action, if any, that should be recommended to the Administrator.

REQUESTING ACCELERATED REPAYMENT ON AID LOANS

I. Problem

To determine the feasibility and desirability of requesting a former[1] AID loan recipient to accelerate repayment or increase the interest rate of AID loans when the recipient's economic situation improves.

II. Background

In accordance with AID M.O. 1262.1.1, Attachment A, one of the standard provisions on all AID capital project loan agreements with governments is a clause which provides for the borrower to agree "to negotiate with AID,[2] at such time or times as AID may request, an acceleration of the repayment of the Loan in the event that there is any significant improvement in the internal and external economic and financial position and prospects or a variation thereof" has been a requirement in practically all loan agreements with governments since 1962. It is not clear at this time what considerations led to the inclusion of this provision, but it is probable that it came about because of our balance

---

[1] It is assumed that accelerated repayment normally would be considered for former recipients, the term "former recipients" referring to countries having repayment obligations under AID loans and for which no new loan assistance commitments are planned. If a recipient, having a loan which is not fully disbursed, is in an economic position meriting accelerated repayment, then deobligation of undisbursed pipeline funds should be the first order of business. It is recognized that both deobligation of concessional assistance and accelerated repayment could be considered concurrently.

[2] Loan agreements, as written, require only that recipient countries negotiate with AID upon AID request. While a recipient country has the option to refuse to enter negotiations, such an act may be considered by AID as an event of default pursuant to Loan Agreement terms entitling AID, as of right, to accelerate repayment. Presumably, a recipient must bargain in good faith with AID, once negotiations have begun.

of payments problem at the time and our efforts to negotiate with some of the European countries accelerated repayment of earlier loans. There is no record of any use of the accelerated repayments provision in AID loan agreements. However, there have been a number of advance repayments by six European countries and Japan on earlier loans extended to them for post-war reconstruction. The sum of the advance repayments between 1950 and the present is $2.4 billion.

Advance repayment essentially implies a renegotiation of the loan terms, i.e., the maturity of the loan. As such, it is not conceptually different from ex post increases in the interest rate of the loan, i.e., it decreases ex post the concessional element in a loan already signed. In fact, in economic terms the two are interchangeable. However, the fact that the standard loan provision does not deal with renegotiation of interest rates currently precludes the use of this alternative instrument.

There is a certain analogy between seeking accelerated repayment and debt rescheduling which the U.S. and other DCs have often undertaken at the behest of LDCs facing balance of payments difficulties or whose income growth is greatly constrained by the availability of foreign exchange. If drastic changes in LDC circumstances for the worse is the basic reason for their seeking debt rescheduling,[1/] there is intuitive logic in the argument that drastic improvement in their circumstances over and above that which could have been predicted when the loan was extended also requires renegotiation of the loan terms.

GAO has recommended accelerated repayment of recent loans extended to Brazil. With the possibility of current or former AID recipients receiving substantial windfalls from rapidly accelerated petroleum earnings, there is apt to be increasing Congressional interest in the possibility of requesting accelerated repayments or increased interest. Given the increasing Congressional reluctance to approve funds for foreign assistance, it is appropriate to determine whether accelerated repayments might offer some help in offsetting dwindling resources.

This discussion focuses only on accelerated repayments (although increased interest rates could achieve the same

---

[1/] Section 620(r) of the Foreign Assistance Act of 1961, as amended, precludes the forgiveness of any principal or interest due the United States under the terms of AID loan agreements.

objective), for two reasons: (a) renegotiation of interest rates is not currently provided for in standard AID loan provisions; (b) increased interest rates would pose different, additional questions pertaining to the issue of establishing a differentiated interest rate structure for AID loans, and this could be viewed as an inferior instrument in seeking to alter debt terms ex post.

IBRD/IDA, IDB, and France do not have provisions in their agreements for accelerated repayments; the U.K. and Canada do have such provisions, subject to the concurrence of the borrowing country. The Export-Import Bank has no provision for accelerated repayments for country loans, but an acceleration clause is usually included in loans to mining companies. The Export-Import clause would generally require the renegotiation for an acceleration of repayment of up to a specified percent of the total loan under very favorable cash flow circumstances (e.g., where the ore yield is better than projected or the price rises substantially).

III. Discussion

To determine under what circumstances it might be feasible to invoke the accelerated repayment clause and to weigh the advantages and disadvantages of so doing requires responses to the following questions:

(1) What criteria are relevant to determine when a former recipient's economic situation has improved sufficiently to justify the USG invoking the accelerated repayment clause?

(2) Under what circumstances is the former recipient likely to be receptive to a USG request for accelerated repayment?

(3) What are the benefits of requesting accelerated repayment?

(4) What are the costs of requesting accelerated repayment?

It should be noted also that even if it appeared in the U.S. interest that AID seek accelerated repayments, any AID action would have to be approved by the appropriate State Regional Bureau because of the political ramifications and by the EB Bureau of State and by Treasury because of the implications for other international lending agencies. The Export-Import Bank also would want to evaluate the effect of the accelerated repayments in terms of its own portfolio.

A. Criteria for Evaluating the Former Recipient's Economic Situation

While it is probably not possible to establish quantitative criteria that will serve in all cases, it would seem that we should not seriously consider requesting accelerated repayment unless a former recipient met all of the following criteria:

(1) The country had an extremely strong foreign exchange position as demonstrated by a very high and/or rapidly rising level of reserves.

(2) The country's per capita income was above a certain level.

(3) The amount of debt owed to AID was significant.

It is difficult to estimate quantitatively what level of reserves would be considered "adequate" or "normal" since the level depends in part on the expected variations in foreign exchange earnings, the structure of imports and the compressibility of payments, and its capacity to borrow at commercial rates if the foreign exchange projections should turn out to be too optimistic, and in part on the degree of risk aversion of central bankers. In calculating future foreign exchange requirements, it is important to take into account the country's foreign trade situation, particularly present levels of protection, its capacity to earn foreign exchange, as well as its need for meeting the increased payments for imports should liberalization occur.

It is important that the level of per capita income be above a certain level,[1/] because it can be argued that a low per capita income country will need the resources represented by the reserves for additional imports over and above those projected from recent trends.

It is impossible to define *a priori* how much AID debt outstanding an LDC must have before it becomes worthwhile for the U.S. to seek advance repayment. However, some minimum should be set, simply because any overture to seek advance repayment is fraught with some political costs, and it would be desirable to seek at least some non-trivial amount.

[1/] Although a precise cutoff for this criterion is difficult, it is clear that as per capita incomes approach the $300-400 level the importance of this criterion diminishes rapidly.

It is clear from this discussion that it is impossible to have precise criteria. However, it is possible on the basis of existing data to arrive at some tentative conclusions as to what countries could be involved at present.

Existing projections show that oil-exporting LDCs are the prime candidates for advance repayment in light of recent trade and payments projections. It is estimated that net increases in foreign exchange earnings of OPEC members will be on the order of $60 billion in 1974. Of the 13 OPEC members, only five--Ecuador, Indonesia, Iran, Nigeria, and Venezuela--have non-trivial debt outstanding and contracted under the Foreign Assistance and related Acts.[1/] Of these five, it can be argued that Indonesia and Nigeria have a per capita income too low ($84 and $150 respectively in 1972[2/]) to qualify under this criterion. This leaves Venezuela, Iran, and Ecuador. Ecuador at present cannot be considered a major oil exporter. While its balance of payments position is strong, it cannot be compared to the situation likely to prevail in Venezuela and Iran.

B. Receptivity of the Former Recipient to Accelerated Repayment

In general it would appear that a former recipient would be most likely to be receptive to a USG request for accelerated repayment of its loans from the U.S. when the following circumstances prevail:

(1) The country agrees with the USG that it (the country) is in a particularly strong economic position and expects that situation to continue;

(2) Either the U.S. is suffering from a balance of payments crisis or the USG proposes to use the accelerated repayments for a particularly worthy cause in the eyes of the former recipient (e.g., utilizing the funds for economic assistance to other LDCs); and

(3) The U.S. request for accelerated repayment would not lead to similar requests from other countries. This would

---

1/ Algeria and Iraq have some PL-480 debt ($6-7 million each).

2/ The DAC has estimated the 1974 per capita income to be $100 for Indonesia, $230 for Nigeria, $400 for Ecuador, $860 for Iran, and $1,800 for Venezuela.

be particularly relevant if the country had a very large amount of external debt held by other countries and international organizations in comparison to that held by the USG. It is conceivable, however, to approach LDCs whose position has improved drastically (particularly OPEC members) on a multilateral basis, seeking advance repayment of a certain portion of all their concessional debt. Extensive precedents for such an approach exist in debt rescheduling.

C. Benefits to the USG from Accelerated Repayments

In considering potential benefits from accelerated repayments, it is useful to distinguish between AID in particular and the USG in general. From the USG viewpoint accelerated repayments would provide an immediate, albeit small, positive increment to the U.S. balance of payments. It is important to note, however, that the total amount owed the U.S. by OPEC members mentioned as potential sources of accelerated repayments is quite substantial. The increased level of receipts resulting from accelerated repayments should also permit a small reduction in Treasury borrowing--assuming a continued budgetary deficit. From the point of view of AID, the question is whether any benefits would accrue unless special arrangements were negotiated with the Congress (and perhaps other USG agencies). At this time only 50% of the reflows (receipts of principal and interest from loans by AID and predecessor agencies) are available to AID for its program and no reflows will be available in FY 1976 and beyond. Furthermore, the 50% which will be available to AID in FY 1975 has already been calculated and Treasury has agreed to make up any shortfalls in actual receipts in return for which it will receive any windfalls. Therefore, no budgetary benefit would accrue to AID unless Congress (and presumably Treasury) should agree to modify current arrangements.

It could be argued, however, that Congress would view favorably the efforts of AID management in taking the initiative in requesting accelerated repayment from selected former recipients. Congress is likely to feel, with justification, that any former AID recipient that had become extremely well off financially should be willing to accelerate repayment of AID loans if so requested. Therefore, it is essential that AID review the possibilities of requesting accelerated repayment.

One alternative to accelerated repayment, in particular cases, could be an agreement by the LDC involved to increase its share of contributions to a multilateral fund to which the U.S. also contributed. For example, a country with a large debt owed to a number of countries may find direct negotiations

with only the U.S. difficult. This alternative may also be appropriate in de minimus cases. Such new contributions of this type could conceivably permit a reduction in future U.S. contributions to that fund or could ensure a larger program without an increase in U.S. contributions.

D. Costs to USG of Requesting Accelerated Repayment

From a foreign policy viewpoint the mere act of requesting accelerated repayments, whether or not the country accedes to the request, has some costs in terms of our bilateral relations with the country. How costly will depend on whether both of the first two circumstances indicated in B above are present; e.g., even if the country is well off economically and realizes it, it can be expected to resist strongly accelerating repayments unless it can see some clear advantage to its relations with the U.S. If the U.S. did not have a serious balance of payments problem, the former recipient is much more likely to be receptive to a request to make more resources available for LDC economic development through increased contributions to multilateral funds or through higher levels of bilateral assistance than to a request for accelerated repayment of U.S. loans. Furthermore, another country or the interested international agency, rather than the USG, might be the leader in the negotiation for the increased contribution.

An added potential cost if the U.S. bilaterally requests accelerated repayment is the engendering of ill will by the international financial institutions and other bilateral lenders--unless the U.S. request to accelerate repayment was coordinated and sanctioned by them.

IV. Recommendations

Whenever it may appear that a former recipient is experiencing, and is likely to continue to experience, growth in its foreign exchange reserves considerably in excess of its import and debt servicing requirements, PPC should undertake the analysis outlined in Section III.A. above to determine whether the country in question met the criteria specified above. If it did, PPC, in conjunction with GC and the appropriate regional bureau, should propose the type of action, if any, that should be recommended to the Administrator and other agencies as appropriate.

Whether accelerated repayment is sought will obviously be determined on a case-by-case basis and in the current context of our overall interests with the countries in question. With

respect to the specific cases of OPEC members, the U.S. has a variety of interests to pursue. We hope, inter alia, that these countries will play a constructive role in: (a) assuring an expanded supply of energy at equitable prices, (b) facilitating orderly capital flows through the international markets consistent with the needs for productive investment, and (c) considering additional concessional financial and assistance measures required to mitigate the effect on LDCs least able to bear increased costs of energy, food, and other essentials. We should stand ready to seek accelerated repayment if this is consistent both with our overall objectives in these countries and our broader domestic and international concerns.

PD-66

CRITERIA FOR DETERMINING AID LOAN TERMS AND FOR REQUESTING ACCELERATION OF LOAN REPAYMENTS

Policy on Loan Terms

There are pronounced differences among developing countries in their level of development, their long-term growth prospects, their access to private capital markets and their ability to service external debt. The existence of these wide differences in economic capacity has called for the development of a number of assistance instruments ranging from grants to soft loans to reimbursable technical assistance which more accurately reflect the differing needs and requirements of individual countries. In recognition of the wide difference in economic circumstances among the developing countries and in order to assist them to move their borrowings from highly concessional to less concessional external capital as their level of development rises, AID has recently established a two tier loan term structure for both Supporting Assistance and Development Assistance Loans. Intermediate loan terms will henceforth be applicable to countries which have made substantial economic progress and enjoy good prospects for continued advancement but are not yet able to rely completely on commercial capital flows for their external capital requirements.

It is now AID's policy to assess annually the situation of each country on the basis of uniform, quantitative data to identify those which can service loans on harder than the minimum authorized by statute. If, after a review of all relevant economic and political circumstances of the individual recipient, it is determined that a country can service its AID loans on harder than standard development loan terms[1/], that country shall be extended AID loans on intermediate loan terms. These are 25 years maturity inclusive of a 5-year grace period and 5 per cent interest for both the grace and repayment period. These intermediate terms satisfy the DAC recommendation for Official Development Assistance (ODA), which requires that such assistance have at least a 25% grant element. This policy on loan terms applies to both Supporting Assistance and Development Loans.

Criteria for identifying countries which might be subject to intermediate loan terms

Four measures have been selected as preliminary indicators of countries which might be able to service AID loans on intermediate terms. These are described in the following paragraphs.

1/ Forty years maturity including 10 years grace, with interest at 2% during the grace period and 3% thereafter.

Per capita GNP is used as a measure of the relative level of development of the country. It is undoubtedly the most reliable single indicator of a country's ability to absorb and utilize capital flows on less concessional terms. This fact has been recognized by the World Bank in its per capita income requirements for eligibility for soft IDA loans. Similarly, other international institutions have weighted heavily the per capita income variable in distinguishing loan term eligibility. Per capita GNP also appears to be highly correlated with other indicators of a country's capacity to service debt on commercial terms, such as its degree of access to private capital markets.

The ratio of reserves to imports of goods and services is used to identify those countries which fall within the intermediate per capita income level but have maintained a relatively strong foreign exchange position, indicating an ability to finance borrowings on somewhat harder terms.

The growth rate in per capita GNP is also used in the case of intermediate-income countries to identify those countries whose growth rate has been sufficiently high over an extended period of time that one would conclude that their economy can service capital flows on harder terms.

The ratio of current account surplus to imports of goods and services is also retained as a criterion because it indicates whether a particular country is a capital exporter. If it is, such a country should be charged higher rates regardless of per capita income. Few countries are likely to meet this criterion.

The following values for the above criteria have been selected solely for the purpose of identifying possible candidate countries for application of intermediate loan terms.

1. per capita income is greater than $500 in 1973 prices, regardless of its balance of payments position;

or

2. per capita income falls between $375 and $500 in 1973 prices;

and

   a. the ratio of reserves to imports of goods and services has been greater than 0.33 over at least a three-year period;

   or

   b. the average growth rate in real GNP per capita for the last five years has been more than 5 percent;

or

3. the average ratio of current account surplus to imports of goods and services has been at least 0.2 for the last three years, regardless of per capita income.

These criteria are to be considered as preliminary indicators of the countries which may be eligible for intermediate terms. Final determination will be based on a comprehensive analysis of all economic and other relevant facts, including overall political and other U.S. interests in the individual country.

Procedures for analyzing the capacity of recipients to service loans on intermediate terms

Every year during the period January 15 to March 15 PPC will review the performance of each country for which loans are planned on the basis of internationally comparable data and then inform the Regional Bureaus which countries meet the criteria described in the preceding paragraphs. The responsible Regional Bureaus, in collaboration with PPC, will then conduct an intensive study of each country on the PPC list which takes into account the totality of U.S. interests in that country, political as well as economic. The Regions have responsibility for incorporating the views of the State Department in this study. These studies will serve as the basis of recommendations to the Administrator as to whether he should approve or disapprove the application of intermediate loans to the individual candidate country for the next fiscal year.

Criteria for identifying possible candidates for requesting accelerated repayment of loans

It is also AID's policy to review annually the economic situation of all countries with significant outstanding AID loan balances to determine whether any of these countries is experiencing such a marked and sustained improvement in its economic circumstances and prospects that it is capable of accelerating repayment of its AID loans. Every year during the period January 15 to March 15 AID will conduct an intensive study of countries which appear to have reached a relatively high stage of development and have the financial resources to cover the accelerated repayments without essentially affecting its own internal capital requirements. The criteria to be applied for the purpose of determining which borrowers should be examined for this purpose are:

1. a per capita GNP equal to or greater than $750 in 1973 prices; and

2. an average ratio of current account surplus to imports of goods and services of at least 0.2 over at least a three-year period; and

3. a ratio of reserves to imports of goods and services greater than 0.5 over at least a three-year period.

These are not intended to be exclusive criteria. AID will consider the advisability of seeking acceleration of loan repayment to other countries if their economic situation seems to warrant such action, even though they fail to meet the specific criteria described above.

The intensive review of the situation of each country so selected will take into account all relevant economic factors, including the candidate's debt situation. All of U.S. interests in that individual nation -- political and commercial as well as economic -- will be considered before a determination is made as to whether a request for accelerated loan repayment should actually be made. (This supplements Policy Determination 61 dated September 16, 1974 REQUESTING ACCELERATED REPAYMENT ON AID LOANS.)

Approved _____

Disapproved _____

Date _____

URBANIZATION AND THE URBAN POOR

PD-67

INTRODUCTION:

This policy determination provides guidance for program development to address the problems of the urban poor under current foreign aid legislation. The determination recognizes the need to deal with some of the critical problems of the urban poor which constrain development and to understand better the process of urbanization as it relates to development. It emphasizes the opportunities for use of existing legislative authorities and program tools to work in this field. It assumes project development and implementation in close collaboration with developing country institutions.

BACKGROUND

AID's resources have been devoted increasingly to the needs of the poor majority in developing countries. The needs of the poor majority are enormous, and AID's resources are limited. Programs are focussed on the rural poor, the most numerous and generally the least advantaged of the poor majority. Because increased food production is basic to improving the quality of life for the poor in general, the small farmers, as food producers, are a major concern. AID has recognized the need to support food production efforts with related administrative, economic, and social institutions and services and with complementary employment and productive opportunities off the farm. This recognition has broadened AID's concern to include rural development which embraces market towns and small cities as well as farms and villages.

Rapid urbanization affects rural areas, too, and there is increasing awareness of the interrelatedness of "rural" and "urban" places and functions in the development process. At the same time there has been a growing recognition in AID and outside of the problems of the urban poor per se. They are increasing rapidly in number -- in the cities of many developing countries more than 50% of the population is reported to be living in squatter settlements and slums -- and are straining existing urban facilities, services, and other resources, as well as the ability of the national economy to be responsive. Some of the worst poverty can be found in large cities. Effective access of segments of the urban poor to employment and services may be as bad as for the rural poor.

AID's early recognition of these factors were contained in the rationale for the current urban development program. (See "Guidance Statement on Urban Development," PD-54, June 15, 1973.) Relevant U.S. expertise is substantial and is sought increasingly by developing countries and other donors as they work on this wide range of matters.

These considerations led to the recent policy development exercise in the Agency, which included also an inquiry into current Agency programs and projects for the direct and indirect benefit gained by the urban poor. This study concluded that many of AID's sectoral activities in population planning, health, and selected development problems, as well as in HIG and PL 480 programs, affect significantly the urban poor.

The Foreign Assistance Act was changed last year to add language to Section 103 (food, nutrition, and rural development) to focus on important off-farm and town-centered activities and to Section 105 (education and human resources) to include attention to the urban poor. Section 106 (selected development problems) was spelled out more clearly to indicate program emphases, and a new Section 107 (intermediate technology) was added. The relevant sub-section of Section 106 is as follows:

> (6) programs of urban development, with particular emphasis on small, labor intensive enterprises, marketing systems for small producers, and financial and other institutions which enable the urban poor to participate in the economic and social development of their country.

The HIG program and PL 480 authorities were amended to ensure these programs address the development problems of poor people. (See also "Shelter Program Objectives," PD-55, revised October 22, 1974.) Both programs -- especially HIG -- have been urban-oriented. In addition, the PVOs have been involved heavily in the PL 480 program.

POLICY GUIDELINES

1. The primary focus of AID programs and projects will continue to be on rural areas and on the rural poor. Included are those among the poor majority who live and work in villages, market towns, and those small cities which are centers of rural regions. Effective rural development requires the development and integration of these places to provide markets, services, employment and balanced growth. A.I.D. needs to and will step up this aspect of its rural development efforts.

2. AID will continue to be interested in broad developmental issues; among them, the process of rapid urbanization, regional development, and the problems of the urban poor.

3. The problems of the urban poor will be addressed in the light of national development goals and policies through specific analysis of host country circumstances, particularly the relative well being of urban and rural populations and any urban bias in the allocation of national resources.

4. Many of AID's present programs (especially HIG, PL 480, health, population and PVOs) benefit the urban poor. These programs and that of TA/UD will be continued. Missions are encouraged to analyze and to take account in their programming of how and how much urban populations benefit directly and indirectly from existing and planned projects.

5. New activities designed to benefit the urban poor will consist of R&D and pilot demonstration projects in three areas. In order of priority they are:

   a) Problems and prospects for employment generation, especially in the informal sector of big cities,

   b) improved urban planning (analysis, methodologies, and techniques) and

   c) the impact of social welfare programs on big city urbanization and of the relative cost and distribution of current social welfare between rural areas and big cities.

   Emphasis will be on projects which seek to demonstrate successful methods and approaches, thus increasing knowledge of how to help the poor majority. Projects which promote active participation of the urban poor in planning as well as implementation will be encouraged.

6. Country program, regional, and central resources will be available for activities which meet the guidelines above (paras. 1-5). With the exception of the HIG program, AID does not expect to have sufficient resources to make significant capital investments in major cities.

7. The collaborative style with host countries is assumed. Collaboration with other donors in project indentification, development, and implementation for the urban poor will be sought.

8. AID will be responsive also to requests for country-funded technical assistance (Sections 607 and 661 of the FAA) to address the problems of the urban poor and to requests for help to urban areas which have experienced natural disasters.

PROGRAM IMPLICATIONS

The urban poor are to be included in Agency programming to the extent that analysis of specific country situations indicates that this should be done as part of the overall strategy of helping the poor majority, that opportunities and support for effective projects in urban areas exist, and that the primary focus of the program on the rural areas and their associated urban linkages permits.

Recognition that the urban poor are a legitimate target population requires enhancement of our understanding of the similarities, differences, and relationships of urban poverty and rural poverty and of ways of dealing with them.

The inclusion of the urban poor as an Agency concern calls for greater awareness in all project design and implementation of the impact of Agency programs, in order to insure that the designated target population, whether rural, urban, or both, actually does benefit.

Research and development and pilot demonstration projects should increase developing country and Agency understanding of the practical significance for policy and program of such things as the different poverty problems in cities, towns, and villages; the degrees of access to productive employment and to services and resources among poor people in different locations; the dynamics of migration to and from cities and towns; and conflicting interests of different groups among the poor majority. Replicability will be a key criterion in selecting and undertaking these projects.

Revisions in the Foreign Assistance Act and Agency policy determinations reemphasize the need to use HIG and PL 480 authorities to address problems of the poor majority. These special authorities can be combined with AID resources. The leverage from both of these special authorities can help influence policy and program development in developing countries. More attention needs to be given to their use in market

towns and small cities in rural areas. The focus should be on investment and productive activities which increase employment opportunities, basic facilities and services as well as the poor majority's access to them.

By itself, the HIG authority can be used for housing and related community facilities such as power, water, and sewer lines within a community or housing project area; basic slum and squatter upgrading; and sites and services. Current squatter upgrading and sites and services projects in several countries are examples.

Under the PL 480 authority, there are already food-for-work programs which are used to help develop food transport and storage facilities for small farmers and urban infrastructure; nutrition programs in conjunction with health and family planning clinics; and feeding center programs -- programs to "directly improve the lives of the poorest...people and their capacity to participate in the development of their countries. "

Where a decision has been made to do something, the expertise and other capabilities of private and voluntary organizations and of the private business sector should be enlisted to help with the problems of the urban poor. They can be especially helpful in assisting developing countries innovatively with the small producer sector, appropriate technology, delivery of services, technical and skills training, and participatory organizations.

The initiative for programming for urbanization and the urban poor may be taken by an AID field mission or by a regional or central bureau in AID/W.

APPROVED: _____

DISAPPROVED: _____

DATE: MAY 27 1976

1, Sup A 1:27

February 10, 1977

POLICY DETERMINATION

PD-69

DEVELOPMENT ADMINISTRATION

Introduction

A crucial ingredient in all recipes for successful development is management capability. Experience in A.I.D.'s programs and projects and evidence from a wide range of development experience have repeatedly confirmed this judgment.

In A.I.D. we have recently given much emphasis to improved systems for design and management of Agency projects and sectoral programs. We have increasingly recognized the need for careful appraisal of host country management capability as an integral element of project design. Some Mission programs and many individual projects have creatively addressed needs to help host countries build management capability or remedy deficiencies so that sectoral projects and programs are better assured of success. But too many of our programs and projects still omit or skimp on the vital management ingredient.

We must now broaden our advance, consistently and imaginatively addressing the managerial needs and constraints of developing country institutions that serve the poor majority. Management improvement is a vital dimension of our assistance in agriculture and rural development, family planning, health, nutrition and human resources development. It deserves attention co-equal with that afforded the economic, technical, political and social dimensions of development.

Policy

1. It is A.I.D. policy to assure the existence or development of competent management in the specific host country institutions responsible for carrying out A.I.D.-financed programs and projects to assure with reasonable certainty their successful completion. Careful analysis and attention will be directed to managerial and institutional factors, particularly remediable deficiencies, early in program (sector and DAP) analysis and early in project design efforts. Such attention

will be continued, and managerial concerns consistently addressed, at all stages of the program and project design (PID, PRP, PP), review, and implementation processes. Appropriate implementation milestones and controls will be used to help assure results and to assure flexibility in adapting to changing conditions.

2. Managerial assistance will emphasize achievement of results under the priorities of the Foreign Assistance Act (FAA) notably in agricultural and rural development, family planning, health, nutrition, education and human resources development, together with widely shared benefits for poor people. Managerial assistance will be planned and implemented in integral relation to technical, economic, political and social/behavioral factors in the host country which affect, or are likely to affect, the performance of the country organizations involved in A.I.D.-financed activities.

3. Host country development needs identified in such Agency documents as DAPs or sector assessments will sometimes require managerial and institution building assistance, including, for example, manpower training, that goes beyond the needs of the specific project or sector, particularly in the least developed countries. Such activities are authorized by Section 105 of the FAA. They merit consideration especially when management deficiencies impose major constraints on the success of development in the priority areas specified by the FAA.

4. Managerial assistance will be provided, consistent with the development priorities identified in the FAA, and with specific country problems and needs, to build host country capacity in both private and public sectors to manage development projects and sectoral programs. Capacity to perform management analysis and planning and to implement and evaluate development activities are of central importance. Contractors or other external resources will be employed in managerial assistance roles in lieu of direct-hire staff whenever appropriate.

5. A.I.D. will expand its efforts to mobilize and apply relevant knowledge and methodology to help developing countries solve their management problems. Such efforts will include the innovative testing, adaptation, and application of relevant business management, development and public administration, economic and other social science knowledge and techniques.

6. A.I.D.'s concerns in management assistance will include means to utilize applicable research results through appropriate delivery systems, wide distribution of benefits, and participation of the poor majority in the fruits of technology.

7. A.I.D. will cooperate with and increase professional communication with international development assistance agencies in the provision of managerial assistance so as to increase the effectiveness, efficiency, and mutual support of the various international development agencies.

8. A.I.D. will foster increased acquisition, development, application, and transfer of management skills by its staff, contractors and grantees. Program and project management skills, including multi-disciplinary analysis, planning, implementation, evaluation and collaboration, are especially needed. Measures to obtain and cultivate such skills will include personnel management, (e.g., recruitment, placement), staff development and training, contracting and procurement, and increased professional and information exchange among A.I.D., LDC, and developed country practitioners and experts.

Reference

Prior guidance on the subject of this Policy Determination was contained in the Report of the A.I.D. Work Group on Management Improvement and Development Administration as revised following consideration of its recommendations by the AAC (August 11, 1975). The policy guidance contained in the Report's Recommendations at pp. 2-6 remains consistent with, and supplements, the policy stated herein.

Approved: _____
John E. Murphy
Acting Administrator

Date: 2-10-77

Attachment:
Excerpt from A.I.D. Work Group on Management Improvement and Development Administration

II. RECOMMENDATIONS:

The major recommendations are listed below. Since managerial problems vary widely in individual countries, the application of the various recommendations will depend on local circumstances. As reflected in the discussion paragraphs, numerous recommendations with narrower applicability might have been offered. However, as suggested by several responses, recommendations have been limited in number.

1. Focus AID management assistance primarily on sectoral results and widely-shared benefits for the people.

The idea of merging managerial concerns with sectoral concerns found solid support in the study and comments. Doing this will require increased management content in food production; rural development and nutrition; population planning and health; and education and human resources development activities. It will require attention to regional approaches to development. Management factors should be addressed in balance with social, economic, and technical factors.

The relatively least developed countries have special needs for building managerial and organizational capacities. The Foreign Assistance Act explicitly lists public administration among the activities to be pursued in the category of human resources development. Public administration and technical support programs--defined as activities to build national managerial capacity--are appropriate for the relatively least developed countries. However, such programs should be linked to specific development objectives in most cases.

2. Move toward sector development goals through a "results" and "service" - oriented program planning and management framework used collaboratively by the developing country and AID.

This approach requires that the host country play the leading managerial role. The framework should involve both private and public management capabilities, and merged efforts at local, regional, and central levels. Both quantitative/rational and "people-oriented" approaches should be used. Services delivery should be seen from the client's

point of view. Programs and projects should build on locally based organization,management and participation. The framework must be applied flexibly, with experimentation to learn while doing, take advantage of opportunities, and move from "pilot" projects to large-scale efforts.

3. Further develop AID programming procedures to assure full consideration of management factors at early stages of the analytic and programming process.

Progress has been made in introducing appraisals of management capacity into AID programming procedures. Managerial analysis is sometimes included in sectoral assessments. Serious consideration of management capacity is now required at the advanced stage of the project design process. But sector assessments should require managerial analysis. Management capacity determination should be made (in balance with other factors) at the project identification and review paper stages of the project cycle. The project paper stage is too late in the process, should management capacity be lacking, to take the long lead time measures required to develop minimal capacity if the project is judged sufficiently important to incur the fairly high risks involved.

Projects which have high priority, but require a major input of managerial training or expatriate management assistance, should be undertaken only after a careful appraisal of the potential benefits and risks. They should include specific plans for indigenous management development. They should also require a strong commitment by the host government to provide indigenous managers by transfer from elsewhere in the economy or by immediate provision of able people for training.

4. Expand the Agency's efforts in operational management research and development for sectoral and area-specific applications.

Respondents agreed on the need for more analysis, research, and testing of methodology regarding sectoral management problems. This is a joint responsibility of the central staffs and the regional bureaus but primary expansion should be undertaken by the latter. Each bureau should emphasize adaptive research and evaluation of

management problems of the countries of its region. The central staff should undertake an agreed upon common core of more widely applicable managerial research and development. The central program should be adequately funded to develop new syntheses of experience and new techniques for inter-regional application.

5. Urge both U.S. and international research institutions, particularly those receiving grants from AID or holding contracts for technical research, to concern themselves with delivery systems, utilization, and benefit distribution problems as well as technical and scientific problems.

Some of these institutions have already recognized the need to take into account the management problems involved in the broad utilization of the new research. Others can be induced to do so if it is made a grant or contract requirement. Such work may be done by the research institutes themselves, or by closely collaborating institutions with a more direct capability for application of results.

6. Continue or initiate general management training in those countries that need it; locate the training in the country with maximum adaptation of training approaches and materials to operational requirements of development organizations.

There is agreement in the Agency on the desirability of relating training to specific sectoral development objectives and on its location, if possible, within the host country. Specific needs will vary in individual countries, and training programs should be tailored to fit those needs. In some situations improvements in management capacity may require training not only in technical managerial subjects but in supporting skills (accounting, secretarial, office management, etc.). One approach of general value is to train personnel in key organizations from top to bottom to help achieve specific goals. Wherever possible, host government personnel should be included in training programs on AID programming methods. This should have dual advantages in making such procedures and training more relevant and in permitting a meshing of local and U.S. budgetary and programming cycles and procedures.

7. AID should seek to build host country capacity for managerial analysis, implementation and evaluation.

Proposals for general management training should continue to take into account the Agency's rich past experience in such programs and should thus avoid possible repetition of past mistakes.

Because of cultural and political factors in-country analysis, implementation, and evaluation will have greater validity and support than external efforts no matter how well done. In selection of contractors and grantees AID should seek either directly or through required sub-contracting to utilize and strengthen local institutions. In addition to greater acceptability, use of such institutions may be less expensive than the hiring of expatriate concerns.

8. Strengthen Agency staffing in development administration, providing leadership through the Office of Development Administration; provide adequate funds for analytic and experimental work on sectoral management problems, and increase consultative services to bureaus, missions, and host countries.

Attention to the management dimensions of development must be increased at multiple points within AID staff and by use of consultants, contractors and intermediaries. To adequately address managerial problems the missions will require inventive use of means ranging from direct staff to consultants, indigenous and U.S. contractors, and joint work with staff, consultants and contractors of the regional and central bureaus.

Particular attention should be paid to acquainting sectoral experts with the practices and techniques of modern management. Existing Agency training efforts such as the new Development Studies Program should be continously evaluated for their current contribution to this need.

Agency staff leadership in development administration should rest with the Office of Development Administration. A modest strengthening of this office and its research and development and field support programs would be a good investment. However, line management from the regional bureaus to the field missions should continue to have the primary responsibility for improving country and project managerial capacity.

9. AID should increase its support of and cooperation with the international development assistance agencies in the provision of management assistance.

An increasingly significant portion of U.S. government assistance for improvement of management in developing countries is supplied through the international agencies. Often the success or failure of sectoral efforts supported by U.S. bilateral aid depends upon the international agencies, since they have a major responsibility for management assistance inputs. Improved coordination of managerial advice and training provided by the multilateral and U.S. programs is needed.

10. AID should seek to establish internal and external facilities for the exchange of pertinent information about sector-oriented management.

Despite progress in establishing an "AID memory" and various Agency efforts to promote the analysis, transfer, and use of knowledge, mechanisms for rapid, targeted exchanges of experience and information remain inadequate. These need to be strengthened and continuously monitored. The problem in the field of management is particularly acute. U.S. academic and research institutions, and private firms and institutions should be encouraged to participate in this process.

POLICY DETERMINATION: AID Financing of Palm Oil, Citrus and Sugar Projects and Related Products

1. Because of the potential injury to US producers of similar products, AID/W will as a matter of general policy examine at the earliest possible stage proposed projects involving production, processing or marketing of sugar, palm oil, or citrus for export. Approval to proceed with project development in these cases must be made by the appropriate Regional Assistant Administrator with the concurrence of AA/PPC and AA/IIA following review by PPC/PDPR/EDD in cooperation with IIA/EA/IEA. These divisions will examine potential injury to US producers on the basis of data supplied by the Mission on the export potential of the project, likely export markets, magnitude of production resulting from the project, and the recipient country's relative share of the world market and/or US import market; and on information available in Washington about the condition of the US industry.

2. Commodities financed under non-project assistance and activities financed by subsequently generated local currencies would be given a similar review with participation by SER/COM when the Mission is aware that the commodities will contribute to establishing or expanding production, processing or marketing of these products for export. However, we do not envisage changing existing procedures governing non-project assistance to require Missions to trace all final uses of imported commodities.

3. Missions are not prohibited from developing project ideas in which these commodities are involved. Rather, they should be aware that their potential impact on US producers is a matter of concern which has resulted in restrictive legislation in the OPIC authorization bill and in the replenishment authorization for the International Financial Institutions. AID should, therefore, only finance such projects when their development rationale is strong and their likely impact on US producers is low.

RHNooter

Robert H. Nooter
Acting Administrator

5/12/78

Date

Address questions about this policy determination to: PPC/PDPR.

POLICY ON AID-U.S. COOPERATIVE ORGANIZATION RELATIONSHIPS

The attached Policy Determination 73 was approved by the Administrator on March 30, 1980.

Attachment

Address questions about this policy determination to:

POLICY ON AID-U.S. COOPERATIVE ORGANIZATION RELATIONSHIPS

Governing Legislation

Section 123(a) of the Foreign Assistance Act, as amended in 1978, declares a public policy in favor of public subsidies to supplement private financial resources in order to expand the overseas development activities of certain private groups without compromising their private and independent nature.

The groups are private and voluntary organizations and cooperatives which embody the American spirit of self-help and assistance to others to improve their lives and incomes.

The purposes of the support are to (1) assist and accelerate in an effective manner the participation of the rural and urban poor in their countries' development and (2) mobilize private American financial and human resources to benefit poor people in developing countries.

The activities to be supported must be consistent with U.S. development assistance policy as stated in Section 102 of the Foreign Assistance Act.

Section 111 of the Foreign Assistance Act directs that high priority be given to the development and use of cooperatives in developing countries which will enable and encourage greater numbers of the poor to help themselves toward a better life.

Section 601(a) of the same law and Section 123(a) also encourage the participation of cooperatives in the implementation of U.S. Government foreign assistance programs.

Background

Cooperatives have played an important role in the economic growtn of the developed world. They continue to figure prominently today. It was easy, therefore, for government to look to the cooperatives of the developed world to make an equally important contribution to the development process overseas. Ideological considerations -- an idealistic association between cooperatives and egalitarianism and social change -- as well as an appreciation of cooperatives as effective business enterprises underlay these conclusions.

The U.S. Congress directed that foreign assistance agencies should promote the development of cooperatives in the developing countries and engage the American cooperative movement in this enterprise. What had been a modest effort in the Point IV era

became a larger, more directed effort in the 60's and into the 70's. And in recent years Congress has shown particular interest in the sum that should be expended for cooperatives.

Almost $3 million is currently provided annually to support international offices of American cooperative development organizations. This amount includes specific grants made to the cooperatives to enhance their skills in project design and evaluation.

The results of efforts to encourage and promote cooperative activity have been mixed. There has been a prodigious growth of credit unions in Latin America and a steady increase in Africa. A major cooperative achievement was the organization of the Indian Farmer Fertilizer Cooperative, including the building of a fertilizer plant and the organization of a cooperative marketing structure. Rural electric cooperatives flourish in several countries. Other demonstrations of the contribution of the American cooperative movement exist as well, but some programs have had spotty histories, failing to adequately address the degree of difficulty and complexity associated with developing cooperative business enterprises in developing countries.

Occasionally questions have been raised about the appropriateness of modern, business-oriented western cooperatives in the context of a developing economy. It has been assumed that the style and talents of the modern cooperative structure would be relevant to, and needed by, developing countries. Yet cooperatives in the U.S. have evolved in a unique environment and in response to unique conditions which do not similarly prevail in developing countries. Their current operational approaches and levels of capitalization make them dramatically different organizations than those which characterized their earlier years.

These questions, observations and recommendations raised in recent literature suggest that the best of the cooperative competence and spirit is not always being engaged in the development effort. More thorough attention should be given to encouraging application of the experience and capabilities of the cooperative organizations to those situations where they can realistically be expected to achieve their objectives.

An examination of such issues, particularly as they related to small farmers, was carried out under the auspices of the Agricultural Development Council. The results of that study were the subject of a three-day conference at Wingspread, the Johnson Foundation's conference center at Racine, Wisconsin, in late April 1978. Scholars, donor agency officials, and cooperative leaders of the U.S., Europe and the Third World were participants.

The conclusions drawn from the exercise follow:

1. That there is indeed a role for American cooperatives to play in overseas development, but that the fit must be carefully made;

2. That AID and the American cooperatives should place new emphasis on direct cooperative-to-cooperative relations and less on cooperatives as instruments of government-to-government aid programs.

3. That cooperative development should be recognized as a long-term process and that U.S. Government and cooperative movement commitments must be of a longer-term nature than has been common in the past;

4. That U.S. Government support should be provided in a manner that leaves maximum flexibility in the hands of the cooperatives;

5. That U.S. Government support should not in the long run be the sole financial basis for direct cooperative-to-cooperative relations.

6. That U.S. (and other foreign) cooperatives have been more effective in providing technical assistance to already organized cooperatives, to national confederations, and regional cooperative organizations, and been less so in organizing local cooperatives and cooperative movements in developing countries.

General Policy

It is our policy to further the development and use of developing country cooperatives which will enable greater numbers of the poor to help themselves to better lives. U.S. cooperative organizations can play a significant role in furthering this objective, consistent with the principles stated in Section 102 of the Foreign Assistance Act.

To assist in the development of cooperatives, AID will support two approaches. First, it will continue to consider cooperative development an integral concern of its bilateral programs and provide support in that context. Second, it will encourage U.S. cooperatives to relate directly to developing country cooperative counterparts as private organization-to-private organization and will support this effort beyond the framework of the usual government-to-government bilateral programs. Each of these approaches will have distinct requirements.

1. In the first category, project financing will continue to be provided by Regional Bureaus and USAIDs with the existing OPG procedures and authorities. Cooperative organizations will also be eligible for contracts related to bilateral aid programs

administered by AID. The application of the collaborative assistance method (Policy Determination 65) will be extended to embrace the cooperative development organizations which are recognized and listed as such by the AA/PDC. Such activities will be carried out in the context and with the usual requirements, including project review and rigorous evaluations, of all of AID's other bilateral programs.

2. In the second category, which emphasizes the cooperatives' private contacts and character, AID will encourage U.S. cooperatives to seek out and develop their own relationships with developing cooperatives. Through fraternal association in international organizations such as the International Cooperative Alliance, International Federation of Agricultural Producers, the World Council of Credit Unions, the Joint Committee for the Promotion of Aid to Cooperatives, etc; through regional organizations such ACOSCA, COLAC, OCA, SIDEFCOOP, etc.; and through familiarity with national cooperative organizations, the U.S. cooperatives have developed relationships which will identify opportunities for assistance. To support further the movement-to-movement relationship, AID will encourage the cooperative groups to decentralize their international headquarters staffs, associating them where feasible and appropriate with national and international affinity groups. AID-supported cooperatives should also be able to continue to function where bilateral programs have terminated except when specifically prohibited by law.

3. Direct cooperative-to-cooperative relations supported by AID must serve both the goal of enabling and encouraging greater numbers of the poor to help themselves toward a better life and the internationally accepted cooperative movement principles of voluntarism, democratic control, equitable sharing of benefits, and business purpose. There are many different kinds of organizations and programs which are called "cooperative." Some do not actually serve this goal, which is the purpose of AID support; and some are out of line with the fundamental international cooperative principles. When AID funds are involved, U.S. cooperatives should seek out "emerging cooperatives" and forego assistance to large, moneyed "establishment" cooperatives, when the latter don't serve directly low-income people.

4. Institutional support to the U.S. cooperative organizations and funds to support independent cooperative-to-cooperative programs will be centrally funded. This centrally-funded support will be provided subject to periodic reviews and funds availability in a manner that leaves maximum flexibility in the hands of the cooperatives, subject to the principles in this statement, including point five below. This support will not be exclusively part of the country programming process. U.S. Government approval for specific activities, for travel, and for other aspects of the work will not be required. The American cooperatives and their local partners will be responsible for obtaining whatever foreign government approvals are required. No logistic or other support will be sought

from U.S. Government officials or agencies other than what might normally be provided for private persons and organizations which operate without Government funding and independent of the Government. AID will assist the American cooperatives with training, orientation and similar services as agreed upon and convenient to both parties.

5. For institutional support to U.S. cooperative development organizations, the review procedures for discrete country program activity will be the same as those now being used for PVO matching grants, per the attached policy guidance for PVOs. The AID-funded U.S. cooperative development organizations, when contemplating program activity, will consult with USAIDs in the countries involved regarding their plans. Should a USAID feel that a contemplated activity is inappropriate, such concerns will be communicated by AID/Washington to the Governing Board of the cooperative organization involved.

6. The provision of support for cooperative-to-cooperative activity should not be regarded as an automatic AID commitment to provide funding for specific project activity which might flow from such cooperative-to-cooperative relations.

7. The success of the independent cooperative-to-cooperative aspects of this policy depends on an expanded commitment of resources by U.S. cooperators on a matching grant basis, the details to be agreed with the cooperatives.

Attachment

USAID ROLE RE CENTRALLY FUNDED GRANTS TO PVOs, INCLUDING CRITERIA FOR ANALYZING MATCHING GRANT PROPOSALS

The following is AIDAC Cable State 015988 dated January 20, 1980 to Principal Posts, U. S. Mission/Geneva, American Embassy/Lagos, American Embassy/Paris, American Embassy/Rome:

A) AIDTO CIRC A-172 w/attachments.

1) Memo for Assistant Administrators and Mission Directors with matching grant guidelines from A-A/AID dated 4/20/79.

2. Dear Colleague letter to PVO's from A-AA/PDC dated 6/27/78.

3. AID's matching grants -- a summary description.

B) Report of conference of AID related PVO's dated 2/10/78.

C) Action memorandum for Administrator dated 6/9/78.

D) Info memorandum for Administrator from AA/PDC dated 12/22/78.

E. Action memorandum for Administrator from AA/PDC dated 3/9/79.

FOR MISSION DIRECTORS FROM ADMINISTRATOR BENNET

1) In February 1978, A.I.D. established a centrally-funded matching grant (MG) program to assist PVO's to expand their development efforts in the Third World. Since that time, there has been an accumulation of decision memoranda and other documents which together describe the background of the program and the criteria which are used in approving proposals. Listed above as references are the principal background documents. Missions have received most of them at one time or another; we will forward those which have not yet been distributed for your information.

2) Although the increasing role of PVO's is generally understood and accepted in the Agency, there appears to be some uncertainty with respect to the Mission role vis-a-vis centrally-funded PVO grants, especially matching grants. Consequently, we felt it would be useful to bring together in one message the principal criteria used by the Agency in considering matching grants and the role to be placed by field missions.

3) Review Criteria

a. While each of the referenced documents contains some useful background material, Bob Nooter's memo of April 23, attached to AIDTO CIRC A-172 (Ref A), describes the Agency's philosophy towards matching grants. In his memo, Mr. Nooter indicated that "the grants are intended to support an expansion of the PVOs own programs, for PVOs with a proven track record. While A.I.D. must exercise enough oversight to assure that the use of the funds is consistent

with our legislation, we should not try to remake these programs in our own image nor should we require the same kind of detailed project documentation used for our regular programs." The point is that we want to capitalize on the resources and management capabilities PVO's can bring to bear on development by supporting but interfering as little as possible in their activities. Bob Nooter's memo had as an attachment the following matching grant guidelines:

1. The purpose of the matching grant program is to support the ability of PVO's to administer effective development programs, within A.I.D.'s overall priorities and legislative mandate. Simultaneously, we seek to facilitate increased resources for developing countries.

Some fundamental corollaries follow this purpose statement, as follows:

--A. The program must be field-oriented rather than headquarters-oriented.

--B. The program must remain the PVO's own program (rather than an A.I.D. program, with all of its formal requirements and programming system).

--C. The program must be "discrete" in the sense that it deals with an identifiable problem (or set of problems) which has some boundries around it (rather than a blank check to do what the PVO may decide to do over the course of the grant period).

--D. The program must be set up in such a way that it is measurable and evaluable, based on broad functional and geographical target areas. (The final report and the previous annual reports, therefore, must be able to tell the development community and A.I.D. something useable about a program and an approach--i.e. water resource development using a community participation methodology, etc.)

--E. The PVO must have clearly established its ability both to carry out the program and to raise the matching funds from non-governmental sources. (Note: It was subsequently decided that exceptions can be made to permit host government contributions in partial substitution for private contributions.)

--F. The PVO proposal must be specific enough to enable A.I.D. to ascertain at least the following: The projected countries in which the matching grant program will be undertaken; sample indications of the program's coordination of the PVO input with host country governments, estimate beneficiaries, host country (indigenous) PVO's or other private groups; the functional areas in which the PVO will work (nutrition, water resources, etc.), and a broad outline of the budget, including other income history and projections and expenditures for the matching grant program.

Each matching grant proposal should have sufficient information about the proposed PVO program for a mission to understand how it would work in that specific country. Projects do not have to be described in the same detail as in the case of an OPG.

Roles of the Mission and AID/W:

A. The central feature of the matching grant program is its support for the PVOs' own programs when those programs fall generally within A.I.D.'s broadly-

viewed development objectives. Agency approval processes and monitoring requirements as well as mission responsibilities are based on recognition of this fact.

B. The originating bureau, usually PDC, seeks the clearance of AID/W regional bureau responsible for the country or countries in which the PVO proposes to carry out its program with A.I.D. support.

C. Prior to forwarding matching grant proposals to regional bureaus and missions for review, PDC/PVC analyzes the credentials of the PVO and the matching grant proposal to ascertain that the proposed program is based on an established track record of performance, that the PVO can assume responsibility for self-monitoring and accountability, and that the PVO has both demonstrated capacity to generate the necessary private support and possesses a long-range financial plan to achieve agreed goals.

D. AID/W will advise missions of any centrally-funded grant application involving a PVO which has carried out significant programs in the respective country and/or seeks to work in that country. We will send relevant missions a copy of the proposal or a complete cable summary, together with separate and specific questions and issues on which we seek and need mission comments and suggestions.

E. The respective regional bureau and PDC must have informed field input. We will ask for mission views and recommendations to ascertain whether (1) the PVO's past performance and reputation has resulted in severely negative attitudes within the host country; (2) the proposed program is incompatible with the country's social, economic or political structure; (3) the proposed activities are in conflict with mission or other donor programs; or (4) the area of the country where the PVO hopes to work is too unsafe for such an activity. The mission's role is essentially one of guidance and suggestion rather than of specific clearance.

F. The PVOs are themselves responsible for obtaining whatever host country concurrences or authorization is necessary.

G. In the actual development and implementation of the program, we will continue to urge and encourage the PVOs to be certain that they discuss with the respective mission their plans and programs. Such consultation, however, is not obligatory, since an effort by A.I.D. to supervise or control matching grant activity would violate the basic premise of the program.

H. In keeping with this spirit, PVOs using A.I.D. matching grant funds need not seek authorization to travel to countries in which their project is operating, with the exception that in countries in which important political or other factors warrant it, Mission clearance can still be required. Conversely, PVOs cannot expect any logistical support from the Mission.

5. We are convinced that the recipients of matching grants, which are the most established and proven of the PVOs, will work best in support of the poor when they are as free as possible of the usual governmental restrictions and impositions. While we do our part to ensure healthy communication among AID/W, centrally-funded PVOs, and missions, we will expect missions to support this important new program and the principle behind it.

POLICY PAPERS

INDEX TO THIS HANDBOOK

This index is derived from the Master Index to the AID Handbook series issued under TM HI:2.

The underlying approach to the Master Index is one of unity, with the series of AID Handbooks considered as a single entity in which topics may appear in one, or more than one, of the component volumes.

Each entry in the Master Index that includes a reference to this Handbook is reproduced here in its entirety, thus providing both a guide to this Handbook and useful references to other Handbooks.

The formats for location citations are intended to match their appearance on the Handbook pages. Beyond the standardized Handbook number with its following colon, the citations used in the index reflect the different formats used in the individual Handbooks themselves.

UNDERSTANDING THE CITATIONS

The standard codes and messages that appear throughout the index, and their exceptions, are defined in this section. It is recommended that all users read this section before using the index.

LOCATION CITATIONS

The location citations are grouped in the following pattern:

Handbook number, colon, Chapter number, Paragraph letter, and further breakdown where needed.

The abbreviations such as App. for Appendix; Att. for Attachment; and Sup. for Supplement are also included in the citations wherever necessary.

Special cases and cross reference messages are described on the following page.

An example of the format used is as follows:

AID Financed Export Opportunities 1B:23A2a(3); 15:10C1a(1)

where the term "AID Financed Export Opportunities" is located in Handbook No. 1B, Chapter 23, Section A2a(3); and Handbook 15, Chapter 10, Section C1a(1).

SPECIAL CASES

Although the majority of the location citations follow the pattern described previously, there are these exceptions:

- In some of the Handbooks, a majority of the text is reprinted from the Foreign Affairs Manual (FAM). All FAM citations are marked by a '#' sign before the section number.

- A major portion of Handbook 14 is composed of the Federal Acquisition Regulation (FAR). All citations to this publication are cited as 14:FAR(section number).

- Three Handbook supplements that are basically separate volumes are cited as, 1B: (Procurement Policy), 3A: and 3B: (Project Managers Guidebook).

- In Handbooks which contain both Parts as well as Chapters, the Roman numeral Part number is separated from the Arabic Chapter number by a dash (-). For example: 21:I-2A8, a citation to Chapter 2 of Part I of Handbook 21.

CROSS REFERENCES

These references provide direction for selection of index terms:-

A '<u>see</u>' reference points from an unused term to the one that is used.

'x' is the reverse of <u>see</u> (do not bother to look) and provides a guide to terms that are <u>not</u> used in the index.

'<u>see also</u>' points to terms that are closely related.

-A-

Agricultural Export Development 1:II-A4

AID policies 1:ALL
core concepts 1:I
cross sectoral policies 1:III
sectoral policies 1:II

Approaches to the Policy Dialogue 1:I-B

-B-

Basic education 1:II-H; 9:10C2

B/Gs; all information related to Borrower/Grantees is listed under the entries for Country contracting or Host countries.

Bureau for Private Enterprise 1:I-C; 17:21; 18:IV-3D15

-C-

Cash Transfer Assistance (ESF) 1:IV-I

Case studies 1:VI

Co-financing 1:IV-F; 3:App.3B2

Continuing operation of completed project 1:III-A2; 3:14C
x Recurrent costs

Contraceptives see Family planning equipment

Cooperating countries see Host countries

Core concepts 1:I
approaches to the policy dialogue 1:I-B
institutional development 1:I-D
private enterprise development 1:I-C

Cross sectoral policies 1:III
environmental impact 1:Ann.AIV-11
human resources development 1:Ann.AIV-2; 1:Ann.AIV-3

narcotics 1:III-C7
PVOs 1:III-C3
recurrent costs 1:III-A2
science and technology 1:Ann.AIV-8; 1:Ann.AIV-9
women in development 1:III-B2

-D-

Development Communications 1:II-I

Disaster assistance 8:ALL
policy statements 1:IV-D; 8:1C
xInternational disaster assistance

-E-

Education programs 1:II; 2:Sup.E; 9:10C2 10:ALL
basic education 1:II-H; 9:10C2
participant training programs 1:II-K; 10:ALL
vocational education 1:II-H

Environmental impact 1:II-L; 1:Ann.AIV-11; 2:Sup.B5; 3:2D3h; 3:App.2D; 3:3C8; 7:4A7

Exchange Rate Policy Guide 1:VII-6

-F-

Family planning equipment 1:II-D; 13:App.4C24; 13:App.4D25
x Contraceptives

Food and agriculture
food and agriculture development 1:II-A; 9:ALL
forestry 1:II-N
PL 480 programs 1:IV-B; 9:ALL
pricing policy 1:II-A1

Food and agriculture development 1:II-A; 9:ALL

Food for Peace Programs 1:Ann.AV-7; 9:3

Foreign disaster assistance see
Disaster assistance

Forestry 1:II-N

-G-

Guidelines on terms of AID 1:VII

-H-

Health and nutrition programs 1:II-C; 1:II-F; 9:10
x Nutrition

Health and sanitation 1:II-G; 9:10C3

Host countries: This term is used for locating all references to B/Gs, Cooperating Countries, Recipients, etc.

Host country capabilities

Continuing operation of completed project 1:III-A2; 3:14C

Host country responsibilities
continuing operation of completed project 1:III-A2; 3:App.3L

Host Government Emp. Salary Supp. 1:VII-7

Human resources development 1:Ann.AIV-3; 2:Sup.B; 2:Sup.E
education programs 1:II; 2:Sup.E; 9:10C2 10:ALL
rural development 1:VI; 2:Sup.C3; 18:IV-3D16
urban development 1:II-P; 2:Sup.F2; 18:IV-D11
women in development 1:III-B2; 2:Sup.B4

-I-

Institutional development 1:I-D

-L-

Land Tenure 1:II-A2

Loan terms 1:Ann.A,PD66; 3:App.6A-1; 19:6C3b(4)
PL 480 loans 1:V-PD9; 9:4B

Local currency programs 1:IV-B1; 3:4B8; 9:11; 19:5

-M-

Mixed credits 1:IV-E

-N-

Narcotics 1:III-C7; 29:App.1GA

NGO's 1:VII

Nutrition see Health and nutrition programs

-P-

Participant training programs 3A:IIC2F; 3B:VIIG; 10:ALL
  policy statements 1:II-K; 10:2B

PL 480 loans 9:4; 9:5
  loan terms 1:V-PD9; 9:4B9

PL 480 programs 9:ALL
  policy statement 1:V-PD9; 9:3

Policy cable/memoranda 1:VII

Policy Determinations 1:ALL; 18:I-6A

Policy Papers 1:ALL

Policy Statements
  policy cables/memoranda 1:VII
    humid tropical forestry 1:VII
    population assistance through NGO's 1:VII
    program sector assistance guidance 1:VII
    terms of AID 1:VII
  disaster assistance 1:IV-D; 8:1C
  food for peace programs 1:Ann.AV-7; 9:3
  PVOs 1:III-C3; 9:11A; 1:VII

Population Assistance
family planning equipment 1:II-D; 13:App.4C24; 15:6B
NGO's 1:VII
policy statements 1:II-B; 1:II-D; 1:II-E; 1:VII
voluntary sterilization 1:II-E; 2:Sup.D5; 13:App.4C26

Pricing policy (food) 1:II-A1

Private enterprise development 1:I-C; 1:III-A5; 1:IV-B3; 18:IV-3D15
Bureau for Private Enterprise 1:I-C; 17:21

Private Voluntary Organizations see PVOs

Project design development 3:3D; 7:4
development communications 1:II-I
population assistance through NGOs 1:VII
humid tropical forestry 1:VII
Program sector Assistance Guidance 1:VII
Terms of AID 1:VII

Proposals
unsolicited proposals 3A:IIB2F(2); 14:715.5; 14:FAR15.5

PVOs 1:III-C3; 9:11A; 1:VII
x Private Voluntary Organizations

-R-

Recurrent costs see
Continuation of completed project

Rural development 1:VI; 2:Sup.C3; 18:IV-3D16

-S-

Salary Supplements
host government employees 1:VII-7

Science and technology 1:Ann.AIV-8; 1:Ann.AIV-9; 2:Sup.F1

Sectoral policies 1:II
development communications 1:II-I
education programs 1:II-H; 1:II-J
environmental impact 1:II-L
food and agriculture development 1:II-A
health and nutrition programs 1:II-C; 1:II-F
health and sanitation 1:II-G
population assistance 1:II-D; 1:II-E
shelter 1:II-S

Shelter 1:II-S

-T-

Title I (PL 480) Programs 1:IV-B3

Title II (PL 480) programs 9:7; 9:8
local currency program 1:IV-B1
policy statements 1:Ann.AV-7; 9:3

Title XII projects 1:IV-G; 13:1B2

Trade Development 1:III-C4

-U-

Unsolicited proposals 1:12B2f; 3A:IIB2F(2); 14:715.5; 14:FAR15.5

Urban development 1:II-P; 2:Sup.F2; 18:IV-D11

-V-

Vocational education 1:II-H

Voluntary sterilization 1:II-E; 2:Sup.D5; 13:App.4C26

-W-

Women in development 1:III-B2; 2:Sup.B4; 18:IV-3D18

AID POLICY ON DEVELOPMENT ASSISTANCE

The development assistance program recognizes that broad based growth that meets basic human needs will not occur without the active participation of all segments of the LDC population, particularly the rural poor. Instead of airports, heavy industrial projects and other major capital intensive investments and general resource transfers which have characterized our aid efforts in earlier years, we must increasingly use our development assistance resources in support of meeting basic human needs for food, safe drinking water, basic health care, education, and shelter.

In rural development, we seek increased food production and increased employment and incomes for the poor. In many countries, such opportunities for the rural poor will necessarily involve significant changes in land tenure and greater access to agricultural markets and resources, including fertilizer, water, transportation and credit. In many countries this effort will require greater recognition of the role of women as responsible for more than half of all agricultural production.

In urban development, as in agriculture, we must place major emphasis on labor intensive production. In the area of human resources, our objectives are to ensure adequate nutrition and greater access to preventive medicine, family planning services, basic education and maternal and infant health care.

Most developing countries could make substantial progress in meeting the basic needs of their populations by the end of the century if they pursue effective national policies and have the necessary resources to support more rapid growth with greater equity. For example, the Club of Rome has suggested the following as attainable goals by the year 2000: an increase in life expectancy from 50 years at present to 65 years; an increase in average literacy levels from 33% to 75%; a reduction in infant mortality from 136 per 1000 to 50 or less per 1000; and a reduction in birth rates from 40 per 1000 to 25 or less per 1000 (thus reducing average population growth rates by 1-1/2%).

If a basic human needs strategy of development implied donor concentration only upon the very poorest people in the poorest countries, it would be a useful but limited humanitarian effort. But meeting basic human needs goes beyond mere welfare: It is a broad and sound basis for effective development.

To meet basic needs requires not only an acceleration of LDC growth rates but greater attention to the production of goods and services for the poor rather than for the high income modern sector. The basic human needs approach requires a fuller use of abundant human resources, greater incomes to the poor in order to generate the demand for basic goods and services and greater political and social participation by the poor.

AID's program concentrates on three major functional categories: food, nutrition and rural development (page 21); population planning (page 23); education and human resources development (page 26); and health (page 29).

In the area of food, nutrition and rural development, AID programs address widespread problems of hunger, malnutrition and general lack of income. There are over a billion under-nourished people. Half have diets so nutritionally inadequate that their health is seriously threatened or imparied.

Rapid acceleration of agricultural production and employment opportunities in both rural and urban economies in the developing world is necessary to alleviate malnutrition and to provide the poor with increased incomes to meet their other basic needs. The poor majority must be the major participants in this process. They are the bulk of the labor force. Those who are farmers have within their potential the means to narrow the food gap.

In support of agriculture and rural development, AID promotes:

-- institutions which provide small farmers access to improved seeds, fertilizer, tools and the necessary credit to obtain such materials;

-- economic policies including land tenure reforms which provide small farmers with adequate incentives to grow more food;

-- agricultural research and extension programs which develop and adapt new technology to local conditions and promote its use by small farmers;

-- small-scale irrigation systems, farm-to-market roads, rural electrification and marketing and storage facilities--all required for small farmer's access to adequate water, power and markets;

-- institutions and policies to increase the access of farmers and small-scale rural industry to credit and technical assistance.

The enactment of Title XII in 1975 has provided a new tool for implementing these programs. Land Grant universities and other qualified U.S. institutions are cooperating with AID to achieve the famine prevention and freedom from hunger objectives of Title XII.

AID also administers U.S. food aid under PL 480. This program represents only a small proportion of the food consumed in poor countries. Yet in some food deficit countries this form of aid is valuable not only as emergency relief but as a means of strengthening development programs. In times past food aid on occasion encouraged a dependence upon food imports, but AID now seeks to ensure that food aid will be used to support rather than retard development.

In the population sector, rapid population growth undermines efforts to improve the welfare of millions living at or near subsistence levels. While birth rates in some developing countries have begun to decline, death rates have also declined. The resulting net increases threaten to double populations every 35 years or so. Declines in birth rates must accelerate if substantial improvements in living standards are to be achieved in the Third World.

Voluntary family planning services can help produce declines in fertility, particularly where social and economic conditions encourage a preference for smaller families. AID recognizes the close interrelationship between population growth and economic development and supports programs which expand safe and effective family planning services at the village level. AID encourages family planning goals in all its development sectors, particularly in the health sector.

Improved health conditions are essential to sound development. The major health problems of the poor in developing countries can be substantially ameliorated through available technology at a low per capita cost. In the health sector, AID supports:

-- low cost local health services which emphasize preventive care, often integrated with nutrition and family planning services; and which rely on village organization, leadership and staffing;

-- clean water and rudimentary sanitation systems;

-- the development of improved methods for control of malaria and major parasitic diseases; and

-- national health planning.

In the area of education, we seek to expand access to basic education for the poor. Despite substantial expenditures on education by developing countries, only about 47% of the population from 5 to 14 years of age is in school. As with health, education services must be relevant to the needs of the poor and utilize available means. Through both formal and nonformal education AID is helping to improve access to functional skills in health, nutrition, family planning, and agriculture. More specifically, AID supports:

-- low cost primary education, particularly for the rural poor;

-- the use of mass media and communications technology, such as radio, in formal and nonformal education;

-- curricula revision and teacher training to increase the relevancy of formal education to meeting basic human needs; and

-- the development of nonformal education and training approaches for rural families and workers in agriculture, nutrition, health and family planning.

AID also engages in a variety of related efforts including such programs as shelter (page 33) and basic services for the urban poor (page 40), development of nonconventional energy technologies (page 35) and environmental protection (page 38).

Several concerns cut across all development activities. Among these are the role of women in development (page 43) and the utilization of light capital or "appropriate" technology.

Improvement of the economic, social and political status of women in host countries is essential to development. Indeed, it may well be that women will prove the decisive force in making a basic human needs strategy succeed. Women are responsible for much of the agricultural production and for most of the domestic food supply in the developing world today. They are directly responsible for the health and nutrition of their families. They are the first and frequently the only teachers of the young. They are critical to the planning and implementation of a population program.

Greater reliance on appropriate technology not only for food production and small-scale industry but also in health delivery systems, educational methods and management techniques, will result in fuller employment, greater productivity and increased incomes in developing countries. AID seeks to maximize the use of appropriate technologies in all projects it supports.

AID POLICY ON SECURITY SUPPORTING ASSISTANCE

Security Supporting Assistance (SSA) is currently the largest component of the United States foreign economic assistance program. It is $2.2 billion out of a total program of $6 billion in FY 1978. (The other components of the program are: Food for Peace sales and donations of $1.5 billion; Development Loans and Grants, $1.3 billion; contributions to the concessional lending facilities of international development institutions, $1 billion.)

Approximately 90 percent of SSA goes to four countries--Egypt, Israel, Jordan and Syria--in support of the United States diplomatic efforts to help secure peace in the Middle East. Most of the rest of SSA goes to countries in Southern Africa to promote peaceful transition to majority rule.

In contrast with Development Assistance designed to assist in the economic and social development of poor countries and peoples through basic human needs programs, SSA has an immediate political orientation. SSA is designed "to promote economic or political stability" in areas where the United States has special foreign policy interests and has determined that economic assistance can be useful in securing peace or averting major economic or political crises.

SSA is a flexible economic instrument which takes the form of commodity import programs, economic infrastructure projects, unrestricted cash grants and general budget support, as well as projects specifically directed toward meeting basic human needs.

The Security Supporting Assistance program grew out of the "Cold War" era in the 1950's when economic aid was provided to allies to bolster their economies so that they could support the defense demands of their mutual security alliances with the United States. Later, major sums of SSA were used for United States programs in Indochina.

Although the primary purpose of SSA is to meet political objectives, these funds also can provide an opportunity to encourage sound development. Congress has mandated that, to the extent possible, SSA be used to promote development efforts which effectively aid the poor. In administering SSA, the Agency for International Development has responsibility for ensuring that it is used for economically and technically sound projects and purposes.

Where SSA is proposed for stabilization of economies undergoing critical economic stress, A.I.D. considers the nature and cause of the economic problem, the kind of support that may be needed, the

chances that the effort will succeed, the possibilities for participation of the International Monetary Fund (IMF) and other international donors, the recipient's willingness to adhere to IMF requirements, and whether other offices of the United States Government, e.g., the Treasury Exchange Stabilization Fund, the Export-Import Bank, Food for Peace program, may be more appropriate sources of assistance, or whether special legislation may be desirable.

At times small amounts of Supporting Assistance have been used in securing agreements for access to military facilities abroad such as naval bases, airfields, or communications facilities. SSA is used today for such purposes in Spain, Malta and Bahrain. It has also been used for the United States contribution to the United Nations Forces in Cyprus (UNFICYP).

The use of SSA for essentially military purposes has been criticized as an inappropriate use of economic aid, and a review of this policy is underway. AID believes that such military funding should not be in the economic assistance budget.

In order to administer SSA effectively, AID subscribes to the following principles:

1. Security Supporting Assistance programs should address verifiable economic needs, and levels should be economically justifiable.

2. SSA should be supportive of and consistent with overall United States foreign policy objectives, including development objectives.

3. SSA proposals should reflect consideration of other potential sources of assistance, including other forms of United States aid; and assistance from other countries, the IMF, multilateral banks, and other international sources.

4. To the extent practicable, consistent with the political and security purposes of such assistance, SSA should be fashioned in accordance with the development criteria that apply to AID's Development Assistance program.

5. Security Supporting Assistance should not be used to pay for military facilities.

AID POLICY ON EDUCATION AND HUMAN RESOURCES

The numbers of unskilled and illiterate poor people in the developing countries are increasing in spite of serious education efforts in many countries to overcome these problems. Developing country school systems are not available to most poor people, particularly in rural areas; fewer than 50 percent of the children of primary school age get the chance to enroll, on average. Of those who do gain entrance, large numbers drop out before completing the full school program. Enrollments at the secondary level and in post-secondary programs also reached only a fraction of the age group, indeed a much smaller percentage than is the case with primary schools. And, although four out of ten primary school students are girls, females comprise only 35 percent of secondary school enrollments.

During the 1960s developing countries and assistance agencies emphasized the importance of higher education to development. Many emerging new countries were without adequately trained individuals to plan and implement effective development programs. During this period, the majority of AID's education grants and loans went to the building of colleges and universities and the training of high level manpower.

Although the emphasis was on third level education, primary education expanded rapidly. The average annual growth rate in primary school enrollments in the 1960s was around 6 percent--keeping ahead of population expansion. For example, the percent of the relevant age group enrolled in first level education went from 36 percent in 1960 to 75 percent in 1974 in Botswana, 30 percent in 1965 to 65 percent in 1973 in Guatemala, and 30 percent in 1965 to 47 percent in 1973 in Pakistan.

Despite these achievements, developing countries as a whole were unable to provide educational access to the majority of their school aged population. By 1973, an investment of 21 billion dollars on public education by developing countries reached less than 1 out of every 3 children of school age. Indeed, as developing countries strained fiscal limits, the rate of growth in primary school enrollment began to decline dramatically. By the mid 1970s the growth in primary school enrollment was down from around 6 percent per annum to about 4 percent--a rate barely sufficient to keep pace with the rate of growth in the school aged population.

Given this situation, developing countries and assistance agencies today stress both formal and nonformal approaches to reach education and training objectives. AID assists in a broad range of educational programs.

AID-assisted satellite school programs have been tested in Honduras, in which "nuclear" schools are established as service centers for surrounding three-year, or incomplete, primary schools. Radio is being used to improve the quality of mathematics instruction in Nicaragua, to train teachers in Nepal, and to improve the delivery of health services by para-professionals in Guatemala. Other approaches are being tested and explored as useful additional alternatives to traditional methods, such as decentralized governance of schools in Bolivia, local education costs sharing or "self-help" initiatives as with Project IMPACT in Asia, and design of special learning "packages" to facilitate the adoption of improved farming, health, dietary and family planning practices.

With respect to literacy, AID supports projects whose main emphasis is upon functional use of literacy skills. In Tunisia, radio, simple newspapers and other low cost aids are being used to teach better nutrition practices. Rural Family Education Centers in Latin America combine agricultural education for out of school youth (ages 15-20) with involvement of their families in classes teaching reading and writing. AID also supports efforts to "work around" illiteracy through the use of different kinds of information-delivery techniques, such as the "photo novella"--picture booklets without words.

Although AID places most of its emphasis on primary school education, it maintains a strong interest in the role of post-secondary institutions in the developing countries. In the past, our help was targeted to a large degree upon construction of physical facilities. Increasingly, we have taken the position that our assistance should be used to help higher education institutions to revitalize their instructional programs and focus on research and community service activites that will be supportive of national development policies and priorities.

In this context, AID is exploring two main avenues. The first is that of working with the American higher education community to help them find ways to associate themselves with their developing country counterparts in a variety of joint endeavors. An AID grant is being used by the major U.S. academic organizations to finance an investigation of the prospects for such collaboration.

The second is to enlist the physical and intellectual resources of the institutions of higher learning of developing countries, in concert with government leadership and the talent of the private sector in technology transfer; that is, to stimulate the employment of technologies available to the more developed nations through such means as adaptive R&D. An example in education is communications technology options that developing countries may find exceedingly helpful in their nation-building efforts: broadcast and two-way radio; rural

telephony; television; even use of satellites and computers under special conditions. These and other elements of communications technology, the planning of their use individually and in system combinations, their deployment, management, monitoring and refinement--all require an alliance of the best brains in this country and in the developing nations. AID believes that if the developing countries, including the poorest, the middle-income and countries nearing the development "take-off" point, are to have a fair chance to realize their potential, all technological, scientific and intellectual channels must be used.

An important component of our effort in technology transfer and more broadly in education and human resources development is participant training. Since 1941, more than 200,000 individuals from foreign countries have received training under the U.S. foreign assistance program. Individuals have been trained in food production, nutrition, population planning, health and education. Specialized programs have been made available to provide leadership in science, business and industry, communications, transportation, housing and labor relations. Former participants include cabinet officers, top-level government officers and public officials from all sectors, university presidents, deans and professors, scientists, and industrial, banking and commercial leaders.

The U.S. position in education and human resources development encompasses a concern for building up developing country public administration and management capability to extend services to the poor. Management components are vital elements of projects in the key sectors of nutrition, health, agriculture, family planning, education and rural development. For example, technical assistance has been given to the Muncipal Development Institute of Guatemala to strengthen the administration or rural village services, and to support the self-help efforts of local governments in the Philippines and Indonesia better to manage local resources for development.

AID POLICY ON HEALTH

Helping developing countries to improve health conditions is essential to overall progress in economic and social development. Poor health and disease--spawned by many factors including malnutrition, bad water, frequent pregnancy, lack of hygienic living conditions, and lack of access to basic health services--continues to debilitate and kill millions of people in developing countries. It retards all development and breeds human misery.

Poor health in the developing countries is reflected in such indicators as: infant mortality rates of approximately 140/1000 live births, as against 27/1000 in developed regions; life expectancy of 40 to 50 years, against 70 to 75 years in developed regions; average mortality in the 0-5 age group of 30 to 50 times that in developed regions. Roughly half of all deaths in developing countries are of children aged 0-5 years. Each year 15 million malnourished children die of intestinal infections stemming from polluted water and soil; over 100 million people suffer malaria; 200 million people suffer snail fever, and 20 million people suffer river blindness.

The principle causes of morbidity and mortality in developing countries are gastro-intestinal afflictions and respiratory ailments that are easily controlled in developed countries; vector-borne diseases, some long eradicated from developed countries; and malnutrition. All these conditions are related to poverty, ignorance and a squalid environment. Poor health, unemployment and low income, ignorance and economic stagnation are mutually reinforcing. Also, repeated pregnancy, childbirth and septic abortion are a major threat to women, including teenagers and children. Weak, emaciated mothers have weak emaciated infants who die or suffer chronic illnesses. When breast-feeding ends, ovulation begins and another pregnancy ensues; and meanwhile, the weaned children often become further malnourished.

Some reduction in overall developing country mortality rates has occurred since World War II, partly the result of improvements in social and economic policies, mass immunization and parasite control campaigns. Nevertheless, serious discrepancies remain between countries, and even more within countries. In developing countries, the World Health Organization estimates 80 percent of the population--some 800 million people--lack access to basic health care services; 20 percent of the urban population and 75 percent of the rural population lack access to reasonably safe drinking water; public expenditures for health average $2 per person annually, and 80 percent of that is for urban services and hospital complexes that benefit only 20 percent of the population.

Helping to improve health conditions in the Third World is a central objective of the Agency for International Development. It is a central aspect of the basic human needs approach to development. Good health is a fundamental human need; indeed, it is virtually synonymous with physical well-being. The dimensions of the problem of meeting basic human needs are directly and indirectly evident in health conditions and problems. Likewise, efforts to improve conditions in agriculture, education and other areas of economic and social development will help improve overall health conditions.

AID's approach to health is one which emphasizes the necessity of a wide range of measures. Undertaken in concert, the Agency believes they will yield fundamental improvements in health conditions:

-- basic, integrated, health, nutrition and family planning services, particularly for the rural poor, that are safe, effective and affordable.

-- production of potable water and sanitation services;

-- control of parasitic diseases;

-- development of adequate capacity for health planning; including better evaluation of the impact on health of existing and planned development programs;

-- development of managerial and administrative capacity to establish and operate facilities providing low-cost health services;

-- research and development of new light capital health technologies;

-- training of paramedicals

AID is currently funding 36 pilot and demonstration projects, in 31 developing countries which provide basic integrated health/nutrition/family planning services to 186 million poor people--and which demonstrate to developing countries how they can expand preventive and basic curative services to their people at a cost that can be accommodated in their budgets. Many of these projects have encouraged governments to concentrate on reaching and maintaining contact with large numbers of low-income people through low-cost basic health care and referral networks, rather than attempting to finance expensive facilities for sophisticated curative services that reach only a few relatively affluent or urban people. For example:

-- AID's Integrated Health Development System loan to Brazil originally covered about 1 million low-income people; but now, the Government of Brazil has replicated it to reach 30 million people.

-- AID's Maternal and Child Health project in Nepal covered about 100,000 rural people, but now the Government of Nepal has extended it over the entire country.

-- The Lampang Health Development project in Northern Thailand, has trained nearly 5,000 auxiliary health workers, organized village health management and policy committees, begun nutrition surveillance, expanded local midwife services to 150,000 local villagers--less than halfway through the project--and will eventually extend basic health coverage to 65% of the people in that province, as opposed to 15% at the start. Furthermore, the training curricula used in this project have now been standardized throughout Thailand; and the Thai Government is currently discussing replication of the project throughout the country.

-- Two health sector projects in South Korea--in health planning and integrated rural health delivery--were directly influential in the Ministry of Health's reorganization favoring rural paramedical delivery systems linked to referral networks.

-- An integrated health/nutrition/family planning project in Narangwal, India, improved infant survival and family planning acceptance appreciably and in the process established itself as a model for replication throughout India; it also performed cost-effectiveness analyses on various service options, providing an important worldwide contribution to maternal and child health project design.

These and other projects have also demonstrated that paramedical primary care workers can handle 70% to 80% of community health needs, in addition to relaying important epidemiological information about their service areas and maintaining essential roles in the referral network. These workers show how communities can be stimulated to participate more in planning and delivering their own health care. At least 16 developing countries have adopted low-cost integrated outreach strategies for preventive and basic curative health services. Health sector allocations as a percentage of total government budgets have increased appreciably in at least seven of those countries.

Some AID health projects address specific components of coordinated multi-donor assistance to nationwide health programs, or even regional programs involving several countries. AID also participates in multi-donor consortia for disease control, like the Club des Amis du Sahel and an onchocerciasis (river blindness) control project in West Africa. In cooperation with other donor governments, World Health Organization (WHO), the World Bank, United Nations Development Program (UNDP),

and the developing countries themselves, AID is planning to support research and training, to address major technical and operational problems inhibiting effective control of malaria, schistosomiasis, onchocerciasis, and trypanosomiasis.

In addition, the Agency separately funds research on malaria (including development of a malaria vaccine) and on control of the major diarrheal diseases. The Agency's strategy for potable water and sanitation is being designed as part of a United Nations effort for world-wide reduction of water-borne diseases.

In all its activities, AID seeks to use the resources and expertise available in American universities, professional associations, foundations and private and voluntary agencies.

AID POLICY ON SHELTER

Shelter is a basic human need, following closely after food and clothing. It typically requires 15 to 20 percent of household expenditures (second only to food) and is the major goal of family savings for all but the wealthy. It is important to development in both economic and social terms, representing 20 to 30 percent of fixed capital formation and profoundly affecting the lives of poor people.

It is estimated that over 800 million people in the developing countries lack minimum adequate shelter. That number is growing, particularly because the cities of the developing world, small and large, are growing at unprecedented rates; most cities will double in population and many will triple in the next 25 years. Most of the new residents will be poor and in need of shelter. The provision of shelter will be essential to coping with the crisis of urban development over the next decades. Shelter is also a problem for the rural poor whose numbers continue to swell and who are flocking to the cities in search of employment and better conditions.

A primary reason why miserable shelter conditions exist in developing countries is unrealistic national housing policies which often utilize inordinate levels of subsidy to provide standard housing. Subsidies frequently do not reach the neediest. Limited available resources go to relatively few beneficiaries. Skyrocketing land costs, and a severe shortage of community facilities and services are also fundamental aspects of the problem. More rational and equitable use of available resources is needed, not necessarily more investment in the cities.

Accordingly, AID's goal in the shelter sector is to assist developing countries to acquire the policy, institutional, and financial capacity to provide decent, affordable shelter, with emphasis on government actions to meet the minimum shelter needs of low-income groups. AID pursues this goal by providing financing for projects for the poor, and by providing technical assistance in shelter policy formulation, and in the planning and development of shelter institutions. In addition, institutions are increasingly encouraged to function in secondary cities and market towns.

At another level, AID has found that the most critical ingredients of an effective shelter strategy are the reduction of physical standards to levels that meet truly basic needs within the cost range affordable by the mass of people; cost recovery from beneficiaries; large, replicable projects and programs; access to credit and access to tenure for lower-income families; encouragement of self-help and community-based actions; control of land speculation and prices; and encouragement of savings.

AID's principal resource in the shelter sector is its Housing Investment Guaranty Program. In recent years, HIG program levels have averaged about $120 million per year. This program is administered by the Office of Housing under the policy control of the Regional Bureaus. Under this program, loans are made by private U.S. lenders with an AID guaranty of repayment. Terms to the borrowing nations are essentially the same as those of the World Bank, i.e., less concessional than AID development loans. This has tended to limit the use of HIG resources in the poorest countries. Accordingly, the HIG program is most effective in reaching poor households in somewhat better off countries. In addition to housing guaranty resources, AID development loans and grants are utilized selectively for shelter activities and related technical assistance, lparticularly in low-income countries.

Countries receiving continuing AID shelter sector assistance should be prepared to provide progressively greater attention to the needs of lower-income families. This will frequently require a major reassessment of national housing policy and priorities. In particular, the level of subsidy should be reduced to ensure a program which can be sustained with greater availability of funds and thereby benefit a larger number of the neediest families in both the short and long term.

By law, the target income group for AID's housing guaranty program is families earning less than the median for the country or city in which the project is located, i.e., the poorer half of the population. In many developing countries, this will limit new housing activities to the "sites and services" minimum shelter or core housing approach.

The existing housing stock is an important resource including the settlements sometimes referred to as shacks, hovels or slums. All available evidence indicates that these areas will be with us for some time. Accordingly, AID encourages and will finance projects which provide for the upgrading of existing low-income areas, including the provision of water, sewerage, access and other community facilities and services.

Finally, AID realizes that despite a considerable body of experience in this sector, it is dealing with a problem of unprecedented magnitude about which not much is known. Accordingly, a "collaborative" style is in order which will generally involve a step-by-step, incremental approach to more rational shelter policies, as both AID and the developing countries gain additional experience. AID works closely with other international donor agencies involved in shelter sector programs. One important role for AID is to transfer the relevant experiences of developing countries to other interested nations.

AID POLICY ON ENERGY

The developing countries today face two distinct energy crises of unprecedented proportions. The first--the crisis of fossil fuels brought on by the sudden escalation of oil prices--primarily affects the more modern sector of the developing world. The second--the crisis of household fuels such as firewood and charcoal used by the world's poor majority--has been long in coming but is now critical due to the rapid increase in population and the accelerated pace of environmental degradation in the developing world.

The less developed countries cannot appreciably reduce oil imports because consumption in most developing countries includes relatively few nonessential uses, nor can they finance the ever-increasing cost of existing import levels. National development in the modern sector is closely tied to increased levels of fossil fuel consumption, and the financial strain of increased costs is limiting LDC national development prospects. The second crisis, that of dwindling supplies of firewood and other traditional sources of energy, may well prove an even more serious problem in the developing world than that of the oil shortage, for the poor majority in the developing world, who never could afford oil products, are today more dependent on traditional energy sources than ever before.

U.S. leadership in providing assistance for energy programs which will alleviate these problems in the LDCs can be crucial for their future. Although AID has not emphasized energy considerations in the past, there is a growing insistence that they be a strong part of the Agency program in the future. Sections 103(a), 106, and 119 of the Foreign Assistance Act now reflect interest in and support for assistance in this area. In addressing LDC energy problems, AID will draw on U.S. resources competent in the field: The Department of Energy, with which AID has agreed to closely coordinate its energy programs in the developing world; other federal agencies; academic institutions; and the private sector.

AID's energy policy is to assist developing nations solve their energy problems in a manner consistent with overall development objectives including resource and environmental control. AID is especially concerned with helping conserve and increase the energy supplies of the rural poor which come from primarily nonconventional sources.

The instruments available for this effort are varied, ranging from direct financial aid and exports to research and the training of manpower. These instruments, which can be effective in varying

degrees, will be coordinated to ensure their maximum overall effectiveness. Using appropriate methods and considering LDC objectives and aspirations, AID will develop alternative sets of energy development options aimed toward enhancing the usefulness of the U.S. energy assistance program. The costs and benefits of these various options will be clearly delineated. In addition, LDC institutional structures for implementing the options (government, industry, voluntary agencies, and universities) will be assessed, and appropriate incentives (fiscal, regulatory, stabilizing, distributive) will be offered to stimulate these institutions for optimum performance.

To help developing countries achieve self-reliance and attain proper control and direction for their energy resources, AID will provide assistance in the following major areas:

a. Assessment of energy potential and establishment of priorities for energy development;

b. Development of manpower to meet increasing demand for LDC experts in the energy field;

c. Support to LDC institutions and agencies engaged in energy policy, planning, research, and development; and

d. Assistance to pilot programs/projects that will determine the feasibility of selected procedures or technologies.

In providing this assistance, AID aims to emphasize both the utilization of indigenous renewable energy resources and the increase of energy food supply to the vast number of poor people. With regard to the latter, AID's present program supports rural electrification (distribution) projects. Because energy is an element of all development processes, the decisions made by developing countries on the many aspects of energy production and distribution will profoundly affect their overall development prospects. Therefore, AID will encourage developing countries to make such decisions within the context of their overall development efforts. Assistance will be given for those efforts which have the broadest potential for meeting self-sufficiency in energy development.

Certain renewable energy technologies must be proven before they can be integrated into the mainstream of development efforts. AID will therefore finance a range of energy technology pilot projects to test their feasibility. These projects will range from very small systems for producing energy at the village level to larger systems in a decentralized but regional context. For example, in countries having a wealth of wood or agricultural waste or possessing a capability to produce wood by tree farming or tree plantations, utilization of biomass may assume priority. In countries with an abundance

of sunlight, direct solar radiation technologies may be chosen for domestic and rural industry use. In other instances, small hydropower plants in decentralized locations may afford opportunity for power and nitrogen fertilizer development; and wind power may be used in conjunction with hydropower.

AID POLICY ON ENVIRONMENT AND NATURAL RESOURCES

Most of the world's developing nations lie within or near the tropical latitudes and, as such, their environment and natural resource bases are more fragile and susceptible to deterioration than those of the temperate climates of most developed countries. The special physical and biological features of the developing countries place distinct limitations on their ability to provide for basic human needs. This task is further aggravated by increased pressures on the environment from an ever expanding population, overgrazing of lands, expansion of subsistence agriculture into marginal areas, soil erosion and rapid forest depletion for human settlements, agriculture and fuel.

The achievement of long-term benefits to the world's poor, whether they be in urban or rural settings, must be based on environmentally sound planning, and on a clear understanding of a country's natural resource potentials and limitations. The President and the Congress have directed AID to address the environmental implications of its development activities and to help strengthen the capacity of the less developed countries to protect and manage their environment and natural resources. In Section 118 of the Foreign Assistance Act, the Congress directed AID specifically to make special efforts to maintain and, where possible, restore the land, vegetation, water, wildlife, and other resources upon which depend economic growth and human well-being, especially that of the poor.

AID seeks to help developing countries avoid both short-term and long-term damage to the environment and to improve it where possible AID is ensuring the environmental soundness of its development programs through the preparation of environmental assessments of its major actions, even though effects may be localized in an AID recipient country. These assessments look at the long and short-term effects of AID activities on the people who are to benefit from the programs and are prepared, to the fullest extent possible, in cooperation with the host country. Professional staff, trained in the environmental sciences, are being located in select missions abroad to work closely with country officials in examining development problems from an environmental perspective and evaluating alternative means of achieving their goals. The Agency will continue to take a critical look at our ongoing and planned activities to see that they conform with these new directives. The best U.S. talent and scientific capabilities will be used to optimize this dimension of our assistance programs. A close working relationship is being developed with host country officials so that we can gain the benefit of their perceptions, knowledge and priorities.

New categories of assistance we expect to provide may include aspects of reforestation, watershed protection, wildlife preservation, improvements to the physical environment, environmental education and institutional strengthening. AID intends to make available to developing countries help in understanding environment and natural resource issues in order to facilitate their ability to select, design and manage environmentally sound programs. A number of projects in these categories are either under way or being planned.

AID will train as many of its own personnel as possible to recognize the critical relationship between environment and development. Both formal and informal approaches will be utilized. Any training materials prepared will be available to others to further the understanding of these relationships.

In developing its environment program, the Agency will draw upon expertise of the Environmental Protection Agency and the Departments of State, Agriculture, and Interior.

AID will also look for new ways to involve specialists of non-governmental organizations in the planning and review of its activities, and will work with other donor agencies to develop coordinated approaches for building environmental safeguards into all development activities.

AID POLICY ON URBAN DEVELOPMENT

The cities of the world, and particularly those of the developing countries, are growing at staggering rates. The present rate of urbanization can be likened to the formation of 2,000 new cities of one million people each between 1970 and the year 2000. The impact of this enormous growth will fall primarily on the developing countries and on existing cities which already lack adequate infrastructure and housing. Urban population in many developing countries is increasing at nearly twice the rate of overall population growth. By 1980, nearly one-third of the people in developing countries -- some 955 million -- will live in cities, which reflects more than a doubling of the urban populations of Asia and Latin America, and nearly a tripling in Africa. By the year 2000, about 44% of the people in developing countries are likely to be living in cities; Latin America has already passed that mark.

Urban population growth is the result of both the continuing high rate of population growth and substantial rural to urban migration. Much of the increase in urban population is occurring in the poorer segments; in some cities 50% or more of the population is living in squatter settlements and slums.

The potential for education, employment, economic and social development, and an overall improvement in the quality of life in urban centers is constrained by the lack of essential facilities and services (e.g. education, family planning, health, housing, sewerage, water, etc.), employment opportunities, and by the resulting vulnerability of people and places to physical disease and political and social dislocation.

As a matter of overall policy the Agency has given priority to rural development problems. However, the preponderance of Agency programs in urban development address the interdependencies between urban and rural areas; and AID's priority sector programs in education, family planning, health, and nutrition seek to improve the quality and outreach of national programs which include the delivery of essential services to poor people in market towns and small and intermediate-sized cities.

The objectives of AID in urban development are (1) to enhance the contribution of urban centers to regional and national development, and (2) to help create urban environments in which the poor will have the opportunity to overcome their poverty.

An important aspect of urban development concerns the productive use of the urban labor force to meet the basic human needs of the urban population, including the housing and infrastructure for the growing proportion of migrants. The extent to which that large and growing labor resource can be used to build and service the cities and the extent to which it has to be engaged in producing goods and services for the rural economy and the rest of the world will have a profound effect on the course of world economic and political development.

A major continuing focus of the Agency's urban development program will be on activities designed to realize the full potential for mutually profitable interchange between small and medium size urban centers and surrounding rural regions. The development of economic activity outside the metropole in these smaller towns and intermediate cities can also act as a catalyst to rural development. This approach will require technical assistance and training in urban and regional planning and management, as well as support of small and medium size enterprises that effectively utilize the resources of the region.

Programs to improve conditions of the poor in major urban centers may act as additional incentives to rural-urban migration and thereby tend to increase the magnitude of the urban problems the programs were designed to diminish. On the other hand, higher real urban wages may constitute a more important reason for attracting people away from the rural areas than improved physical environment. The main focus of AID efforts to assist the poor of major urban centers is likely to continue to be in countries where the major share of the population already resides in urban areas.

Whether major or minor urban center, our greatest interest will be in: (1) technical assistance and selective pilot support to help provide such essential services as potable water and sanitation, health care, and family planning; and (2) experimental technical, credit, and training assistance for household and small scale enterprise programs.

Research and development activities and field demonstrations are underway in small and intermediate-sized cities to increase employment and income for the poor through small-scale enterprise development and the provision of credit, job skills training and placement services, and marketing assistance.

On another level AID activities will be directed towards increasing AID's and developing countries' understanding and competence to deal with the great movements and changes which are inherent in the process of urbanization. Examples are research and development efforts and field tests which (a) study the causes and consequences of rural to urban migration and pressures on major urban centers; (b) analyze the impact of urbanization on lowering fertility rates and use this knowledge in population and other program development; (c) create guidelines and methodologies for identifying poverty groups and locations, analyzing their developmental potential, and designing projects to benefit them; and (d) develop planning processes and management tools, especially for smaller cities, which can be used in coping efficiently with the problems and opportunities of urbanization and development.

Integral to AID policy on urban development is the AID effort through the Housing Investment Guaranty program and other housing programs. (See AID Policy on Shelter, page 33.)

A.I.D. POLICY ON HUMAN RIGHTS

The protection and enhancement of internationally recognized human rights is a principal goal of United States foreign policy. It derives from the historical and legal tradition of the American people and the commitments of the United States, especially in the Charter of the United Nations, to promote universal respect for and observance of human rights and fundamental freedoms without distinction as to race, sex, national origin or religion. It is recognized as national policy by Section 502B of the Foreign Assistance Act of 1961.

The United States program of economic assistance, administered by the Agency for International Development, promotes human rights by helping the world's poor majority to meet their basic human needs and improve their opportunities for economic, political and cultural development.

The fulfillment of such basic human needs as food, shelter, health care and education for the world's needy people is essential to, and an integral part of, the protection and enhancement of all human rights.

As described by Secretary of State Vance, the human rights which the United States seeks to promote fall into three categories:

> First, there is the right to be free from governmental violation of the integrity of the person. Such violations include torture; cruel, inhuman or degrading treatment or punishment; and arbitrary arrest or imprisonment. And they include denial of fair public trial and invasion of the home.
>
> Second, there is the right to the fulfillment of such vital needs as food, shelter, health care and education. We recognize that the fulfillment of this right will depend, in part, upon the stage of a nation's economic development. But we also know that this right can be violated by a Government's action or inaction -- for example, through corrupt official processes which divert resources to an elite at the expense of the needy, or through indifference to the plight of the poor.
>
> Third, there is the right to enjoy civil and political liberties -- freedom of thought, of religion, of assembly; freedom of speech; freedom of the press; freedom of movement both within and

> outside one's own country; freedom to take part in government. (Address, University of Georgia Law School, April 30, 1977.)

These rights are complementary and mutually reinforcing. They are recognized in the Universal Declaration of Human Rights, which the United States helped fashion and which the United Nations approved in 1948.

In addition to efforts to assist the poor in meeting their basic human needs, under the "new initiatives in human rights" begun in 1976 and Section 116 of the Foreign Assistance Act, A.I.D. sponsors legal aid and other programs to help the poor achieve effective access to their civil and political rights.

The Agency may withhold or modify its assistance to disassociate the United States from a repressive regime. Development assistance, as well as the financing of agricultural commodities under Title I of P.L. 480, will be withheld from any government that:

> engages in a consistent pattern of gross violations of internationally recognized human rights, including torture or cruel, inhuman or degrading treatment or punishment, prolonged detention without charges, or other flagrant denial of the right to life, liberty and security of person, unless such assistance / or P.L. 480 agreement / will directly benefit the needy people in such country. (Section 116, Foreign Assistance Act; Section 112, Agricultural Trade Development and Assistance Act.)

In the case of countries which violate human rights, development assistance which directly benefits the needy may be continued to avoid penalizing the hungry and poor for the human rights abuses of their governments.

Security Supporting Assistance -- an economic instrument for promoting political and security objectives -- is withheld by statute from any country which engages in a consistent pattern of gross violations of internationally recognized human rights, unless extraordinary circumstances and national interests necessitate a continuation of such assistance.

An inter-governmental task force chaired by the Deputy Secretary of State is charged with ensuring coordination among the various departments and agencies of the United States Government on issues of human rights and economic assistance. A.I.D. participates in this group, and A.I.D. programs, as those of other departments and agencies, are reviewed by it on an ongoing basis.

AID POLICY ON LABOR

AID's labor policy is to encourage the legitimate rights of workers in the developing countries and to ensure that they share equitably in the economic and social benefits of development. It is essential that the fulfullment of workers rights and aspirations be reflected in increased employment opportunities, especially among the poor; improved levels of income and working conditions; programs of social security and employment protection. AID labor policy seeks to carry out in a practical fashion the following principles of the Universal Declaration of Human Rights:

-- Everyone has the right to form and to join trade unions for the protection of his interests.

-- Everyone has the right to work, to free choice of employment, to just and favorable conditions of work and to protection against unemployment.

-- Everyone, without any discrimination, has the right to equal pay for equal work.

Increasing the social and economic well-being of workers in developing countries and assuring that economic benefits of development are shared equitably require both enlightened development strategies oriented to employment and mechanisms by which workers may collectively protect their legitimate rights. Increasing productive and freely chosen employment opportunities in agriculture, industry and commerce is essential to economic growth and reducing poverty. It requires the enhancement of the occupational skills of the labor force and improvements in the organization of the labor market to permit the more efficient utilization of the labor force. Finally, AID labor policy objectives also focus on the development of labor intensive projects, the specific provision of jobs for the neediest workers and the integration of women, minority groups and rural workers into the labor force.

AID implements its labor policy by: 1) helping to strengthen free, effective, and well organized trade unions representing both urban and rural workers for the purpose of protecting their legitimate rights; 2) supporting Ministries of Labor in coordinating and improving working conditions; 3) incorporating labor factors and programs in USAID Missions' overall country plans; and 4) supporting efforts to increase the utilization of women in the labor force.

The Foreign Assistance Act of 1961, as amended, provides in Section 601 that "...it is declared to be the policy of the United States... To strengthen free labor unions..." Free and responsible trade unions, enjoying the right to engage in collective bargaining, help to improve the well-being of workers, help to assure the equitable distribution of income and act as a force for change on issues related to working conditions, human rights and family planning.

AID implements the purpose of the Act to strengthen free labor unions by supporting programs carried out by three AFL-CIO sponsored labor institutes: the American Institute for Free Labor Development (in Latin America), the Asian-American Free Labor Institute, and the African-American Labor Center. Among the achievements of these institutes are the development of trade union leaders through training programs, the construction of low-cost worker housing units, the development of vocational training programs, the establishment of farm cooperatives for purchasing farm equipment and marketing farm products, and the establishment of workers' health programs.

Ministries of Labor also have a vital role to play in protecting the wages, working conditions and security of workers as well as improving the employment and income conditions of the poor. AID can further implement its labor policy by supporting the efforts of labor ministries to develop and utilize the skills of the labor force, and to assure safe, secure working conditions and living standards which cover the basic needs of workers and their families. AID therefore gives special attention to Ministry programs related to wages, employment, employment standards, social security, skill training, labor statistics, and employment services.

USAID Missions implement AID labor policy by incorporating labor factors and programs in their overall country plans and development strategies. This provides the best means for furthering AID objectives regarding labor intensive development projects, providing jobs to the neediest workers and promoting the integration of women, minority groups and rural workers into the social and economic mainstream of the developing countries.

AID development programs also emphasize increasing the utilization of women in the labor force. Women throughout the world constitute a significant group which traditionally has been denied opportunities in training and employment. As one means of implementing this element of its labor policy, AID supports efforts to strengthen institutional and governmental agencies for women, such as womens commissions, women's bureaus, and the UN Regional Commissions.

AID Policy on Trade, Investment and Development

Trade and foreign investment play crucial roles in economic development. Trade allows countries to specialize in the production of those goods and services in which they have comparative advantage. Foreign investment allows recipient countries to supplement domestic savings, increase capital stocks and improve productive capacities, thereby increasing both incomes and employment.

The relative importance of trade, private capital flows, and concessional assistance varies among LDCs, depending upon their level of development. Low-income LDCs require concessional assistance to supplement their low export earnings, while more developed LDCs rely more on non-concessional private capital flows.

Exports are the most important source of foreign exchange for LDCs, accounting for 70 percent of total foreign exchange receipts of non-oil exporting LDCs in recent years. This contrasts with net bilateral official development assistance which accounted for five percent of total receipts. Sixty-five percent of total LDC exports go to the industrialized countries, whose trade policies and economic performance significantly affects the export prospects of the developing world.

Exports generate foreign exchange needed for crucial imports and encourate increased domestic efficiency and productivity necessary for long-term development. While some limited import substitution may be in the long-run interest of a developing country, experience has highlighted the benefits of open, export-oriented development strategies as against costly inefficiency of inappropriate import substitution policies often adopted by LDCs. The U.S. encourages policy reforms within LDCs aimed at market-oriented price policies and reducing levels of protection.

The well-being of the poor in LDCs can be advanced significantly by export-oriented trade policies in labor-intensive products. Employment generation is an important objective of a growth-with-equity development strategy. It requires trade, financial and exchange rate policies conducive to export growth.

Export-earning instability is a major problem for many LDCs. It results in part from having reliance on one or two major commodities for the bulk of their export earnings. International prices for these commodities tend to fluctuate greatly. Export-earning instability is being addressed in international negotiations under the auspices of UNCTAD's Integrated Commodities Program where a common funding arrangement for buffer stocks is being considered. Where feasible, the U.S. supports efforts to stabilize commodity prices in line with long term market trends. These efforts would supplement the IMF's Compensatory Financing Facility which assists member countries having export-earning shortfalls.

Industrial countries are the major market for developing country exports. As a result, industrial country trade policies and economic performances greatly affect LDC economies. The U.S. market is of particular importance to LDC exporters. The U.S. is the largest importer of developing country products, accounting for over 20 percent of the total. LDCs are also major markets for U.S. exports. Non-oil LDCs received 25 percent of total U.S. exports in recent years, ranking them ahead of the European Community, Japan, or Canada. LDCs are also important sources to the U.S. of certain agricultural and non-fuel mineral commodities such as tin, rubber, cobalt and manganese.

Exports and concessional capital are not, however, sufficient to finance capital imports needed to meet growth requirements. With the recent large LDC current account deficits, foreign private capital flows have become increasingly important to many LDCs. For example, in 1976, 20 percent of the external financing requirements of LDCs were met through Euro-currency borrowing. These aggregate figures obscure the high concentration of borrowing by a small group of middle income LDCs with the credit standing to secure private loans.

In addition to portfolio capital, LDCs receive significant amounts of direct foreign investment resources, particularly from the U.S. In 1976, the LDCs received direct investment flows from the U.S. which accounted for 45 percent of total U.S. direct foreign investment in that year. The total accumulated U.S. investment in the LDCs is as a result now equal to one-fourth of the total stock of U.S.

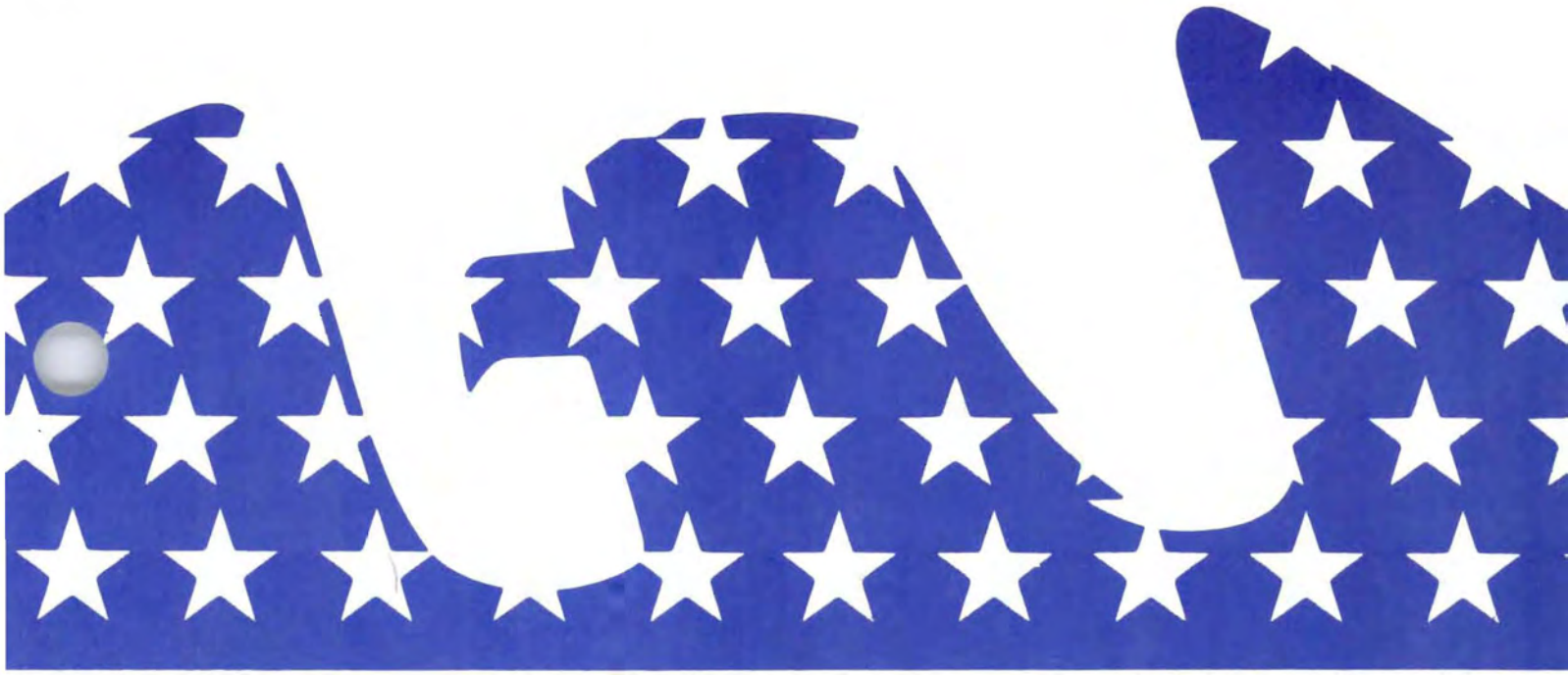
direct foreign investment. Such direct investment has resulted in the transfer of technology which further enhances LDC productivity. To encourage investment in LDCs, the U.S. has supported the programs of the Overseas Private Investment Corporation, the World Bank and other international institutions, particularly in the energy and natural resource sector, which would increase the attractiveness to both the investor and host country of direct financing investment.

II.I (TM 1:34)
11/9/84

POLICY DETERMINATION
Agency for International Development

PD-10 February 17, 1984

DEVELOPMENT COMMUNICATIONS



A.I.D.

POLICY DETERMINATION

DEVELOPMENT COMMUNICATIONS

EXECUTIVE SUMMARY

This Policy Determination provides guidance on the objectives and the conditions under which A.I.D. will support the fuller application of communications technologies in U.S.-assisted development programs. This guidance applies to all Development Assistance-funded programs and, unless otherwise authorized, to programs supported with Economic Support Funds. A.I.D. will seek to assist developing nations in using these technologies as tools in their own development programs and in making informed consumption and investment choices among the available technologies. A.I.D. will also make use of these technologies to reduce costs, extend services and information and increase the effectiveness of projects it supports in all sectors.

A. Summary Statement of Objectives

Communications technologies are powerful tools for development, with substantial potential for (1) reducing rural isolation, (2) increasing the productivity and effectiveness of economic and social development programs, (3) strengthening key private and public sector institutions, and (4) advancing the basic human right of people to have the information needed to make informed personal choices.

The priority for A.I.D. will be "development communications," defined as the application of existing communications technologies and media to problems of development. A.I.D. will also give attention to "communications development," defined as the development of new or additional communications infrastructure and capacity, but will not give priority to investments in infrastructure.

B. Summary Statement of Program Emphases

The emphasis will be on technical assistance and training to support the application of communications to problems of development.

While a substantial increase in support for communications activities is anticipated, A.I.D. does not expect to support communications as a distinct program sector. Most A.I.D. assistance to communications is expected to be as integral components of projects. However, A.I.D. will explore the potential of using communications in all sectors and will include communications components as integral elements of project design wherever appropriate and cost-effective.

C. Summary Statement on Support for Infrastructure

A.I.D. will limit direct investments in communications infrastructure development and will concentrate instead on technical assistance designed to ensure that infrastructure projects are effectively implemented and utilized (e.g., training for key technicians and managers, technical assistance to organizations making use of existing infrastructure).

Support for multi-purpose communications capabilities will be limited to those systems which serve primarily development purposes consistent with CDSS priorities. For example, rural telephony or radio systems may be appropriate for A.I.D. support where the general need to reduce rural isolation and facilitate transmission of information to and from rural areas is a priority strategic task. Other multi-purpose capabilities (for example, government or commercial printing operations, radio/TV broadcasting, journalism, post and telephone/telegraph systems) will generally not be considered appropriate.

D. Summary of Guidance on Program Management

A.I.D. development communications assistance will be primarily on a bilateral project basis. Projects with communications components should be anticipated in CDSS and ABS planning. A.I.D. will assist host country participation in international organizations or regional/international communications infrastructure only indirectly through national institutions and activities in A.I.D.-assisted member countries.

Regional and international activities not involving support for infrastructure, such as regional training programs and information exchange systems, may be supported through Regional or Central Bureau programs.

Priority activities for Central Bureau and Regional support:

1) support for USAIDs in pre-project assessment, planning and project design, and project evaluation.

2) training and information services for project and program managers on the use of communications technologies.

3) clearinghouse, network and resource base activities, including liaison with international communications organizations and programs;

4) selected research and development activities;

Activities which serve functions specific to a particular appropriations account will be allocated from that account and attributed in A.I.D. program summaries and reports to the relevant sector. Where large projects serve more than one sector, funding should be split between the accounts to the maximum extent feasible consistent with program management and orderly budgetting requirements. Communications activities of general relevance to all sectors may be funded from Section 105 Education and Human Resources or from Section 106, Special Development Activities.

PD-10
February 17, 1984

A.I.D.

POLICY DETERMINATION

DEVELOPMENT COMMUNICATIONS

I. Introduction

For most of the world over most of its history the main means of communication have been the human voice, the written word and various systems of signs and symbols. Over the past few decades additional communications systems which once seemed only remote possibilities have begun to be familiar in developing country towns and villages.

Radio and newspaper coverage has increased. One or both now reach most developing country towns and villages. Telephones and television are available in most of the larger cities. Satellite TV receiving stations are proliferating and telephonic communication systems (terrestrial, microwave and satellite) have begun to link institutions and individuals thousands of miles apart. Increasing use is made of video and audio recording equipment in training and extension systems. Microcomputers, photocopiers and other information technologies are beginning to be available in public and private sector offices.

Over the next decade there is every reason to expect declining costs, increasing availability and diversified application of these and related communications technologies. Communications capabilities will grow dramatically in some countries and much more slowly and unevenly in others.

The emerging technologies, and combinations of these with more familiar technologies, present both major opportunities and new problems throughout the developing world. They are powerful tools for development which can be used to enrich the development environment with diverse types and sources of information. However, they are only tools. Their potential impact on the processes of development depends on the problems to which they are applied and the relevance of the information being communicated. Extending information which is not fully relevant to people's needs or through channels which people do not trust to be factually correct and unbiased is likely to be a very expensive and relatively futile exercise at best and can seriously distort and impede the development process.

[For a summary of A.I.D.'s current activities in the area of communications, see A.I.D. and Development Commmunications, S&T/Office of Education, August, 1983]

A.I.D. has made extensive use of radio as a cost-effective means of extending information for diverse populations (e.g. rural mothers, farmers and primary school students) and diverse subjects (e.g. mathematics, agriculture, family planning and oral rehydration therapy for diarrheal diseases). A.I.D.-supported experimentation with both satellite and terrestrial telecommunications systems is helping to speed the exchange of developmentally important information and data over great distances and among multiple participants, linking research institutions and universities, facilitating technical and business teleconferencing. In short, the potential for using communications technologies to help resolve a wide range of development problems has been demonstrated. A.I.D. is in a strong position to provide further leadership, reflecting over a decade of experience with the experimental application of communications in development.

This Policy Determination provides guidance on the objectives and the conditions under which A.I.D. will support the fuller application of these technologies in U.S. development assistance programs. This guidance applies to all Development Assistance-funded programs and, unless otherwise authorized, to programs supported with Economic Support Funds. A.I.D. will seek to assist developing nations in using these technologies as tools in their own development programs and in making informed consumption and investment choices among the available technologies. A.I.D. will also make use of these technologies to reduce costs, extend services and information and increase the effectiveness of projects it supports in all sectors.

II. Objectives of AID Communications Assistance

A. Summary Statement

Communications technologies are powerful tools for development, with substantial potential for (1) reducing rural isolation, (2) increasing the productivity and effectiveness of economic and social development programs, (3) strengthening key private and public sector institutions, and (4) advancing the basic human right of people to have the information needed to make informed personal choices.

The priority for A.I.D. will be "development communications," defined as the application of existing communications technologies and media to problems of development. A.I.D. will also give attention to "communications development," defined as the development of new or additional communications infrastructure and capacity, but will not give priority to investments in infrastructure.

B. A.I.D.'s general objectives are:

1) to ensure the effective implementation of A.I.D.-supported projects and programs in all sectors. Communication of information is a key implementation objective for most projects and communications technologies are tools to be used in implementation;

2) to assist countries in making sound technical and policy decisions as they consider major investments in new communications capacities, establish public policy and administrative frameworks for communications systems and use communications in their own development programs.

3) to contribute to broad foreign policy objectives, including encouraging the development of communications systems in all countries which respect the principles of the free flow of information and maintaining U.S. access to valuable global communications resources such as frequencies and orbital slots. Ensuring that developing countries are able to obtain communications technologies and technical assistance to address their own communications needs contributes to these objectives.

C. More specific objectives include encouraging the use of communications and information technologies to:

1) Reduce the physical isolation of rural communities. Basic communications capacities such as telephones, newspapers and radio broadcasting as well as newer technologies such as electronic data transmission and satellite television change the social and economic dynamics of rural communities in indeterminate but powerful ways. As individuals and institutions become better able to obtain and share information outside their immediate community new personal and institutional relationships become possible, additional services become feasible, businesses can function as part of larger markets and the quality-of-life improves.

2) Diversify the types and amounts of information available to individuals, thereby increasing the ability of individuals to make informed personal choices. The fullest possible access to information by all participants is essential to the efficient functioning of competitive markets. Projects with major communications components should ensure that as wide a range of technical information and alternative viewpoints as possible is disseminated.

3)Diversify the sources and channels of information available to individuals and groups, thereby increasing the competition of ideas and the free flow of information. Project designers must select among the available options and most projects will make use of only one or two communication channels or media to serve a specific purpose or audience. Nevertheless, A.I.D. will stress the importance of diversifying information channels and facilitating the broadest possible access to existing communications media both in the selection of projects and in technical assistance for overall system planning and assessment.

4) Increase the productivity and effectiveness of economic and social development programs and projects in all sectors supported by A.I.D. by:

a) extending information and services cost-effectively to additional clients;

b) providing in-service training and other support services to field workers; and

c) strengthening administrative, logistic and management systems, using communications technologies to link dispersed components and field workers. Such linkages may help to reduce operational costs (staff time, transportation, administrative paperwork) even where no new functions are added.

5) Support private sector investment and entrepreneurship in communications-related activities. As communications capacities expand and diversify, a wide range of commercial services may emerge, both supplying goods and services to communications systems and adapting the communications capacity to new purposes. While A.I.D. resources will not be used for direct investment in or subsidy of private sector initiatives, private sector investment and entrepreneurship in communications-related activities may be supported through:

a) technical assistance, training and advisory services to the private sector;

b) utilizing private sector suppliers of communications goods and services needed for project implementation;

c) utilizing private communication channels where they exist (e.g. privately-owned newspapers) for disseminating project-related information; and

d) policy dialogue, technical assistance and training to assist countries in developing (1) public policy for communications and (2) administrative and technical support systems which facilitate competitive purchase of equipment and services, competitive sponsorship and ownership of communications media and access by private individuals and enterprises to publicly owned and managed telecommunications infrastructure.

III. AID's Development Communications Emphases

A. Summary Statement

The largest part of A.I.D. assistance to communications is expected to be as integral components of projects in each of the development sectors in which A.I.D. works. While a substantial increase in support for communications activities is anticipated, A.I.D. does not expect to support communications as a distinct program sector.

B. Discussion

Communications technologies have applications in all sectors. A.I.D. will explore the potential of using communications in all sectors and will integrate communications components in projects wherever appropriate and cost-effective. Means of using communications to accomplish program or project objectives should be considered along with other options during the initial planning and design processes. However, A.I.D. will not encourage the addition of communications components unrelated to sector strategies and project purposes.

Bilateral projects with the specific purpose of assisting communications as a sector or of strengthening communications institutions and infrastructure will be approved only when identified as a need in CDSS and related analyses.

Centrally-funded programs will continue to (1) support research, development and experimentation on selected aspects of communications, (2) facilitate international exchange of technical information and experience with communications applications and (3) provide technical support to missions in the design and evaluation of communications components for projects in all sectors. In addition, Central Bureaus will continue to be responsible for articulating Agency policy and strategy for development communications both internally and through liaison with other U.S. Government, international and private sector organizations with interests in communications.

C. Components to be considered include:

1) technical assistance to improve project implementation:

--design, planning and equipment selection;

--training for local project staff (technicians responsible for installation, operation and maintenance; content specialists responsible for software design and development; managers responsible for system planning, operations and evaluation).

--in-service training for project field workers as needed to provide them with skills to use communications technologies and processes effectively

2) equipment and commodity inputs to the extent needed as direct inputs to the assisted project

3) selected additions to communications infrastructure as needed to facilitate project objectives

4) partial support for operational costs of the communications component during the developmental or experimental phases

D. Project design and selection considerations:

1) support for development communications should focus on specific applications in functional sectors such as agriculture, education, health, nutrition and population.

2) the primary purpose of the communications activity should be developmental. While communications capacities will often have secondary purposes including entertainment and the dissemination of general information (e.g., newspapers and radio/TV broadcasting) the developmental impact of the increased communications capacities must be sufficient to justify A.I.D.'s investment independent of such secondary purposes.

3) where communications components are included as a response to an institutional constraint (e.g., fragmented authority) or as a substitute for other project inputs (e.g., as a substitute for improved textbook supply), economic and institutional analysis should examine the cost-effectiveness of the communications components as compared with other options for resolving the same constraint.

4) the entire range of communications technologies and media is appropriate for support. There is growing interest in the potential of advanced technologies such as satellite telecommunications and computer-assisted information processing. A.I.D. will support both research and development and project applications of these technologies. However, it will also continue to support both R&D and project applications of more familiar technologies such as radio and print, which have been demonstrated to be cost-effective in many applications and to have important technical advantages such as mobility, ease of maintenance and relatively less requirement of highly skilled technicians for implementation.

5) selection of appropriate communications technology should reflect a design process based primarily on the characteristics of the beneficiaries, their informational needs and the development objectives of the activity. Design processes based primarily on a desire to explore the potentials of the technology are inappropriate and can often lead to activities which are neither cost-effective nor developmentally relevant.

6) A.I.D.-supported development communications activities should be consistent with A.I.D.'s objectives of increasing decentralization and community participation in development decisions. Two-way or interactive communication systems (using interactive technologies or combinations of one-way technologies) which facilitate feedback from the receiving and using audiences and/or which enable individuals or groups to initiate their own messages and requests for information are generally to be preferred over one-way communications and extension systems. It is particularly important to ensure participation of and feedback from the intended audience(s) in the design of systems and in the ongoing development of programming and services.

7) the information and/or the communications components of the activity should be made as widely accessible as is technically feasible and cost-effective. They should contribute to a net increase in the quantity, diversity and quality of information to the primary beneficiaries (for most purposes defined as individuals in households and the productive workforce).

8) in general, the more limited the range of communications channels the greater will be A.I.D.'s concern for ensuring diversity and balance in the content. Where existing channels are closely controlled (whether by governments or by private factions and

special interests) such that developmentally important information is being distorted or ineffectively disseminated, A.I.D. will give attention to means of establishing additional or alternative channels.

9) Essential to the efficient functioning of competitive market economies is the fullest possible access to information by all participants. See items 6,7,8 above for guidance. Other means by which A.I.D.-supported development communications activities will support private sector objectives include:

a. assisting countries to establish public policies and administrative mechanisms for communications infrastructure which minimize public subsidy while encouraging diverse use and wide access.

b. ensuring that the private sector has access to information being disseminated through government channels, particularly information disseminated by A.I.D.-assisted projects.

c. ensuring that the private sector (both in the U.S. and in the assisted country) has opportunity to compete to provide project-related training, technical assistance and other communications goods and services.

d. including technical assistance directed to the LDC private sector to identify ways to use communications to improve productivity.

e. encouraging private initiatives in communications services such as privately owned and managed radio, printing and newspaper facilities as well as in the provision of goods and services to the communications sector.

IV. Guidelines for Infrastructure Support

A. Summary Statement

AID's development communications activities will limit direct investments in infrastructure development and will concentrate instead on technical assistance designed to ensure that infrastucture projects are effectively implemented and utilized (e.g., training for key technicians and managers, technical assistance to organizations making use of existing infrastructure).

B. Discussion

In most cases AID will not provide direct support for general purpose communications infrastructure such as telephone switching systems, radio or television broadcasting facilities, communications satellites and groundstations, postal or telegraph systems, printing and publishing industries.

A.I.D. fully recognizes the importance of such infrastructure. However, several considerations require A.I.D. to limit communications infrastructure investments in most countries.

--most missions do not have the resources to fund such infrastructure on the scale required, especially in view of the recurrent costs of operation and maintenance (See Recurrent Costs Policy Paper for additional guidance). Those missions able to commit the necessary resources should apply the same criteria as for other capital projects.

--other financing mechanisms (both conventional and concessional) exist for communications infrastructure, as for other types of capital infrastructure.

--in most countries, the government plays a major role in the establishment and maintenance of communications infrastructure. Typically, the government exerts a substantial amount of control over content of and access to such general purpose communications systems as radio/television broadcasting and government printing capacities. Any A.I.D. investment in strengthening such systems must be done with the greatest care and generally will be limited to those elements of infrastructure which must be added to enable specific activities in sectors assisted by A.I.D. to be implemented effectively or efficiently.

C. Guidance on Infrastructure Components

A.I.D. assistance for the development of communications infrastructure will concentrate on the provision of technical assistance and training to help countries (1) assess their technology needs both for specific sectors or functions and for entire communications systems, (2) plan for infrastructure expansion and (3) develop operational and maintenance skills for existing as well as new infrastructure. Technical assistance and training involving managers and decision-makers responsible for general purpose communications infrastructure will emphasize the transfer of skills and experience leading to more effective use of communications in the development process.

While capital assistance will be limited in most cases, technical assistance may be appropriate in selected cases in support of communications systems which address development constraints given priority in the CDSS. For example, rural telephone or radio systems may be appropriate for A.I.D. support where the general need to reduce rural isolation and facilitate transmission of information to and from rural areas is a priority strategic task. Other multi-purpose capabilities (for example, government or commercial printing operations, radio/TV broadcasting, journalism, post and telephone/telegraph systems) will generally not be considered appropriate.

A.I.D. financing for communications infrastructure investments generally will be limited to meeting specific project implementation requirements. This may include "add-ons" of specialized equipment or facilities to establish capacities for development activities additional to those normally provided by the existing system. For example, while in most cases AID would not provide capital or operational funding for a general purpose radio/TV broadcast capacity, it could justify additions to existing capacity (e.g., production studios, audio and video tape duplicating equipment, ground receiving stations) to enable developmental materials to be prepared for broadcast or received from broadcast signals.

V. Guidance on Program Management

A. Bilateral Assistance

A.I.D. assistance for development communications will be primarily on a bilateral project basis. This means that:

1) A.I.D. assistance should be anticipated in CDSS and ABS planning along with other assistance requirements, beginning with the submissions for FY 1986;

2) A.I.D. assistance should be limited to activities requiring investments or expenditures in or by the A.I.D.-assisted countries, and should exclude any A.I.D. financing of host country participation fees or membership contributions in international organizations or regional/international communications infrastructure and;

3) A.I.D. assistance for regional communications activities (e.g., regional telecommunications networks or regional satellites) should be implemented through national institutions and should support activities in A.I.D.-assisted member countries.

While assistance will be mainly on a bilateral basis, A.I.D. will continue to coordinate its research and development activities and otherwise to maintain close liaison with regional, multilateral and international communications programs (e.g. International Program for the Development of Communications), services (e.g INTELSAT and COMSAT) and administrative bodies (e.g. International Telecommunications Union).

B. Central Support Functions

In addition to the liaison functions described above, Central Bureau and Regional support for development communications activities will concentrate on technical support and backstopping for the bilateral development communications activities. Priority activities include:

1) support for USAIDs in pre-project assessment and program planning and in project design and evaluation. Central Bureau support functions should be structured to provide technical assistance to USAIDs for communications applications in all sectors.

2) training and information services for project officers and program managers in all sectors to keep them aware of technological advances and the potential for use of communications technologies. As A.I.D. encourages the fuller use of communications technologies, this will be an increasingly important central support role.

3) support for clearinghouse, network and resource base activities that emphasize cost-effective utilization of communications in support of AID program objectives.

4) support for selected research and development activities related to anticipated or potential communications applications and/or solution of recurrent problems in the cost-effective application of communications technologies in development;

C. Attribution by Funding Account and Sector

Funding for development communications activities will be according to the sector of primary application. Central and Regional Bureau support functions and communications activities of general relevance to all sectors (for example, the Communications Clearinghouse and the Communications Studies and Applications Project) will continue to be funded from Section 105 Education and Human Resources. However, centrally-managed communications activities which primarily serve one sector or functions specific to a particular appropriations account will

be allocated from that account and attributed in A.I.D. program summaries and reports to the relevant sector. Where large projects serve more than one sector or functions specific to more than one appropriations account, funding should be split between the accounts to the maximum extent feasible consistent with program management and orderly budgetting requirements. Where it is not possible or desirable to allocate funding to a functional account, funding under Section 106, Special Development Activities, should be considered. Similarly, projects funded under the Economic Support Fund or Sahel Development Program should be classified by purpose according to the sector(s) of primary application.

Approve _____

Disapprove _____

Date Feb 17, 1984

POLICY DETERMINATION
Agency for International Development

PD – 11

July 26, 1984

USING PL 480 TITLE II FOOD AID FOR EMERGENCY OR REFUGEE RELIEF

PD - 11
July 26, 1984

A.I.D.

POLICY DETERMINATION

USING PL 480 TITLE II FOOD AID FOR EMERGENCY OR REFUGEE RELIEF

I. Introduction

PL 480 Title II authorizes the President to determine requirements and provide agricultural commodities, on behalf of the people of the United States of America, ". . . to [*inter alia*] meet famine or other urgent or extraordinary relief requirements . . . and for needy persons . . . outside the United States."[1/] The Act further states that the President may furnish the commodities through friendly governments and private or public agencies, including multilateral organizations.

The United States historically has shared its bountiful food supplies with victims of natural disasters (such as floods, droughts, earthquakes and hurricanes) and has helped to avert starvation for victims of man-made problems (such as refugees from civil disturbances or armed conflict). This humanitarian food assistance has been provided as emergency or refugee relief without regard to the political philosophy of the government whose people receive the food aid.

Like all forms of PL 480 food aid, requests for emergency or refugee relief are reviewed and approved under established procedures set forth by the inter-agency Development Coordination Committee (DCC). A.I.D. chairs the PL 480 Title II sub-committee of the DCC. All program approvals require unanimity.

II. A.I.D. Policy

It continues to be A.I.D. policy to provide food aid for emergency or refugee relief requirements of needy persons without regard to the political philosophy of their government. The guiding principle underlying this policy is that a hungry child knows no politics. The desire is to mount a concerted effort quickly and decisively in response to a humanitarian need.

1/ Agricultural Trade Development and Assistance Act of 1954, as amended (PL 480), Sec. 201.

In determining the appropriate response to a request for such food aid, A.I.D. must take into consideration several factors including: (a) whether the food is to be provided through private or multilateral organizations, or on a government-to-government basis; (the provision of food on a government-to-government basis requires that the recipient government is "friendly" as defined in Section 103(d) of PL 480); (b) the nature of the emergency or other requirement -- including the need to provide food as quickly as possible; (c) the nutritional needs of the population affected; (d) the amount and type of food assistance provided by other international donors; (e) the logistical requirements of delivering the food to those in need; (f) whether or not there is reasonable assurance that the food will reach the intended beneficiaries, which may require on-site inspection by A.I.D. or an intermediary; (g) a determination that adequate storage facilities are available in the recipient country to avoid commodity spoilage or waste; and (h) a determination that the distribution of the food aid will not result in a substantial disincentive to or interference with domestic production or marketing.

In reviewing emergency or refugee food aid requests, A.I.D. must be sensitive to the enormous complexities associated with mounting an effective and timely response to urgent needs under uncertain circumstances that frequently require hard choices and immediate judgements. A.I.D. will review such requests to assure to the extent practical that the assistance is not a substitute for action which a responsible recipient government may need to take to assure adequate food supplies for its people, and that it will not create a dependency on further food aid shipments. At the same time, in deciding whether or not, or to what extent, to provide such food assistance, A.I.D. will endeavor not to penalize those in need of assistance for the politics of the government under which the people live.

The following additional factors will also be taken into account.

1. Emergency Situations. A.I.D. is reluctant to provide "emergency" food aid to help alleviate a chronic food-deficit situation that occurs year after year in the same country which in substantial measure is brought about by inappropriate government policies, since this reduces the resources available to respond to those emergency situations that are sudden and unanticipated. In such cases, the provision of emergency food aid should be linked to (but not necessarily conditioned on) a policy dialogue with the recipient country with the view to correcting the policies which bear significant responsibility for the chronic deficit. Emergency food aid provided in this fashion

(perhaps in part under Title II, Section 206 authority) can help to assure adequate availability of food in the future. In cases where the chronic food deficit is related to weather or natural resource constraints (in contrast to policy constraints), the provision of emergency food aid should be linked to (but not necessarily conditioned on) a dialogue concerning measures that might help to mitigate or ameliorate the problem.

2. Situations Involving Refugees or Displaced Persons. Under these circumstances, A.I.D. may provide food aid to those in need under government-to-government programs and/or non-government programs, whichever is appropriate.

Persons requiring emergency food aid may reside in a country which, while their own, is controlled by a government unsympathetic to their legitimate need for food aid; or they may reside in an area of that country which is not under government control. Provision of food aid on a government-to-government basis under these circumstances should only be considered where A.I.D. can be assured that the food will actually be delivered to those in need.

M Peter McPherson

M. Peter McPherson
Administrator

26 JUL 1984
Date

POLICY DETERMINATION
Agency for International Development

PD-3 September 1982

VOLUNTARY STERILIZATION

PD-3
September 1982

A.I.D. POLICY GUIDELINES ON VOLUNTARY STERILIZATION

I. OVERVIEW

The World Population Plan of Action of the World Population Conference of 1974 observed that: "All couples and individuals have the basic right to decide freely and responsibly the number and spacing of their children, and to have the information, education and means to do so ..."

The Foreign Assistance Act (FAA) of 1961 (as amended) reflects additional considerations:

(1) the process of economic and social development, which is in turn affected by the pace, magnitude and direction of population growth; and,

(2) in many LDCs high rates of population growth limit attainment of broader development goals, contribute to economic hardship and hazardous health conditions, and deny opportunities for improved quality of life for many parents and their children.

In carrying out a comprehensive population assistance program authorized by the FAA, A.I.D. has responded to the growing number of LDC requests for assistance and has helped to make the various methods of family planning permitted by our legislation available on a broader scale to the rural and urban population for use on a strictly voluntary basis.

More recently, LDC governments and non-government organizations have requested assistance to extend the availability of voluntary sterilization (VS) services.* Such requests are partially in response to the preparatory work conducted by various organizations which have received A.I.D.

*VS service programs included those activities which are primarily intended to provide voluntary male and female sterilizations to persons requesting this type of contraceptive procedure. For purposes of this discussion, however, VS training programs are included, since training generally requires that trainees conduct supervised procedures on patients who have voluntarily presented themselves at a service/training facility for sterilization.

support, including the Association for Voluntary Sterilization (AVS), the Pathfinder Fund, the International Fertility Research Program (IFRP), and the Johns Hopkins University Program for International Education in Gynecology and Obstetrics (PIEGO) as part of its broad program of advance training in obstetrics and gynecology. These organizations have contributed to significant advances in the development of new surgical techniques which make sterilization safer, simpler and less expensive as an outpatient procedure. They have developed specialized equipment and given LDC medical personnel specialized training in the practice of obstetrics and gynecology, including endocrinology, identification of cancerous conditions, maternal care, and the management of infertility and fertility, including sterilization procedures.

In providing support for sterilization services, A.I.D. must reaffirm its long-standing and complete commitment to the basic principle of voluntary acceptance of family planning methods and determine basic conditions and safeguards within which A.I.D. support for sterilization activities can be provided. These conditions and safeguards are needed because of the special nature of sterilization as a highly personal, permanent surgical procedure and to ensure that the needs and rights of individuals are scrupulously protected.

The official positions of national governments are mixed. While voluntary sterilization has become a basic part of comprehensive family planning services in many countries, in some there is only unofficial approval for action by non-government agencies while in other countries there is opposition to the method. A.I.D. staff and A.I.D.-funded grantees and contractors must be fully aware of national sensitivities and must receive AID/W and mission approval before making any commitments on commencing support for sterilization activities in any context.

II. General Guidelines

A.I.D. acknowledges that each host country is free to determine its own policies and practices concerning the provision of sterilization services. However, A.I.D. support for VS program activites can be provided only if they comply with these guidelines in every respect.

A. Informed Consent: A.I.D. assistance to VS service programs shall be contingent on satisfactory determination by the USAID (bilateral programs) and/or A.I.D.-funded grantees or contractors that surgical sterilization procedures, supported in whole or in part by A.I.D. funds, are performed only after the individual has voluntarily presented himself or herself at the treatment facility and given his or her informed consent to the sterilization procedure.

Informed consent means the voluntary, knowing assent from the individual after he or she has been advised of the surgical procedures to be followed, the attendant discomforts and possible risks, the benefits to be expected, the availability of alternative methods of family planning, the purpose of the operation and its irreversibility, and his or her option to withdraw consent any time prior to the operation. An individual's consent is considered voluntary if it is based upon the exercise of free choice and is not obtained by any special inducement or any element of force, fraud, deceit, duress or other forms of coercion or misrepresentation.

Further, the recipient of A.I.D. funds used all or in part for performance of VS procedures must be required to document the patient's informed consent by (a) a written consent document in a language the patient understands and speaks, which explains the basic elements of informed consent, as set out above, and which is signed by the individual and by the attending physician or by the authorized assistant of the attending physician; or (b) when a patient is unable to read adequately a written certification by the attending physician or by the authorized assistant of the attending physician that the basic elements of informed consent above were orally presented to the patient, and that the patient thereafter consented to the performance of the operation. The receipt of the oral explanation shall be acknowledged by the patient's mark on the certification and by the signature or mark of a witness who shall be of the same sex and speak the same language as the patient. Copies of these informed consent forms and certification documents for each VS procedure must be retained by the operating medical facility, or by the host government, for a period of three years after the performance of the sterilization procedure.

USAID Missions should note their responsibility to monitor A.I.D.-assisted VS programs -- whether such programs are funded bi-laterally or by A.I.D.-funded grantees or contractors -- to ensure continuing adherence to the principle of informed consent. In order to carry out this monitoring function effectively, all proposed programs -- either bilaterally funded or funded by A.I.D.-supported intermediaries -- shall be approved by the mission and AID/W prior to any commitment of funds or promise to commit funds for VS activities. In carrying out this responsibility, USAID staff should be thoroughly familiar with local circumstances and government administrative patterns and be able to communicate effectively with host country representatives.

B. Ready Access to Other Methods: Where VS services are made available, other means of family planning should also be readily available at a common location, thus enabling a choice on the part of the acceptor.

C. Incentive Payments: No A.I.D. funds can be used to pay potential acceptors of sterilization to induce their acceptance of VS. Further, the fee or patient cost structure applied to VS and other contraceptive services shall be established in such a way that no financial incentive is created for sterilization over another method.

D. Quality of VS Services: Medical personnel who operate on sterilization patients must be well-trained and qualified in accordance with local medical standards. Equipment provided will be the best available and suitable to the field situations in which it will be used.

E. Sterilization and Health Services: To the fullest possible extent, VS programs -- whether bilaterally funded or conducted by A.I.D.-funded private organizations -- shall be conducted as an integral part of the total health care services of the recipient country and shall be performed with respect to the overall health and well-being of prospective acceptors. In addition, opportunities for

extending health care to participants in VS programs should be exploited to the fullest. Consideration must also be given to the impact that expanded VS services might have on existing general health services of the recipient country with regard to the employment of physicians and related medical personnel and the use of buildings or facilities.

F. Country Policies: In the absence of a stated affirmative policy or explicit acceptance of A.I.D. support for VS activities, USAIDs should take appropriate precautions through consultation with host country officials in order to minimize the prospect of misunderstandings concerning potential VS activities. In monitoring the consistency of A.I.D.-supported VS programs with local policy and practice, USAIDs and A.I.D.-funded donor agencies shall also take particular note of program activities among cultural, ethnic, religious or political minorities to ensure that the principles of informed consent discussed under "A" above are being observed and that undue emphasis is not given to such minority groups.

M. Peter McPherson

SEP 1982

Date

Addendum to PD-3
September 1982

Additional A.I.D. Program Guidance for
Voluntary Sterilization (VS) Activities

1. INTRODUCTION: The previously provided Policy Determination No. 3 (PD-3), remains in effect. However, in light of several years experience, additional clarification of a number of points relating to the application of PD-3 and specific interpretation of its provisions appears to be needed.

2. APPLICABILITY OF PD-3: PD-3 states (page 2) "A.I.D. support VS program activities can be provided only if they comply with these guidelines in every respect". This means that the provisions of PD-3 must be applied if A.I.D. funds are used for whole or partial direct support of the performance of VS activities. However, as also noted in PD-3 (page 2), A.I.D. acknowledges that each host country is free to determine its own policies and practices concerning the provision of sterilization services". The provisions of PD-3 do not apply if A.I.D. provides support for population and family planning programs within a country and provision of VS services is not called for in the support agreement, i.e. VS activities may be a part of the host country's program, but A.I.D. funds are not used to support such services. For example, if A.I.D. support for VS program activities is geographically confined to particular parts of a country, PD-3 applies only to those areas with VS program activities supported by A.I.D. PD-3 does not apply if activities and projects are only peripherally related to provision of VS services, for example, A.I.D. support for construction of multipurpose buildings or broad-based training in reproductive health which includes VS techniques. Finally, in A.I.D.-supported population and family planning programs in host countries which use A.I.D. funds for activities other than VS and support VS activities with their own or other non-A.I.D. funds, PD-3 does not apply.

3. INFORMED CONSENT: The recipient of A.I.D. support used fully or in part for performance of VS procedures must obtain and document voluntary informed consent as part of the conduct of any VS procedure. A.I.D. does not require any specific format for this procedure. However, the elements of the procedure described in PD-3 (i.e., an explanation of the nature of the procedure, the attendant risks and benefits, availability of alternative methods of family planning, that the procedure is irreversible, and that the patient may withdraw consent) all must be part of the process of obtaining informed consent.

4. METHODS OF PAYMENT: All acceptor and/or provider payments in cash or kind beyond VS service costs as well as fees charged for VS and other contraceptive services shall be established in such a way that no financial incentive is created for sterilization over another contraceptive method.

(A) Payment of Acceptors: It should be noted that guidance differs for payments which may be made to acceptors of VS as contrasted to payments to providers of VS (guidance applicable to providers of VS services is described in para 4.B below). As stated in PD-3, para C, page 4, "No A.I.D. funds can be used to pay potential acceptors of sterilization to induce their acceptance of VS". Further, A.I.D. support generally cannot be provided to VS services which include incentive payments paid to potential acceptors. For example, a VS program supported by A.I.D. cannot be supplemented with acceptor incentives to induce acceptance of sterilization services. Determination of what constitutes an incentive must be made locally based on thorough knowledge of social and economic circumstances of potential acceptors. In general, recompense to acceptors for legitimate, extra expenses related to VS program services such as transportation, food during confinement, medicines, surgically related garments and dressings an the value of lost work are not considered incentive payments and are eligible for A.I.D. support. It should be emphasized that these payments must be of reasonable nature and aimed at making VS services equally available at the same cost as other contraceptive services. For example, payment for lost work must correspond to a reasonable estimate of the value of lost labor over a reasonable duration of convalescence.

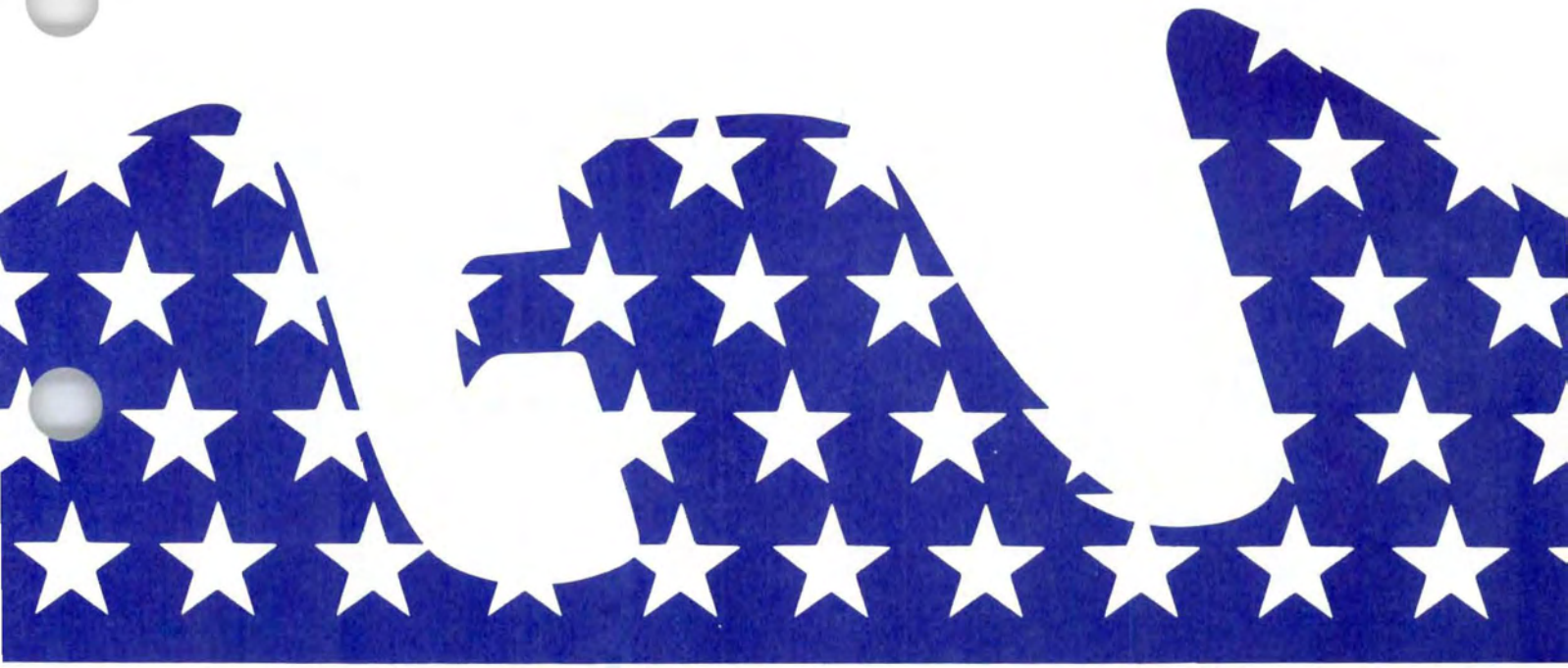
(B) Payment of Providers of Services: In light of experience, it seems desirable to modify the previous A.I.D. program guidance relating to reimbursement for VS services as defined in AIDTO Circular 393 (10/27/77), page 6, section 3, "operating service costs", para. 4. The suggested prohibition of reimbursement to providers of VS services on a per-case basis has not proven practical in that payment per case or procedure is the time-honored method of paying for surgical procedures both in developed and less developed countries. Reimbursement of physicians, paramedical and other service personnel on a per-case basis can be an acceptable procedure. Compensation to providers for items such as anesthesia, personnel costs, pre and post-operative care, transportation, surgical and administrative supplies, etc., on a per-case basis is also generally acceptable. These payments to providers must

be reasonable relative to other medical and contraceptive services provided so that no financial incentive is created for the providers to carry out VS procedures compared to provision of other methods of family planning. As in the case of payments to acceptors, this is a judgment which will have to be made on a country and program specific basis. However, in both cases, AID/Washington will provide assistance and guidance in making such determinations, and decisions relating to application of PD-3 should be submitted to AID/Washington for review. Even though payment on a per-case basis is often customary, A.I.D. Missions are advised to encourage patterns of service delivery and methods of payment which do not unduly emphasize VS procedures compared to other methods of fertility control. For example, if physicians who carry out the surgery are paid on a per-case basis and they have no role in the selection or counseling of patients, these service providers cannot induce additional patients to accept sterilizations over other contraceptive methods. Payments of physicians on a per-session rather than a per-case basis may also serve the same function. Since payments on a per-case basis do raise questions, often of a complex nature, beyond those raised by other types of compensation, where a mission can persuade a government to use such other frameworks for payment, whether immediately or phased-in, it should do so.

IV.C (TM 1:34)
11/9/84

A.I.D. Policy Paper

BUREAU FOR PRIVATE ENTERPRISE POLICY PAPER



U.S. Agency for International Development
Washington, D.C. 20523

May 1982

IV.C (TM 1:34)
11/9/84

A.I.D. Policy Paper

Bureau for Private Enterprise Policy Paper

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523
May 1982

PREFACE

The A.I.D. policy paper "Bureau for Private Enterprise Policy Paper" describes the program strategy and program processes of the Bureau for Private Enterprise (PRE). The paper was drafted by PRE, thoroughly reviewed in A.I.D./Washington, and approved by the Administrator. It is being issued as an A.I.D. policy paper by the Bureau for Program and Policy Coordination.

TABLE OF CONTENTS

	Page
I. Goals of the Agency's Private Sector Initiative	1
A. Program Rationale	1
B. Objectives	1
C. The Program as a Response to Policy & AID's Congressional Mandate	2
D. Challenges Facing the Agency's Response to Policy	2
E. Role Models for the Agency's Program	2
F. Role for AID Among Other Agencies' Related Programs	3
II. PRE Program Strategy	3
A. Target Countries and Sectors	4
B. Investment Modes Considered	5
(1) Cofinancing with Commercial Banks	5
(2) Financing the Interest Rate Differential	5
(3) Convertible Debentures	6
(4) Subordinated Debentures	6
(5) Guaranties — Reserve Fund	6
(6) Equity Investment	6
(7) Stock Options	6
C. Investment Selection Criteria	7
D. Investment Reconnaissance Missions	8
E. Technical Advice and Assistance	8
(1) Project Related Technical Assistance	8
(2) Policy Advice to Improve the Investment Climate	8
(3) Managerial Training	8
III. Program Roles and Process	9
A. Overview of PRE Private Sector Roles	9
B. Relationships with Other Central Bureaus	9
C. Project Identification and Development	10
D. Project Appraisal and Authorization Process	11
E. Project Implementation Process	11
F. Policy Development and Evaluation	12
G. PRE Relationship with External Parties	13
IV. Program Funding	13
A. FY 82 Funding	13
B. FY 83 Funding	14
C. Long-Term Budget Strategy	14

I. Goal of the Agency's Private Sector Initiative

The goal of the Agency's new private sector initiative is to foster the growth of productive, self-sustaining, income and job producing private sectors in developing countries using the financial, technological, and management expertise of the U.S. private sector, indigenous resources, multilateral institutions and Agency resources where appropriate. The Bureau of Private Enterprise (PRE) was established by the Administrator to take the lead for the Agency in providing this new initiative.

A. Program Rationale

The initiation of an AID program intended to harness private sector resources for development purposes is based on a multi-faceted rationale.

Developing countries are, by definition, short of capital and management expertise. Those nations which have encouraged private sector development, both indigenous and from abroad, have generally achieved more rapid, sustained and developmentally sound economic growth than those which have not.

Indigenous private enterprises, responding to profitable opportunities, produce jobs, foreign exchange, and a managerial and technical skill base. These by-products of profit-making enterprises are an essential complement to meeting basic human needs in developing countries. Investment opportunities are created in the first instance by markets and trade. There is a strong link between U.S. trade promotion programs such as those offered by Commerce, the Trade and Development Program (TDP) of A.I.D. and the trade policy of the U.S. Government and PRE's engaging the U.S. business community more actively in private sector development in developing countries.

The U.S. private sector has much to offer as a partner in, if not a direct instrument of, officially provided U.S. foreign assistance. It has the capital, technology and management expertise which host country enterprises need. It has demonstrated success globally in making these transfers. It is well motivated, fast to act, and results-oriented. And, U.S. private sector trade and investment activities are increasingly gravitating to the third world. Private sector development in developing cour .ies assisted by AID will accelerate and sustain this trend.

If the Agency can facilitate business relationships and ventures between the U.S. and indigenous private sectors in developing countries, the Agency can increase the likelihood of private sector investments in projects which meet developmental, as well as business objectives. To the extent the Agency can facilitate business ventures which are profitable to U.S. enterprises and developmentally oriented, it can extend the Agency's limited resources and build up a new U.S. constituency in support of the AID program. The International Finance Corporation (IFC) has achieved substantial leverage of official resources and support for its aid programs. The general approach and specific techniques have been proven by this organization over many years. What remains to be done is to adapt them to AID programs and priorities, the U.S. business community and its prospective partners in selected countries.

B. Objectives

After a thorough examination of pertinent development issues, the tools at hand, and direction from the Administration and the Congress (see Section C, below), the PRE Bureau translated the program's goal into the following objectives:

1. In association with host country, international financial institutions, and U.S. private investors, assist in financing the establishment, improvement and expansion of productive, developmentally desirable private enterprises in priority sectors in developing countries;
2. Bring together investment opportunities in developing countries, U.S. and host country capital and experienced management, thereby transferring technical, managerial and marketing expertise from the U.S. to the developing countries;
3. Stimulate and help create conditions conducive to the flow of U.S. and host country private capital into productive investments in priority sectors in developing countries.

Based upon Agency experience and observations of other entities committed to similar objectives, the Agency can act in the following ways in carrying out the above objectives:

— Facilitate or undertake in developing countries private sector project identification, development, promotion, packaging and financing;
— Help to establish, finance and improve privately owned development finance companies and other financial institutions which will provide the capital and management expertise for the development of the private sector in developing countries;
— Make investments, in forms appropriate to the situation, in individual productive private enterprises in developing countries;
— Encourage the growth of capital markets in the developing countries;
— Provide counsel to host countries on how to create a climate conducive to the growth of private investment;
— Create in the capital-exporting countries interest in portfolio investments in enterprises

located in the developing countries;
— Help to establish training institutions and programs, both managerial and technical, to support private sector development and business relationships and ventures between the U.S. and LDC private sectors; and
— Promote, and where appropriate, finance business relationships and ventures between U.S. and LDC groups and associations with similar private sector interests and concerns.

An essential organizational initiative for AID to accomplish these objectives was the creation of PRE, a central bureau, responsible to the Administrator, to focus on new private sector activities for the Agency. This will require new modalities of operations and procedures and risk taking in the new Bureau. The Administrator also believes that private sector thinking and programs must be promoted Agency-wide. PPC will coordinate this effort, in close consultation with PRE. Private sector programs are fully consistent, indeed complementary, with AID's current activities.

The past several months have indicated widespread Agency and U.S. business interest in the private sector approach, but the most difficult challenge inside the Agency is to make it work in the Agency's main stream with central bureau stimulation, facilitation, and support.

C. The Program as a Response to Policy and AID's Congressional Mandate

The Program's objectives are firmly rooted in Administration policy. In his October speech to the World Affairs Council in Philadelphia, the President detailed his ideas about economic development in the Third World. He emphasized the importance of economic freedom in national development and human progress—freedom to make decisions without overpowering government intervention; freedom to sell a product in the world market; and freedom of access to capital, as well as the expertise and skills needed to produce. In the developing world, the governments which have adopted and sustained the policies and business environment which encourage private initiative at home, private investment from abroad, as well as competitive pricing policies, are those which have enjoyed a relatively high rate of economic growth, in spite of worldwide recession.

This theme of U.S. foreign assistance policy was underscored in the President's comments at the subsequent Cancun meetings, and also in the Administrator's testimony given to the Subcommittee on Trade, Productivity and Economic Growth of the Joint Economic Committee on October 19, 1981.

The program's goal is also clear in several portions of the Agency's Congressional mandate. Section 601 of the Foreign Assistance Act, for example, directs the Agency to make the maximum use of private sector expertise and other resources, and to help forge effective cooperation between the American and indigenous private sectors. Over the years, AID has responded with a variety of programs, such as intermediate credit institution-building projects, housing guaranties, and investment promotion assistance. Some of these are among the Agency's most conspicuous successes. And, existing authorities can go a long way to meeting the objectives of the Agency's present private sector initiative.

D. Challenges Facing the Agency's Response to Policy

Even though private sector-related projects are not completely foreign to the Agency, AID faces several significant challenges in redoubling its efforts to make the private sector a more potent development force in developing countries. These challenges include:

— The limited amount of existing AID expertise in such critical areas as business management, private sector finance and marketing, cofinancing with commercial banks and packaging and brokering private sector business opportunities;
— Limited contact with U.S. firms and banks, and therefore little knowledge of how they work and on what basis they invest;
— Limited knowledge of the capital and marketing needs of, and desirability of foreign partnerships for, indigenous private firms in host countries;
— The lack of established policies and procedures within the Agency for identifying, developing, approving and implementing developmentally oriented private sector projects in a timely manner; and
— Limited recent experience in counseling host governments on how to improve the conditions for increased domestic and foreign private investment.

E. Role Models for the Agency's Program

One of the largest and most successful mechanisms to leverage foreign assistance funds and efforts directed at indigenous private enterprise is the program of the International Finance Corporation (IFC). Proven in 25 years of operation, the IFC has enabled the formation of almost $18.5 billion in total investment in their enterprises with an IFC investment of about $4.1 billion. Financial leverage to this degree—attraction of an additional four dollars for every one dollar originally committed—is essential for the

U.S. to meet its economic development aims in the current budgetary environment.

Most of the industrialized countries have officially supported agencies which seek to harness their own private sectors to provide not only capital, but also technical and managerial know-how to private enterprises in developing countries. They not only use some of the investment banking and venture capital approaches to satisfy the financial requirements of indigenous private sectors, but also play a catalytic role to assemble a financial "package" (in some cases where they do not invest at all) and to facilitate the transfer of technical and managerial expertise. We are interested in these models to the extent that they do not abuse mixed credits for export financing. Mixed credits will be considered in a separate Agency paper.

F. **Role for AID Among Other Agencies' Related Programs**

The intended shape of the program is compatible and complementary with those of other internationally-concerned agencies. With respect to the Overseas Private Investment Corporation (OPIC), the fit is particularly good. OPIC's customer base consists of U.S. corporations seeking investment in the developing world, while AID's "customers" are host countries, whose private sectors need capital and management expertise for their investment. OPIC's investment promotion tools, primarily political risk insurance and loan guaranties for U.S. firms complements the various debt instruments which the Agency will use for indigenous firms and institutions for developing countries (see Section II, B). And AID's overseas presence can serve not only AID's needs with respect to this program, but also OPIC's needs to a greater extent than at present.

The Agency's private sector initiative also complements the activities financed by the U.S. Export-Import Bank (EXIM). Many of the goods required by enterprises which receive AID and U.S. private sector and multilateral investment are prospective purchasers of U.S. industrial goods and services. Exim Bank export financing can potentially play an important role in equipping, modernizing and expanding these local firms.

The Agency's private sector program also fits well with the programs of IFC and World Bank. U.S. involvement in the former can be expected to be more active than in the past because the new AID program is also targeted on indigenous private enterprise and will seek to expand official and private U.S. investment in them. Both IFC and AID are interested in advising LDC governments on the investment climate and establishing intermediate financial institutions for private sector development. But IFC has limited technical assistance money which AID can supplement. Also, it is likely that AID's efforts will focus on some sectors which recently have constituted a relatively small percentage of IFC's resources (e.g., agribusiness), thus further complementing that institution's activities. Because the World Bank is actively seeking to expand its cofinancing program with commercial banks, the new AID program is likely to reinforce its success by drawing together World Bank, AID, and U.S. bank investment funds.

II. **PRE Program Strategy**

PRE was established to develop and experiment with *new* initiatives and modes of operation for the Agency in private sector development and to support and supplement where appropriate, the private sector development programs of the AID missions and other central and regional bureaus. Using funds allocated to it, PRE intends to make three types of investment in host country private enterprise:

— Cofinancing with commercial banks and other financial institutions, such as IFC, in appropriate highly developmental projects;
— Capitalization of privately owned intermediate financial institutions which serve the private sector; and
— Direct investment in selective agribusiness, industrial, leasing or other business ventures in developing countries where replication by other enterprises, both indigneous and U.S., would greatly facilitate private sector development in host countries.

This kind of investment activity translates into three categories of functional activity which will be pursued in conjunction with other central and regional AID bureaus as appropriate:

— Identifying and screening investment opportunities, developing them for appraisal, and reviewing them for authorization for an AID investment;

— Facilitative activity ("packaging") where AID acts as a catalyst to assemble the parties involved and to obtain funding from other sources, such as the IFC; and

— Advice and technical assistance of three types:

— To host governments to improve the climate for investment by (1) removing barriers such as undesirable limitations on capital and profit repatriation, tax disincentives for private investment or (2) by establishment of financial intermediaries to tap and channel savings into investments;

— To prospective investment partners (e.g., indigenous enterpreneurs, U.S. firms, and multilateral institutions) to develop projects in a specific way for AID to consider them for investment or packaging; and

— To public and private host country institutions to build investment "infrastructure," such as securities markets, and to provide managerial training to serve the indigenous private sector.

These three activities are not only inter-related, but also mutually reinforcing. For example, to the extent that PRE is successful in improving the conditions for investment it will be drawn to look for specific project opportunities. And, the skills applied and contacts developed are largely the same for both investment-only and packaging situations. The sections following discuss the principal elements of the recommended approach for all three activities.

A. **Target Countries and Sectors**

Not all countries are prepared or of sufficient importance to U.S. foreign policy for this program activity. Moreover, Agency's resources make the prudent course a selective one.

The long-range operation of the program should allow, however, for the expansion of countries which fit the necessary criteria (see below). AID should identify these potential countries and consider assisting the host governments to further improve conditions for private sector development.

The criteria used to select host countries that will receive the initial attention of the PRE's private sector program were:

— Existence of a viable private sector which is encouraged and supported by the host government;

— Strategic and commercial importance to the United States; and

— Presence of an AID mission.

The set of initial countries selected includes neither the middle income class of developing nations, such as Brazil or Taiwan, nor the very poorest. Nor does it include countries dominated by government-managed economies.

The initial targeted countries for FY 82 and FY 83 are:

— Indonesia
— Sri Lanka
— Thailand
— Pakistan
— Egypt
— Ivory Coast
— Kenya
— Zimbabwe
— Jamaica
— Costa Rica

In terms of existing AID programming and budgetary classification, the set of countries reflects a mix of Development Assistance and Economic Support Fund programs. Their needs for private sector development also differ. For example, investments in Jamaica should be particularly pointed at the pressing needs for job creation and the country's critical foreign exchange shortage. Investment in Thailand, on the other hand, should key on the need to upgrade the value-added component of industrial and agricultural products.

This leads to consideration of sectoral priorities, which will also vary, by country. Initial thinking has resulted in the selection of the following as worthy of immediate consideration:

— Agribusiness
— Intermediate credit institutions and other elements of indigenous capital markets
— Leasing of capital equipment
— Manufacturing
— Management training

Agribusiness heads this list for good reasons. The Agency has considerable experience in this field, and it deserves the top development priority in many of the target countries. In addition, the President's remarks following the Cancun meetings placed a very high degree of importance on the transfer of U.S. agricultural expertise to the developing world.

Establishing and investing in intermediate financial institutions is another priority activity because of the Agency's extensive experience and success with this type of project. However, this experience has to be extended to cover other mechanisms for developing and transferring capital. Those under active consideration include venture capital and investment banking entities in addition to conventional development and export finance banking. When appropriate, the creation and development of local stock and financial market institutions, with expert U.S. technical assistance, will be undertaken.

Leasing can be expected to be valuable in situations where equipment and machinery are needed, but where local enterprises are unable to finance the purchase price of large ticket items. Leasing can lead to a greater transfer of technology than an outright purchase because lease agreements may contain "trading up" provisions providing for the replacement of outdated equipment with technically superior or more appropriate models. Leasing companies are able to spread more capital goods over a broader private enterprise base thus leveraging capital. Leasing can also contribute to the development and growth of local manufacturing and processing industries.

Manufacturing investments could cover a broad spectrum of ventures to address particular countries' raw materials, labor, and market potential. For these investments substantial employment generation and technological improvements will be sought.

Managerial training is a critical need in all of the target countries. PRE's intention is to invest in training programs that are self-sustaining through fees, contracts and private sector contributions. Unlike other management training programs being carried out by missions and the other central bureaus, PRE intends to support primarily the development and operation of private sector oriented, advanced management, M.B.A. programs and management and advisory services as an adjunct to services provided by private sector intermediary financial and training institutions. These would be on an in-country basis with fees or tuition covering the operating expenses and debt on capital costs. PRE plans to set aside money in FY 82 for advisory and capital assistance to identify and develop private sector management training programs in the targeted countries.

B. **Investment Modes**

By making selective investments itself, rather than just facilitating others' investments, PRE and AID gain the following advantages:

— Increased influence over the nature and extent to which the invested funds serve specific developmental aims;

— Increased standing with others whose financial participation is necessary;

— Increased likelihood that AID "seed money" will position the recipient venture to attract others' capital; and

— Increased expertise and contacts which will enhance the Agency's ability to package projects and provide investment-related technical assistance.

In order to be able to pursue a range of investment opportunities with satisfactory development benefits and to meet a variety of other investors' requirements, PRE will have to be equipped with a variety of investment methods and financial requirements. Irrespective of the investment modes, the principal risks and decisions must be assumed by the private sector partners. As discussed below, several of the many investment approaches investigated by PRE can be undertaken with existing authorities, while others would require new authority. A sufficient range of methods and instruments is available under existing authority. While these consist of concessional loans and other forms of debt, their new applications, in a few cases, require a policy decision to permit PRE to proceed.

1. **Cofinancing with Commercial Banks**—The chief advantage of this approach is the financial leverage it achieves. PRE would make loans to private businesses and new ventures or financial intermediaries involved in developmentally beneficial projects in host countries either in parallel or jointly with commercial lenders. PRE and the other party(ies) would establish their respective terms, determining the current maturities, interest rates and grace periods. The leveraging of AID's funds would be achieved in two ways; reducing the level of AID's participation in a particular project (which AID would finance in any event) thereby increasing the number of projects A.I.D. could finance, and increasing the number of projects financed by commercial banks. Although cofinancing has its concessionary aspects, it is not the same as "mixed credits" which are applied liberally by other donor countries to finance exports. As suggested above, a separate paper on the distinction between export financing and mixed financing of development projects, is currently being prepared.

In addition AID, by taking the longer maturities or providing funds at less than market interest rates, could not only attract cofinancing with commercial banks but decrease the debt service load on the country or enterprise business. AID has some experience in cofinancing with multilateral institutions and other bilateral assistance agencies. The biggest challenge will be to learn how to market cofinancing opportunities to commercial lenders and meet their technical and legal requirements. PRE will take the lead for the Agency in working out these initial agreements.

2. **Financing the Interest Rate Differential**—This is a specialized type of cofinancing or parallel financing. Like the basis form, it is intended to increased the amount of capital available to the borrower or local firms while lowering its cost. However, it differs in that in a cofinancing arrangement the AID loan would be a long term commitment and part of the main financial package. Financing the interest rate differential is required in those cases where capital is available, but because of risk consideration or market conditions would only be available at prohibitively high interest rates. AID, by providing concessional funds, can lower the effective interest rate and make possible the influx of needed capital.

Financing interest rate differentials takes three basic forms. One is for PRE or AID to make a grant or concessional loan at the same time as a

commercial bank. In this case, financing the interest rate differential is made "up front" in a one-time transaction. The second form is simply for PRE to continue financing the interest rate differential of the commercial loan during its entire term. In this case, financing the interest rate differential has less of a budget impact than financing part of the project directly, and the budget impact is spread over many years. A third form is to sell part of PRE's debt portfolio to a commercial bank, and pay the difference in what was charged the borrower and what the commercial bank requires. (This would only make sense if PRE has a revolving fund and could roll this money over indefinitely to finance additional projects.) When AID decides to subsidize interest rates, care must be taken to not encourage investment which could not survive over the medium and long term without this subsidy.

3. **Convertible Debentures**—Convertible debentures are debt instruments which are convertible to equity. Initially debt instruments, they generally pay some interest during the period before they are converted to equity shares. PRE could grant or lend money to a private entity, take convertible debentures in return, and hold them during the period of greatest risk to the venture—say the first 3-5 years, or until the company or financial intermediary began to show a profit. After that time, PRE could sell the debentures to private investors at a price which reflected their worth. In this way, the use by PRE of convertible debentures benefits private enterprise both in the developing countries, by providing capital, and in the U.S. or in the developing country, by providing investors an opportunity to purchase interests in enterprises after the period of initial risk. It also contributes to the formation of local capital markets, another PRE objective.

AID has the authority to make loans to developing countries and then sell the portfolio of loans it has made to commercial or investment banks. This transaction is similar to selling convertible debentures—basically AID can acquire and sell instruments or indebtedness.

4. **Subordinated Debentures**—Subordinated debentures are debt instruments which are subordinated to other debts of the same party, and therefore are paid only after the more "senior" debts are paid. In this respect, subordinated debentures are somewhat similar to an equity investment, in that the capital involved is initially at very high risk. Although there is no appreciation potential in subordinated debentures as there is in equity investment, the risk that the subordinated debt will not be paid becomes smaller as the debtor companies become more profitable.

5. **Guaranties—Reserve Fund**—This form of debt-related investment involves a contingent liability other than an initial capital outlay. PRE would not provide funds to an indigenous private firm or financial intermediary, but would guaranty that the firm or financial intermediary will repay its borrowed funds to lenders who do make such loans. This can be a potent inducement to banks and other lenders to make loans to enterprises that can offer such a guaranty.

At present, AID has authority to guaranty promissory notes and convertible debts, but lacks a specifically authorized reserve fund with which to back up such guaranties. Congressional action would be necessary to permit PRE to set up such a fund. At an appropriate time, PRE will request the Administrator to seek such authority from Congress.

6. **Equity Investment**—Holding equity in a firm or financial intermediary would offer to PRE larger influence over the firm's strategy and operations, and would also permit more extensive leveraging of its funds than a loan. Its most likely application is to capitalize intermediate financial institutions. The Agency lacks authority to purchase equity securities. One reason for this restriction is to prevent PRE from holding voting shares in a company and being required to make management decisions and sit on the board of directors. However, there are several forms of non-voting equity participation which could obviate this drawback, and one of them is discussed below.

7. **Stock Options**—If PRE were to obtain authority to make equity investments, the use of stock options could provide a useful investment vehicle. PRE could grant funds to a private concern, take options in return and hold these options during the period of greatest risk to the venture, say for the first several years. At that point, PRE could sell the options to private investors at a price which reflected their worth. In the event the enterprise failed, and PRE was not able to sell the option, PRE could exercise the options and receive whatever came from liquidation of the company, if anything. Once again, at the appropriate time, PRE will request that such authority be recommended for Congressional consideration.

Based on the analysis of these and other more traditional financing methods and instruments, the PRE Bureau believes that the loan and other debt mechanisms outlined above will provide an adequate experimental start for the program. First, the needed statutory authority exists for AID to cofinance using concessional loans, as well as to employ convertible debt and subordinated debentures. Second, the debt approach will not draw the Agency into the management

role generally required for cofinancing in the form of equity. And third, the expertise required for making loans is easier to acquire and retain than that required for making equity investments. Nevertheless, the use of debt in the form of cofinancing with commercial banks and convertible and subordinated debentures represents a new departure for the Agency. Their use also requires a demanding technical exploration by both financial and legal specialists. Although they represent a shift in policy, they are well suited to achieve the objectives outlined for PRE in this paper. PRE would take the longer debt maturities in most cases to facilitate investments and financing of developmentally oriented private sector projects.

With respect to loan guaranties, the PRE Bureau believes it would be duplicative for the Agency to seek the required reserve fund authority from Congress since OPIC has a suitable loan guaranty authority. However, there is a great potential for fruitful cooperation between AID and OPIC in making investments in private enterprise in LDCs, especially with respect to making the guaranty authority a readily accessible complement to PRE's financial packaging activity. Guaranty authorities warrant further study.

Equity participation poses some substantial legislative, technical and managerial challenges. While other countries use it to achieve developmental aims, PRE believes that the private sector program can do without it at the start. In deferring the use of equity, however, PRE believes that it warrants further study, particularly as an instrument for investing in financial intermediary institutions.

C. **Investment Selection Criteria**

The investment selection criteria will be used internally to guide the screening of projects and to determine which projects are opportunities for PRE investments. These criteria also should be incorporated into the existing framework used by other bureaus to make decisions on private sector related projects. The criteria will be circulated within the private sectors in the U.S. and LDCs to inform them of the types of projects in which PRE is willing to invest. Based upon AID's overall mandate and PRE's initial contacts with the business community and multilateral institutions, the following elemental criteria have been formulated:

— Projects must be in the targeted countries and sectors (see Section A, above), must fit the country-specific criteria to be developed (e.g., job-creating and foreign-exchange producing for Jamaica) and be consistent with the existing AID country programs and strategies;

— Projects must fall into one of the three categories of new Agency private sector activities to be undertaken by PRE:

  — Cofinancing with commercial banks, other financial institutions, or multilateral institutions in private sector projects;

  — Capitalization of new types of intermediate financial institutions or new types of financing arrangements to serve the private sector, such as venture capital firms, investment banks and project financing through commercial banks; or

  — Direct investment in operating enterprises where replication of the enterprise's approach to marketing, technology transfer, management and skill training is highly desirable.

— Recipient enterprises must demonstrate that they have or will be able to develop market and financial expertise that will allow effective management and show profit making potential;

— Recipient enterprises must be, in part, privately owned or operated or willing to operate on private sector criteria;

— The activities of the recipient enterprise following the AID investment must be specific, demonstrable, and have desirable development benefits which rank high on the list of host government priorities and AID's analysis of economic needs of the country. In any case, special attention will be given to employment generation and transfer of technical and management skills;

— The recipient enterprise must demonstrate that the amount of capital which PRE provides is not otherwise available, or available on reasonable terms. (Appraisal of project proposals will include appropriate tests for "additionality");

— PRE will never invest alone, because the program is intended, in part, to mobilize and supplement, rather than to replace, private capital;

— Although there should be no limit to the overall size of project for which PRE will consider and try to arrange financing, the Agency's participation for one project (investment for its own account) is anticipated to range between $0.5 million and $5 million;

— The recipient enterprise's capital requirements and the several sources of capital should be such that PRE may take the longer maturities for loans and others, e.g., commercial banks, will take the shorter maturities; and

— Interest rates for loans and other forms of debt will be established within the bounds of statutory requirements and according to the needs and requirements of the investment opportunities, but in most cases higher than normal AID terms.

D. **Investment Reconnaissance Missions**

PRE plans to undertake an investment reconnaissance mission to each of the target countries. To date, successful missions have been conducted in Indonesia, Sri Lanka, Kenya, Thailand, Ivory Coast, Egypt and Pakistan. The Bureau has had extensive contacts with Jamaica.

The purpose of these missions, which are composed of private sector executives and AID staff are, in consultation with the AID Mission Directors and appropriate regional and other central bureau staff to:

— Determine the adequacy of the climate and conditions for foreign investment; at issue are laws and government regulations, as well as the presence of adequate "investment infrastructure," such as financial markets;
— Identify the development sectors and priorities most amenable to successful private investment which can serve development, as well as fundamental business objectives; and
— Identify key business investment opportunities, be they nascent ideas worthy of development, or business propositions worthy of detailed consideration. These opportunities must be developmentally oriented and meet the other tests of PRE's investment selection criteria.

These missions will trigger a portion of PRE's project and non-project activity and part of the AID missions' future project portfolio. Projects identified may undergo additional study and development or receive expedited consideration for PRE investment and packaging. Non-project assistance may be appropriate, in which case the activities described in Section E, below, will be initiated and funded either by PRE or the appropriate AID regional or central bureau.

E. **Technical Advice and Assistance**

The PRE Bureau has a mandate to help developing countries create the environment conducive to the flow of private capital in support of development objectives. The Bureau plans to undertake three modes of technical advice and assistance to developing countries and to the AID missions. One will be specific to the projects which the Bureau is helping to finance. The others will go beyond projects, and will assist governments in the development or modification of policies, institutions and programs to enable the private sector to make a greater contribution to economic development.

1. **Project Related Technical Assistance**—The Bureau will take an active role in the identification and development of projects which show considerable promise in meeting PRE's investment selection criteria. In conjunction with appropriate regional and central bureaus, PRE's prospective roles in this regard are to:

— Take lead responsibility or help develop a project from its inception through any necessary technical and business studies and appraisals, finding technical and financial partners, and putting together a financial plan;
— Take responsibility or help organize and finance companies engaged in promoting investments in a specified sector or area;
— Participate in the financing of companies organized to develop specific projects; and
— Provide assistance to applicants, if necessary, to satisfy Bureau needs for certain preliminary information to enable the Bureau to decide whether an investment proposal warrants serious consideration.

2. **Policy Advice to Improve the Investment Climate**—The PRE Bureau will help pave the way for future private investment by assisting host governments and commercial institutions to identify investment barriers and develop ways to lower or reduce them. The form of assistance will be expert advice and counsel from the Agency and outside experts.

Examples of this activity include assistance to:

— governments in establishing a legal and institutional framework for their capital markets in general, and securities markets in particular;
— governments on policies to promote private development through such activities as assessments of the impact on private enterprise of more open and competitive market environments;
— organizations to help establish new or expand existing financial institutions and to governments on policy and regulatory matters to help them strengthen their financial markets; and
— governments to develop financial sector plans, establish the legislative and regulatory environment and identify needed institutions.

3. **Managerial Training**—In conjunction with appropriate bureaus and to complement work already undertaken, PRE intends to assess private sector managerial training needs in the target countries and identify particular vehicles for filling the void if appropriate. The approaches to be employed include partnerships between host country institutions or private groups and U.S. business schools, groups or training institutions. PRE will finance advisory services to identify needs and design management training programs, both short or long term with a specific emphasis on senior and middle management intensive management seminars. PRE or the missions may "invest" some of its funds to finance the programs, but PRE expects that the program established will be self sustaining within a reasonable period of time. PRE emphasis will be on intensive management training

for the private sector while other bureaus and missions may be developing and financing a broader spectrum of programs.

III. Program Roles and Process

This section discusses how the private sector program activities will fit within the existing organizational role of the Agency and outlines the relationship between PRE and other bureaus.

A. Overview of PRE Private Sector Role

The establishment of PRE as a new bureau which will make investments with and in private enterprises, and the existence of private sector-related project activities within the regional bureaus requires that responsibility and accountability for AID investment in private sector activities be clearly delineated.

PRE will have funds for financing new private sector initiatives in the targeted countries. For the next year or two, PRE will engage directly in four types of projects in these target countries; cofinancing with commercial and investment banks, financial intermediary institutions, and multilateral institutions; capitalization of new types of intermediate financial and asset management institutions which are at least in part privately owned and which serve primarily private sector development; direct investment with and in operating businesses; and private sector management training institutions or programs. Some of these are new and high risk areas where it is expected the Bureau will take the lead in the Agency for the next year or so. A second source of funds which are termed "set aside" funds, are appropriated to the regional bureaus and allocated to the individual country programs of the ten countries targeted for new private sector initiatives. These funds are an additional source for these and other types of new private sector projects. (See Section IV for a detailed discussion of funding sources.)

In those cases where PRE funds are used, AA/PRE, with concurrence from the appropriate regional and central bureaus, will authorize the projects and take lead responsibility for their success. If necessary, PRE will rely upon the AID country missions to take an active role in assisting in project management.

In those cases where regional bureaus' set-aside funds are used, the regional bureau and PRE must mutually agree on the project before it can be authorized by the regional administrator concerned. The form of "mutual agreement," a requirement stated by the Administrator, will consist of clearance at the AA or DAA level of PRE for PID approval and project authorization. However, the regional bureau with concurrence from PRE is responsible for preparing documents for authorization, and the appropriate mission is responsible for developing and managing the project. The AID mission may draw upon the expertise and assistance of PRE, if required. PRE will, to the extent its resources are available and appropriate, offer advice and counsel to the bureaus and missions concerned with these projects, but the authorization authority and responsibility for their success properly resides with the Mission and regional bureaus.

Some projects will be funded from both PRE and regional bureau sources. In these cases the regional AA concerned and the AA/PRE will authorize their respective shares of the funding and agree in writing which bureau will take lead responsibility in both developing and managing the project. The AID mission will be responsible for monitoring the project with assistance, if necessary, from the regional bureau and PRE.

Because PRE will be jointly involved with the regional bureaus and missions in this program, the need for coordination and efficient communication is particularly acute. This need can be substantially met by the appointment of private sector officers within each bureau and mission in the target countries. These officers will be the prime contact between PRE and the rest of the Agency. They will receive policy and operational guidance from PRE, receive technical backstopping assistance when required, and represent their bureau's or mission's interest in the process of developing or implementing private sector projects. In the case of the mission-based private sector officers, it is essential to minimize any potential conflict in their line supervisory arrangements. Accordingly, they should be responsible to the Mission Director and come under the mission's ceiling and operating budget. Regional private sector officers likewise will be responsible to the regional AAs and come under the regional bureau's ceiling and operating budget. PRE is prepared to assist in identifying and training private sector officers for either the missions or regional bureaus.

B. Relationships With Other Central Bureaus

The PRE Bureau will maintain close relationships and coordinate with the other central bureaus to assure consistent policies and complementarity in the Agency's private sector project/program activities. PRE will call upon cognizant central bureaus to provide:

— Technical assistance (either from internal expertise or recommendations on outside experts) in project design, development, implementation and evaluation;

— Policy guidance on matters related to specific technical issues; and

— Recommendations on the selection of consultants needed for project development, implementation and evaluation.

For all private sector projects taken under consideration by PRE and the regional bureaus, the cognizant central bureaus will be consulted and requested, wherever appropriate, to make inputs on technical issues and requirements. This should help ensure maximum utilization, not only of technical expertise within the Agency, but also allow PRE to capitalize on existing relationships and programs between other central bureaus and private entities.

To further this objective, PRE should be consulted on any other central bureau funded project with a private sector entity. To eliminate potential duplication of effort and to help assure consistency in the maximum utilization of Agency relationships and programs with private sector entities, it is expected that other central bureaus will coordinate with PRE in such involvement.

C. Project Identification and Development

The procedures developed by PRE concern at this time only the projects which will be funded with PRE appropriations and, to the extent possible, with funds specifically set-aside in the regional bureaus for new private sector initiatives. Compared with the traditional approach, these procedures are streamlined and more expeditious. It is intended that, like the IFC, these projects be ready for an authorization decision within six months from the emergence of an acceptable project idea. The features which permit this less complex and more rapid approach are intended to synchronize Agency activities with the more rapid pace required and achieved by private sector investment decision-makers, and to take advantage of investment opportunities before they may diminish in desirability for AID and for other investors.

Project ideas—investment opportunities—will arise from several sources:

— U.S. firms and commerical lenders
— IFC and the other multilateral initiatives
— Indigenous private enterprises
— Host governments
— AID bureaus and missions
— PRE

Using the established project selection criteria, the bureau or mission concerned, in cooperation with PRE, will prepare an investment opportunity paper (IOP). If the idea originates outside the Agency, the bureau or mission concerned will give any assistance necessary to the originator to develop and present the following information in the three- to four-page IOP:

— Description of the ownership, business and management capability of the recipient enterprise or institution;
— Need for, and size and purpose of, the investment;
— Specific development objectives which will be served over what time period;
— Products and proposed marketing plan;
— Sources of raw material and labor;
— Pricing;
— Pro-form cash flow and income statements and balance sheets;
— Other prospective sources of financing;
— Implementation strategy;
— Timing considerations; and
— Nature of any specialized additional study(ies) needed.

This summary statement in addition to information normally required in a PID (i.e., facesheet, policy issues, costs, project preparation strategy and initial environmental examination) will become the vehicle for PRE in conjunction with the respective regional bureau and country mission to determine if there is enough promise to warrant further development. The IOP will be reviewed simultaneously in the regional bureau concerned and PRE concurrence will be requested from the mission concerned on the project for it to go forward from this stage.

If PRE, the regional bureau and country mission agree to go forward, three activities are undertaken simultaneously:

— PRE, with assistance from the respective regional bureau and cognizant central bureau seeks a formal expression of interest from U.S. private investors, technical partners, and other agencies which may participate in the financing;
— The resident AID mission consults with the appropriate agency of the host government to determine if there is support or objection and the local private sector to identify potential participants; and
— Any specific studies necessary to make an investment decision are identified and undertaken as well as who will finance and undertake the studies.

PRE, in conjunction with other central bureaus, will be responsible for providing (either from internal resources or from outside the Agency) technical assistance to other parties at this stage. For example, if a marketing study is necessary, PRE will determine its scope with respect to business or financial aspects. PRE will also be directly responsible for handling relations with all U.S. and multilateral institutions and for backstopping the mission concerned with respect to working with indigenous parties.

If a positive outcome results from these three activities, the investment proposal (IP), which is the conceptual equivalent of a project paper, is prepared. The content areas discussed in the investment proposal are comparable to those addressed in a conventional project paper, including those required by statute or Agency regulation. The substantive parts of the project prospectus should include the following:

— Detailed project description;
— Developmental objectives;
— Business rationale;
— Intended development effects and business results (e.g., financial viability and profit, market share impact, etc.) of the investment;
— Legal or regulatory problems;
— Sources of finance and rationale for these arrangements;
— Marketing plan;
— Cost and availability of raw material;
— Implementation plan, including:
  — A general project schedule; and
  — Clear delineation of responsibilities among the participants;
— Projected financial results of the venture after infusion of AID and others' capital contributions (pro forma cash flow and income statements, and balance sheets);
— Detailed qualifications of the business entity which will receive AID funds;
— Technical assistance requirements;
— Projected development impact (numbers and type of jobs generated, wage income produced, technical skills added, multiplier effects in the economy, etc.); and
— Negotiating issues to be worked out with other project participants.

Under present conditions and procedures the preparation of a project paper can be a lengthy, labor-intensive effort. Private sector projects must be subject to an abbreviated process which undergoes less complicated processing in a shorter period of time.

Responsibility for preparation of the IP will rest with the originating business entity and investment partners in conjunction with PRE. To the extent feasible, the investment proposal should be the responsibility of the business entity or other investment partners. PRE, with assistance from other central bureaus, will provide needed technical assistance and funding, as appropriate, for the preparation of the investment proposal.

In the case in which a U.S. firm or multilateral institution originates an investment idea and it is well developed, PRE will coordinate preparation of the IP. This will involve either counselling the firm or institution on the content and form of information the Agency requires, or providing assistance to prepare the document. If an indigenous firm approaches an AID mission with a well developed idea, the USAID will assure that the investment proposal is prepared, with technical backstopping by PRE, the regional and other central bureaus, as needed.

Because it will save time, conserve Agency resources, and make the most of private sector expertise, perhaps the "best case" for the Bureau is the one in which a U.S. or indigenous firm or multilateral institution originates the project idea and supplies most of the effort to develop it. Nonetheless, the Bureau must be involved at critical points and work with these external parties in order to assure that the necessary information for the Bureau's own project appraisal and authorization is reliably produced. For those projects that are fully developed (such as those that might be referred from the World Bank), every effort should be made to proceed directly to the investment proposal review stage. To do so, the appropriate documentation will be distributed by PRE to the regional bureau and the appropriate mission, and a date will be set by PRE for convening the project review group.

D. **Project Appraisal and Authorization Process**

The completed IP is the vehicle for this decision-making segment of the AID investment project cycle. Both PRE and the regional bureau concerned will review the document and convene a meeting to reach a decision. The authorizing responsibilities were outlined in subsection A of this section.

The investment proposal will be made available to all bureaus which wish to review it. They may offer their comments in writing or at the meeting at which PRE and the regional bureau concerned reach a decision concerning authorization. Prior to authorization PPC and GC will provide clearance from their respective policy conformance and legal perspectives.

E. **Project Implementation Process**

Like prior stages of the project cycle, the implementation of private sector projects may depart from AID's traditional practices. This change will result from AID's partnership with U.S. and indigenous private firms and the nature of the projects themselves. AID, by definition and statutory limitations, does not run private enterprises, be they industrial companies, service firms, or intermediate credit institutions.

The Agency's role in a particular investment will be determined by the nature of the project and the intended role of its partners. Different types of new projects will require discernably different levels of intensity of Agency efforts.

In the case of cofinancing with commercial banks and the multilateral institutions, PRE will rely

substantially on its investment partner's efforts and the borrower to prepare reports to enable PRE and the cognizant regional bureau and country mission to monitor the investments. This case will be the least AID labor-intensive and falls into the category of a portfolio investment for the Agency.

When the project is a privately-owned intermediate financial institution, PRE will again rely primarily on the investment partners to prepare reports to enable investment monitoring. AID's interest will be directed at the level of the institution, rather than its private sector clientele. The intensity will be comparable to that experienced with existing publicly owned intermediate credit institutions.

The most AID labor-intensive case is the one in which AID is investing in or with an operating firm. Here, PRE will want to be more active, but again PRE will look primarily to the partners to prepare reports that will enable effective investment monitoring.

AID's posture during implementation, then, translates into one or more of the following types of activities:

— Reviewing periodic financial statements and other management reports, as a commercial lender or other investor would do;

— In the case of intermediate financial institutions, reviewing their financing cases to see what types of projects they rejected and accepted and how their clientele are performing;

— Exchanging information on the health of the enterprise and its plan with other investors;

— Ensuring AID's investment is protected through appropriate consultations with the host government when its actions have, or could, markedly affect the ability of the enterprise to survive;

— Arranging for the AID missions, or, in extraordinary situations, financing observation visits to the institution or enterprise, or financing specialized technical assistance to the enterprise;

— Performing technical evaluations, not only to firmly understand the strong and weak points of a particular investment, but also to find ways to strengthen the private sector program; and

— Evaluating the development benefits and impact to assure consistency with AID objectives.

Even if several projects are undertaken simultaneously, these activities will be of a part-time, intermittent, or ad hoc nature for a particular investment. Because this set of implementation activities is tailored to a new role for the Agency, PRE will want to confirm with the General Counsel that the implementation arrangements are fully adequate to monitor the expenditures of appropriated funds.

Regarding geographical location, it is desirable for the project officer to be as close as possible to the enterprise itself. Therefore, the AID mission concerned should designate a project officer for each PRE or set aside fund investment. Technical backstopping assistance will be provided by PRE, in cooperation with other central bureaus as needed, including occasional field visits and communication with U.S. and multilateral co-investors.

F. Policy Development and Evaluation

Because of the Agency-wide involvement in the private sector program, the policy development and coordination functions for the Agency should reside with PPC. On its part, the PRE Bureau has established a Policy Officer position, which reports to the DAA/Investment and Policy to represent the Bureau in Agency policy matters. Given the breadth and complexity of the program, PPC should establish and house a position for Policy Advisor for Private Enterprise. This advisor's role and responsibilities would be similar to those of the policy advisors for energy and the environment.

PPC should also chair reviews of overall Agency private enterprise strategy in the CDSS process, as well as overall Agency private enterprise program levels in the ABS process. These roles will follow naturally from PPC's current effort to prepare an Agency-wide private sector policy paper. PRE should be represented at these meetings.

The Administrator's October 19, 1981 testimony before a subcommittee of the Joint Economic Committee designated the PRE Bureau "to formulate and coordinate private sector policy within A.I.D." The exact procedure to be used must, however, fully accommodate the need for participation in the process by the other bureaus, in line with traditional AID policy formulation activity. Mutual agreement between PRE, PPC and other bureaus is essential for the program to succeed. This process should be followed not only in the critical first detailed development of the Agency's private sector policy, but also when future conditions warrant additions or revisions to the program strategy.

Another important resource in policy formulation will be the International Private Investment Advisory Council on Foreign Aid, which the PRE Bureau will establish. Made up of senior private sector executives, the Council will provide a conveniently accessed and expert forum in which to sound out the acceptability and attractiveness of the Agency's private sector program approach. PRE intends to establish smaller country ad hoc groups composed of private sector advisors.

Each project will contain an evaluation plan. In the case of PRE funded projects, PRE will be responsible for conducting the evaluation. Projects funded by the regional bureaus and missions will be evaluated by the appropriate office. After a two-year period, PRE intends to perform an overall program evaluation of the area program, the elements for which will be initially specified by the end of FY 82 when the shape of the first round of project activity is clear.

G. PRE Relationships with External Parties

The most obvious structural innovations contained in the Agency's private sector initiative are its partnership with indigenous and U.S. private sector firms and banks, and broadened involvement with the multilateral institutions and other U.S. Government agencies. Given the multiple bureau and office involvement in private sector program development and implementation, it is quite possible that the Agency will tend to confuse these new partners. The risks include the appearance of a less than fully consistent policy, too many governmental elements with which to deal, and the appearance of too much red tape and delays in decisionmaking.

By virtue of its charter and central bureau nature, the PRE Bureau shall serve as the Agency's liaison with the multilateral private sector development agencies. PRE will also serve as the principal Agency point of contact with the U.S. private sector and other U.S. agencies on operating policy-related activities, new investment modalities, as well as the "front end" of project-related work, i.e., project identification, development, and review and approval for authorization for projects PRE will finance. The other bureaus will be kept informed and then views sought. During project implementation the regional bureaus and missions will necessarily be very much involved as explained in Section E, above.

Within host countries, following traditional practice and making good use of the USAID's natural role, AID missions will serve as the prime point of contact with pertinent government agencies. Likewise, they will necessarily be the point of contact sought by local enterpreneurs (who, for instance, may step forward with a project idea which suits the Agency's program), and local representatives of U.S. firms and banks and then multilateral institutions. When these contacts concern project identification and development, the missions will be expected to inform PRE to allow PRE to assist in determining its appropriate handling.

PRE will also share responsibility with regional bureaus and country missions in providing and funding organized technical assistance to host governments who wish to improve the climate for foreign investment. Special expertise will be needed. PRE will screen but not necessarily direct, these resources, and, when appropriate and practical, cooperate with OPIC and other institutions in these efforts. On-site work will be facilitated by the mission's private sector officer, who will receive technical backstopping from PRE.

IV. Program Funding

This section covers only those investment-related portions of the Agency's private sector program in which PRE will play a lead role. Because PRE was not established until mid-FY 82, a distinction is made between FY 82 and FY 83 funding mechanisms. The Bureau's alternatives for the longer term—the use of a revolving fund and/or reflow authority—are also discussed below.

A. FY 82 Funding

Funds for new private sector initiatives will come from two categories of sources during the current fiscal year. The first, $26.1 million, will be FY 82 funds allocated to PRE. The IESC program will be expanded and focused more on Central America and the Caribbean Basin. Money will be programmed for private sector management training in selected countries. A fund will be established to draw on investment banking and other U.S. business expertise to identify and package developmentally oriented private sector projects in selected developing countries. Also money will be set aside for project identification and development, and advisory service to governments on the investment climate prevalent in their respective countries. The World Trade Institute's role in promoting developing countries' exports and foreign exchange earnings, including export strategies and policies, and strengthening their capability and expertise in formulating and undertaking practical export programs, will be expanded. In addition, and separate from this funding, the TDP program will be expanded to finance other feasibility studies for critical resource related developmental projects in middle income LDCs. $16.0 million will be used for investments in selected private sector developmental projects in the Bureau's targeted countries. Examples of these investments are a private venture capital firm in Jamaica, agribusiness industries in Kenya and Sri Lanka, a venture capital firm in Kenya, and a venture capital firm and stock market development in Indonesia. In addition to utilizing AID funding, most of these projects will be financed from several other sources including the indigenous private sectors, U.S. private firms, and other bilateral or international institutions or firms.

These projects will be approved by the AA/PRE in consultation with the regional bureaus concerned after review and input from pertinent central bureaus. They will be managed by PRE and monitored by the AID Mission in which the project takes place.

The second source of funding consists of a total of $80 million (FY 82-83) which the Administrator has designated to be set aside from existing and proposed country programs in the targeted countries. The set aside involves the earmarking of these funds for new private sector projects which are mutually agreed upon by both the regional assistant administrator concerned and the AA/PRE. The project could be initiated by PRE or the AID Mission. The regional bureaus will authorize and manage the projects.

To date, the set-asides agreed upon are:

	U.S. Millions
Indonesia	$10.0 (FY 82 and FY 83)
Costa Rica	5.0 (FY 82 and FY 83)
Kenya	1.5 (FY 82)
Thailand	5.6 (FY 82 and FY 83)
Sri Lanka	2.5 (FY 82 and FY 83)
Egypt	50.0 (FY 82)
Jamaica	5.0 (FY 82)
Ivory Coast	to be determined
Zimbabwe	to be determined
Pakistan	50.0 (FY 83 through FY 87)

B. **FY 83 Funding**

The PRE Bureau has prepared a portion of the Agency's Congressional Presentation which will permit the appropriation of funds directly to the Bureau for authorization by PRE. The budget requested for the elements of the private program in FY 83 total $22.7 million, the principle elements of which are:

— $14 million for investment
— 1.7 million for program development and support
— 5.0 million for IESC

The program for investment will be similar to those in FY 82 except $5.0-10.0 million will be programmed for co-financing developmentally oriented projects with U.S. commerical and investment banks. We expect that at least $5 million will be programmed for a revolving fund, subject to Congressional Authorization of this approach. No decision has been made on programming the set aside funds in the mission programs for private sector development programs.

C. **Long Term Budget Strategy**

Like the IFC and officially supported bilateral organizations with comparable aims, the PRE Bureau plans ultimately to put its investment activities on a self-sustaining basis. This approach has the advantage of reducing and eventually eliminating the requirement for appropriations each year to make new investments. It will also permit the Bureau to run this element of the overall private sector program like a business. It could manage its portfolio, sell off portions of it when particular projects have received the full benefit of AID's financial involvement, and make further investment.

One means to do this is for PRE to regain the "reflow" authority the Agency once had. This would enable PRE to take the funds received as loans when repaid or sold and apply them to new loans without Congressional appropriations. The Agency once had this authority with respect to its traditional concessional loan program, but it was cut back and then phased out in the late 1970s. Its reinstitution, which would require an amendment to the Foreign Assistance Act, is one vehicle with which to establish the revolving fund and permit the roll over of its assets into a succession of new investments, which at the moment are confined to debt instruments. At the appropriate time, following the experimental stage of the Bureau and its activities, PRE will make a recommendation to the Administrator concerning the request to Congress to re-instate this authority.

A.I.D. Policy Papers and Policy Determinations

The following reports have been issued in a series. These documents with an identification code (e.g. PN-AAM-323) may be ordered in microfiche or paper copy. Please direct inquiries regarding orders to:

AID Document and Information Handling Facility
Suite 1010, 1500 Wilson Blvd
Arlington, VA 22209

Title—Policy Paper	Date	'Fiche #
Domestic Water and Sanitation	May 1982	PN-AAM-323
Food and Agricultural Development	May 1982	PN-AAM-322
Nutrition	May 1982	PN-AAM-321
Recurrent Costs	May 1982	PN-AAM-319
Population Assistance	September 1982	PN-AAM-320
Private and Voluntary Organizations	September 1982	PN-AAM-318
Women in Development	October 1982	PN-AAL-777
Pricing, Subsidies, and Related Policies in Food and Agriculture	November 1982	PN-AAL-373
Approaches to the Policy Dialogue	December 1982	PN-AAM-431
Basic Education and Technical Training	December 1982	PN-AAM-190
Institutional Development	March 1983	PN-AAN-108
Co-Financing	May 1983	PM-AAN-457
Local Organizations in Development	March 1984	PN-AAQ-157
Energy	July 1984	PN-AAQ-160
Urban Development Policy	October 1984	PN-AAQ-158
Shelter	February 1985	PN-AAQ-162
Private Enterprise Development (Revised)	March 1985	PN-AAQ-163
International Disaster Assistance	May 1985	PN-AAQ-164
Cooperative Development	April 1985	PN-AAQ-165
Trade Development	July 1986	PN-AAV-461
Health Assistance (Revised)	December 1986	PN-AAV-462
Environmental and Natural Resources	April 1988	PN-AAV-464
Financial Markets Development	August 1988	PN-AAV-465

Title—Policy Determination	Date	'Fiche #
PD #1—Narcotics	August 5, 1982	PN-AAM-443
PD #2—Mixed Credits	September 29, 1982	PN-AAM-444
PD #3—Voluntary Sterilization	September 1982	PN-AAM-445
PD #4—Title XII	October 5, 1982	PN-AAM-446
PD #5—Programming PL 480 Local Currency Generations	February 22, 1983	PN-AAM-591
PD #8—Participant Training	July 13, 1983	PN-AAP-273
PD #9—Loan Terms Under PL 480 Title I	September 27, 1983	PN-AAN-753
PD #10—Development Communications	February 17, 1984	PN-AAP-616
PD #11—Using PL 480 Title II Food Aid for Emergency or Refugee Relief	July 26, 1984	PN-AAQ-159
PD #12—Human Rights	September 26, 1984	PN-AAQ-161
PD #13—Land Tenure	May 9, 1986	PN-AAQ-166
PD #14—Implementing A.I.D. Privatization Objectives	June 16, 1986	PN-AAQ-167
PD #15—Assistance to Support Agricultural Export Development	September 13, 1986	PN-AAV-460
PD #16—Program Financing Arrangements with Independent Organizations	October 9, 1987	PN-AAV-463
PD #17—Microenterprise Development Program Guidelines	October 10, 1988	PN-AAV-466
PD#18 - Local Currency	July 30, 1991	PN-AAV-467

I.C. (TM 1:35)
8/14/85

A.I.D. Policy Paper

PRIVATE ENTERPRISE DEVELOPMENT

(REVISED)

U.S. Agency for International Development
Washington, D.C. 20523

March 1985

I.C (TM 1:34)
11/9/84

A.I.D. Policy Paper

Private Enterprise Development

Bureau for Program and Policy Coordination
U.S. Agency for International Development
Washington, D.C. 20523

May 1982

CONTENTS

Private Enterprise Development

Page

I. **Introduction** 1

II. **The Importance of the Private Sector in Third World Development** 1

A. **Economic Importance** 1
B. **Social Importance and Human Rights** 2

III. **Nature of the Challenge to the Development of Market Economies in LDCs** 3

A. **Constraints Established by Government Policy** 3

1. The LDCs Strategy for Economic Development 3
2. Government Policies and Regulations Derived from Its Development Strategy 4
3. Policies That Discourage Private Sector Participation In Traditional Government Programs 6
4. Government Ownership of Enterprises and the Designation of Monopoly Responsibility 8

B. **Constraints Related to Commercial and Country Risk** 9

1. Investment (Commercial) Risks 9
2. Country Risks 9

IV. **A.I.D. Policy to Meet the Challenge** 10

Statement of General Policy 10

V. **Specific Components of the A.I.D. Policy** 11

A. **Agency Target Group** 11
B. **Policy Dialogue** 11
C. **Legal and Regulatory Constraints** 12
D. **Assistance to the LDC's Private Sector** 12
E. **Private Sector Participation in the Provision of Traditional Government Services** 14
F. **Parastatals and Government Authorized Monopolies** 15
G. **Capital Saving Technology** 15
H. **Training Activities** 16
I. **Infrastructure** 16
J. **Research and Studies** 16

VI. **The Responsibilities of Missions and Regional Bureaus** 16

ANNEX A 17

PRIVATE ENTERPRISE DEVELOPMENT

I. Introduction

A society in which individuals have freedom of economic choice, freedom to own the means of production, freedom to compete in the market place, freedom to take economic risk for profit and freedom to receive and retain the rewards of economic decisions is a fundamental objective of the A.I.D. program in less developed countries. Such a private enterprise economy is held to be the most efficient means of achieving broad-based economic development. 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. Moreover, significant equity objectives can be achieved when market forces operate to stimulate an economy toward full employment.

This policy paper builds upon A.I.D.'s experience in assisting private enterprise development. It also draws upon the research conducted for the President's Task Force on International Private Enterprise. The guidance in this document should help A.I.D. strengthen and more fully integrate private enterprise development into the mainstream of Agency activity, as recommended by the Task Force. This policy paper supersedes the A.I.D. policy papers entitled **Private Enterprise Development** and the **Bureau for Private Enterprise Policy Paper** (both dated May 1982). However, the goals of A.I.D.'s policy toward private enterprise remain the same. These goals are, in the first instance:

- to encourage LDCs to open their economies to a greater reliance on competitive markets and private enterprise in order to meet the basic human needs of their poor majorities through broadly-based self-sustained economic growth.

Secondly, as a corollary to the above:

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

II. The Importance of The Private Sector in Third World Development

A. Economic Importance

The most efficient allocation of scarce resources occurs when individuals seek to increase their incomes in an environment characterized by open competition in the supply and exchange of goods and services. When complemented by prudent management of necessary government services, the aggregate effect of individual free market behavior is growth and development of the economy at large.

However, many LDCs have not relied on open, competitive markets to determine resource allocations in many sectors of their economies. Rather, LDC governments have attempted to direct essential activity in agricultural and industrial production and trade by administrative determinations. Except for small-scale activities often characterized as informal, the economies of many LDCs are marked by extensive government efforts to determine production levels, prices and consumption patterns.[1] A wide variety of historic, ideological and other reasons explain a particular LDC's mix of public and private sector activities.

Aside from the provision of universally accepted public goods like national defense, public safety, monetary policy and enforcement of contracts, further government involvement in an economy follows from the belief either that a market cannot be established or that the result of market decisions will lead to socially unacceptable outcomes. In certain cases, such as natural monopolies, goods with important externalities, and merit goods (See Annex A for definitions), a government may determine that public involvement in production or distribution is important to achieve social objectives. **But it is clear that LDCs which have overextended the role of the public sector and restricted the operation of the private sector have experienced slow growth, heavy budget deficits and rising debt burdens.**

[1]Recent efforts at measuring the extent of private sector activity in Sudan and Peru suggest that despite claims to the contrary, private enterprise is thriving. In Sudan a recent A.I.D. funded study identified between 13 and 16 private health care services per commercial block. See A. Bekele, "Briefing Notes on Health Care Financing in the Democratic Republic of Sudan," Draft Report, AID OTR-4121. Peru's "underground economy," which parallels the highly restricted public market in that country, absorbs 60 percent of the workforce, provides 85 percent of internal transportation and has achieved growth rates which exceed those of the formal, legal sector. See C. Rosette, "How Peru Got a Free Market Without Really Trying," *Wall Street Journal*, January 27, 1984.

LDCs that maintain a broad definition of natural monopolies and public goods pay a higher price in overall economic growth. Such countries have typically experienced real per capita growth averaging 3% per year over the last ten years. Many have been at or near zero growth. However, those LDCs which have more narrowly defined the role of the public sector and allowed competitive markets to determine the price and quantity of most goods and services have experienced growth rates averaging 7% per year.[2]

In terms of equity, countries with a high level of government interference in the market fare no better in the short run than market economies, probably because slow growth reduces employment opportunities.[3] In the long run, government dominated economies may fare worse, because sustaining equity-oriented services becomes difficult when growth, and therefore revenue, lags.

Government is thus in a unique position to establish a favorable climate for private investment. Moreover, that climate is critical to the attainment of both economic growth and equity objectives. The extent and nature of public and private sector roles must be defined and balanced to ensure equal access to opportunities and high economic growth. This is the challenge in A.I.D.'s private enterprise policy.

B. Social Importance and Human Rights

Economic freedom for individuals—an essential condition for viable competitive markets—encompasses the notion of the right of persons to make personal choices in providing for their livelihood and that of their families. Such economic freedom permits individuals to pursue, within the bounds of generally accepted norms of behavior, activities which utilize their comparative advantage in innate capabilities, acquired skills and interests.

The essentially independent decisions of suppliers and consumers in competitive markets result in a diffusion of economic power. The greater the competitiveness of the market and the economy at large, the more dispersed is the power to influence the market and the economy for individual gain. Free markets are the most effective way of mobilizing human energies, assuring responsiveness to consumer demands, and avoiding the exploitation of the poor typical of public or private monopoly or oligarchical enterprise. Given the close association of economic power with political power, a key attribute of a society which permits free competitive markets is a pluralistic body politic. As LDCs remove restrictions on the operation of markets, they are simultaneously encouraging behavior which supports the development of popular representative political institutions. A democratic government is not an automatic outcome of a competitive market environment. However, competitive markets generate greater likelihood of progress towards a form of government which provides for popular representation than towards authoritarian forms of government. Furthermore, a society in which economic power is widely dispersed is more likely to be one in which transfer of political power by election is permitted than in a society where exclusion from political power carries with it exclusion from economic power.

A.I.D. notes that when representative institutions emerge in a free market economy, reciprocal benefits in the form of efficiencies in the provision of public goods and services are likely to occur. In societies which permit open debate, the levels of public goods supplied and the roles of state authorized monopolies are adjusted in the normal political process to the particular level of popular demand. These adjustments attempt to minimize the social and financial costs of these exceptions to competitive markets. However, adjustments in authoritarian societies may not occur until a situation becomes untenable; an abrupt restructuring may then follow civil unrest, a **coup d'etat** or revolution. The society pays an ever increasing price in terms of reduced growth and inequity before the change takes place. Furthermore, the abrupt nature of the change may only produce a different but equally inefficient solution to the supply of goods and services provided or controlled by the public sector.

[2]Agarwala, Ramgopal, "Price Distortions and Growth in Developing Countries," World Bank Staff Working Papers Number 575, 1983.

[3]For a convincing case showing how the expansion of the public sector has stretched the managerial capacity in many countries see The World Bank, *World Development Report 1983*. See also Alvin Rabushka, *Free Markets and Economic Development in Postwar Developing Countries* (December 1983) which shows how most of the countries which have outgrown poverty in the Post-War II period have emphasized free market economic policies.

III. Nature of the Challenge to the Development of Market Economies in LDCs

Greater reliance on competitive markets in LDCs and the growth of indigenous private enterprises are constrained by policy, administrative and developmental impediments. This section focuses on often encountered constraints.

A. Constraints Established by Government Policy

1. The LDCs' Strategy for Economic Development

Government determines the direction of development by establishing the overall development policy environment and a particular strategy. From these government determinations flow the sector policies and regulations which govern the day-to-day activities of the economy. The success of A.I.D. and other donor efforts to support reform of sector policies and government procedures through individual project efforts may not meet expectations if the country's strategy for economic development is not compatible with proposed reforms.

Many LDCs enunciate their overall strategy in their published development plans. But this is not always the case. In fact, development plans sometimes mask real priorities with rhetoric designed to appeal to donors. Efforts to introduce market pricing and producer competition in an LDC committed to socialism and central economic management will not yield the desired results. However, A.I.D. is more often confronted with less severe strategies which also may involve a strong element of central control of the economy by government. In particular, an LDC with a strategy of general import substitution may be reluctant to expose its domestic market to imports even though this may be a policy reform essential for long run, broad-based economic growth. A country whose fundamental development strategy is to achieve food grain self-sufficiency also may not be receptive to policy changes which stress its comparative advantages in other products and its ability to more cheaply satisfy its food requirements through international trade.

The results of general import substitution policies have largely been contrary to the LDCs' expectations.[4] They have entailed serious resource misallocations, have not reduced the dependency on imports (although they may have changed their composition) and have inhibited export growth. As a consequence, foreign exchange constraints and dependency on external resources have been aggravated, not improved, and growth potential has been adversely affected.[5] In contrast, export oriented strategies have given rise to a variety of LDC success stories.[6] Overall, countries that have adopted measures which have let their private sectors aggressively pursue opportunities to export have done relatively well in terms of growth and improvement in living standards. The exports may have been products of indigenous resources (agriculture surplus, natural resources, etc.), or value added to imports. Export oriented strategies have proven their value in promoting economic growth because LDC domestic demand is usually neither sufficient to support the number or sizes of domestic production units required for healthy competition in many product markets, nor sufficient to achieve full employment. **Consequently, A.I.D. encourages a shift from policies which promote general import substitution to policies which open an economy to international trade.**[7]

The transition to an export oriented strategy and A.I.D.'s involvement in it must, however, take cognizance of two basic issues. First, the obstacles to economic liberalization are substantial. Many LDCs have conceptualized their form of import substitution strategy in terms of national security objectives and are reluctant to consider alternatives. In most cases the most sensible (and feasible) approach to assisting an LDC reorient its overall strategy involves the gradual dismantling of controls and price distorting policies first in those areas where success is most likely and change is least threatening to the LDC's perceived national security objectives.

Second, import substitution is not bad **per se**. Efforts that do not run counter to reliance on the price mechanism and which

[4]Bela Balassa and Associates, *Development Strategies in Semi-Industrial Economies* (The World Bank 1982).

[5]Anne O. Krueger, *Trade and Employment in Developing Countries Synthesis and Conclusions* (Natural Bureau of Economic Research 1983).

[6]*Ibid.*

This overall objective is not intended to conflict with specific statutory provisions (e.g. FAA Section 620(d)) and existing Agency policies proscribing activities that would result in direct competition with U.S. enterprise.

seek to exploit productive activities in which a country has a real competitive potential are sound.

Thus, A.I.D. believes it is critical to focus on the development scheme of the government, to assure that its effects are known and weighed. It is also critical to determine the real motives behind what otherwise appear to be poor economic choices in the management of an LDC economy. Finally, in cases in which an LDC is reluctant to modify its overall strategy, there still may be significant scope for private sector activity and use of market prices. **A key objective of A.I.D.'s strategy is to promote, through the policy dialogue associated with U.S. assistance, a greater reliance on market determined prices and the initiative of the private sector.**

2. Government Policies and Regulations Derived from Its Development Strategy

A country's fundamental strategy gives rise to policies and regulations through which that strategy is implemented. The economies of many LDCs are burdened with diverse policies and regulations which seriously impede enhancement of the private sector's role because, as previously explained, many LDCs have until very recently followed development strategies which involve import substitution and public sector control of the economy. This section describes frequently encountered policies and regulations. In this review, it is important to be aware that there is frequently a lag between a change in an LDC's basic strategy and the subsequent change in sector policies and regulations which were derived from it.

• **Foreign exchange policies and regulations:** Most LDCs do not operate an open market in foreign exchange. As a consequence, their foreign exchange rate often differs from that which would occur under free market conditions. When this difference reflects an undervaluation of foreign exchange the outcome is equivalent to a tax on exports and a subsidy on imports. This distorts factor prices in production.

In countries that do not rely on the market for foreign exchange operations, government rules regulating banking sector activities prohibit or severely limit the buying and selling of foreign exchange except for specific (sanctioned) purposes as determined by the national planning process. Foreign exchange for essential requirements of the private sector, such as spare parts, fuel or other inputs, becomes unavailable or is rationed on political criteria, rather than priced according to the urgency and economic importance of its use. Consequently, the buying and selling of foreign exchange by private firms requiring non-santioned commodities occurs in black markets or through totally offshore transactions. The domestic private sector serving the domestic market usually operates in the black market while foreign investors conduct their foreign exchange transactions offshore. In both cases the regulations impose an extra cost on doing business. While some LDCs have allowed parallel markets to develop, the exchange rates in each market are almost always different from each other. Individuals or firms permitted to deal in the official market have a significant price advantage over those who must deal in the parallel market.

• **Import and export restrictions:** LDCs frequently restrict certain types of imports and exports, severely tax some goods, use non-market mechanisms to allocate other imports and establish a large number of procedures for import and export transactions. On the import side, most LDCs require businesses to obtain licenses prior to importing needed commodities. The issuance or denial of these licenses is the mechanism by which the government substitutes political control for the economic judgments of the market place. Licenses are also used to help ration undervalued foreign exchange. On the export side, restrictions are imposed to artificially maintain the domestic supply of a particular good so that prices for domestic consumers may be held down. Of course, the result is also to depress the incentives and financial capability to expand supply.

• **Banking restrictions:** LDCs have traditionally controlled the activity of the private sector through a wide array of rules and restrictions imposed on the banking sector. Interest rate regulations frequently set less than market interest rates causing only the most risk-free loans to be made. The low lending interest rate also suppresses the interest rate on savings, which results in little institutionalized mobilization of resources. Institutional capital does not flow to the most productive uses, particularly the more dynamic and labor intensive small and medium enterprises. Rigid controls may substitute for economic considerations in determining the quantity of loanable funds which can be made available for different types of production and investment credit

needs. Government imposed or permitted collateral requirements narrow the number of entrepreneurs who are eligible for institutional credit.

• **Market entry restrictions:** Many LDCs have erected a ponderous structure of rules and procedures related to the issuance of business licenses and the establishment of corporations. A firm can be established in a few days in a developed market economy, but it may take months or years to legally establish a firm in an LDC. Not only are a large number of steps formally required; the reality of LDC bureaucracy is that each step may require unofficial payments by the entrepreneur in order to move to the next step. Even without corruption, time is money, and long planning times impose a substantial cost which small-scale entrepreneurs lack the capital reserves to manage. Thus, there are considerable financial as well as administrative barriers to market entry.

• **Limitations on investment:** Many LDCs specify a level of investment which they feel is warranted in a particular industry. In some cases the specification is in the form of a limitation on the maximum size of private sector investment. Any number of entrepreneurs may enter the industry, but none can operate above a certain size. This restriction is usually made to protect a large firm which may be owned by the government and would not be able to compete with a private firm of equal size.

Other LDCs restrict the number of firms which can operate in a specific industry. While the purpose of these restrictions is to prevent overinvestment in the industry, the effect is to give the lucky investors excess profits, and government personnel another opportunity to exercise discretionary authority for political or other interests through the rationing of business licenses.

• **Investment promotion programs:** Government may offer a package of investment incentives in order to attract entrepreneurs into activity which the government wishes to promote. This can be done without restricting investment in other industries, but often it is not. However, problems arise when the activities which are promoted follow from administrative determinations which do not reflect the country's comparative advantage in production as might be determined in an open competitive market. Funds invested in promoted industries may be funds denied to other more productive activities which have not been included in the promotion program.

• **Price-fixing:** Countries often set a maximum price to maintain artificially low prices for certain goods. The activity is easiest to enforce when the government operates a price-setting parastatal. However, price-fixing and related enforcement is practiced even without parastatals. The most popular items for price regulation are essential foods and agricultural inputs; however, many countries fix the price of other commodities such as shoes, clothes, batteries and liquor. Price fixing which results in higher than market prices also occurs when the number of private firms in a particular industry is limited so that a suppliers' cartel can be formed.

• **Subsidies:** Closely related to price-fixing are government subsidy programs. Subsidies may be offered to expand consumption or to temporarily protect particularly vulnerable groups from the cost of well advised corrections. However, they are often required to compensate for inefficiencies in production which arise because of policies which restrict private enterprise. Furthermore, perpetuation of subsidies frequently becomes a political necessity for outlasting any temporary justification.

• **Labor Market Laws and Regulations:** Minimum wage legislation that sets excessive levels of wages and fringe benefits, and employment rules that overly restrict hiring and firing processes act to reduce employment opportunities and favor the substitution of capital for labor. Minimum wage laws which set wages above market clearing wage rates do not reflect labor market demand and supply conditions. Either because they are set at unrealistic levels or through their effect on other wages (which change when minimum wages change), they act to push labor costs beyond the capacity of some firms. The impact of fringe benefits, which form a substantial proportion of labor costs in many LDCs, and of regulations covering hiring and separation practices, tends to further dampen demand for labor. Developing countries with a large labor surplus should ask themselves whether the economic and social costs of higher unemployment and economic dislocation are truly compensated for by the perceived political or social benefits of high minimum wage laws.

• **Taxation and User Charges:** LDCs depend more on indirect taxes which are relatively easy to administer (e.g. taxes on exports and imports) than on direct taxes which are more expensive to administer (e.g. income or consumption taxes). Such indirect taxes often impact primarily upon the producers of export commodities, particularly rural producers, and retard export growth. LDCs also tax in an effort to accomplish a specific social purpose, sometimes resulting in very high marginal rates being applied to high income earners and very high duties being levied on "luxury" goods. In these cases, the administration of the tax usually has serious shortcomings and tax amount of evasion is widespread. Also, taxes on income and property usually have high exemption floors. The effect of exemption floors and tax evasion is that the actual number of people or amount of property subject to the tax is very limited and inequitable; administration becomes politicized, and law abiding taxpayers in effect subsidize those who evade taxes. High rates exacerbate inequities and encourage the sheltering of income, including offshore investments. Tax policies should be reviewed, and generally revised to foster development and encourage saving and investment.

User charges, particularly for water, sewers, power and transportation rarely cover costs, and the supply of these services must be financed in part from tax revenues.

3. Policies That Discourage Private Sector Participation In Traditional Government Programs

A variety of policies and regulations similarly discourage private sector participation in the social sectors. For example, the private sector has an important role to play in the delivery of health and family planning services in developing countries. Government resources often cannot support the provision of services for all those individuals who may want them, and some individuals may actually prefer to receive services from sources other than the government.

Governmental policies not only affect their citizens' desire for family planning services, but also the acceptability and availability of the services themselves. Private sector involvement is likely to be more consumer oriented and more likely to offer the range and mixture of product and assistance desired by the public. Moreover, and this is especially important in the family planning area, use of the private sector as a delivery mechanism increases emphasis on personal choice and responsibility and reduces dependency upon the government. The active involvement of the private sector in the delivery of family planning services may depend to some degree on government policies regulating not only the distribution and advertising of particular contraceptive methods, but also on policies which cover the organization and operations of non-governmental organizations.

Many LDC governments sustain policies whereby all government services are provided free of charge, regardless of governments' ability to finance these services and in spite of demonstrated client willingness to pay for some or many of these services. Yet, at the same time, all LDC governments lack the financial resources to provide nationwide access. The result of these policies is the underfunding of basic health services, which are often of extremely poor quality (thinly staffed and deficient in drugs and supplies) or existent more in theory than in fact. Clients are left **de facto** to rely on whatever private health services exist, and these services must compete with "free" (albeit inaccessible) goods.[8] Furthermore, insistence on government provision of services has impeded the private sector from filling the health care gap. Studies in various settings have demonstrated strong consumer demand (as evidenced by willingness to pay) for quality health services provided by government and private sources.

Similarly, there is potential both for involving the private sector more fully in the provision of education and training services and inputs, and for shifting some of the costs of education from the public to the private account.

At the primary or basic schooling level there is potential for private and local organizations to play larger roles in the administration of schools. People in most LDCs are no different from people in our country. Education of one's children is a highly valued objective. In most cases, schooling at this level will continue to require some public subsidy from central revenue sources. However, most strategies of localizing and diversifying school systems require the active

[8] A.I.D. Evaluation Specific Study No. 20, "Prospects For Primary Health Care In Africa: Another Look At The Sine Saloum Rural Health Project In Senegal", April 1984, Abby L. Bloom.

encouragement of private and local organizations including community self-help groups, in the provision of basic schooling (see A.I.D. Policy Paper entitled **Basic Education and Technical Training**).

Such organizations are also prominent in the provision of pre-school education and non-formal education or skills training for adolescents and adults. The initiative for starting and sustaining these programs tends to be private, as they tend to be additional to the government's basic education mandate. The most effective form of public support is often some form of technical support services, rather than direct subsidies.

At the secondary, vocational/technical and higher education levels there is an even stronger case for shifting more of the costs of education to the private account, either through tuition and other fees or through reliance on private organizations and employers to provide the training, perhaps supported by partial tax credits. In many countries, half or more of the education at these levels is provided privately, with little or no public subsidy other than essential technical services such as examinations administration. It is essential to keep in mind that at higher levels of education and training, the private benefits tend to equal or exceed social benefits. This is true especially where only a minor fraction of those eligible are able to benefit. Thus, excessive public subsidy of these levels and types of education and training drains resources needed for the provision of basic education and skills training with higher social benefits.

Finally, regardless of how education and training systems are administered and funded, there is great potential for the private provision of education and training inputs. For example, private contractors can often build schools and handle the printing and distribution of texts and other instructional materials at less cost, more quickly and with more attention to local demand or design requirements than can central ministries. (And not to be overlooked is the development of managerial and entrepreneurial skills which can have a multiplier effect on a society.) As school systems expand, other opportunities for privately provided services also expand, ranging from housing and transport for students and teachers to commercial media, data processing and telecommunications services.

In the agricultural sector, government policies and programs have restricted the operation of markets and entrepreneurs. Agricultural subsidies and related price controls adopted by many LDC governments in areas such as food marketing and distribution, marketing of agricultural inputs, and agricultural credit have tended to result in substantial reductions in efficiency and productivity with little or no benefit to the disadvantaged groups they are often supposed to help. Moreover, LDC governments often intervene directly in the physical distribution system for both agricultural inputs and outputs in order to enforce such controls.

While there are certain areas in the agricultural sector (such as agricultural research and extension) where government involvement is useful or essential, this involvement should permit parallel or complementary private sector activity. For example, private seed and fertilizer/pesticide companies have been important research centers in the U.S.

Finally, many LDCs maintain policies that discourage the efficient provision and maintenance of infrastructure, both in rural and urban areas. Private road maintenance, urban public transit, water supply and sanitation are examples of other areas where enhanced private participation in the provision of both services and infrastructure can produce significant efficiencies.

Performance contracting for private road maintenance is one such instance. In 1970, for example, in a very large South American country, the highway department began a contracting-out program that by mid-1981 had reduced the size of the public maintenance network by 75% and there were 264 contracts for private maintenance. Similar experience in many other countries for some 19 categories of private road maintenance activities was shown in a recent IBRD study to have resulted in an average 37 cost percent reduction in comparison to public provision of like services. In one large African country, the results were more dramatic because no maintenance had been occurring prior to private contracting.

In urban "public" transport also, the pressure for private provision has grown as a result of shifts in public attitudes and the demonstrable efficiencies that have occurred as the result of the shift from public to private provision. Until rather recently, conventional attitudes were that large public systems operating with fixed routes, large operating units and larger vehicles were

more efficient than private systems. These attitudes have changed substantially as the result of careful empirical studies comparing the relative efficiency of public vs. private service in numerous large Asian and South American cities, as well as the experience with large operating deficits and poor service of the existing public systems.

The experience with private vs. public provision in the developed world and the problems of infrastructure provisions in LCDs has also led to renewed interest in private ownership as well as operating and maintenance agreements between ministries and private firms. Careful econometric studies of private water enterprises in the U.S., for example, have shown that private operating expenses were some 25 percent less than those of comparable public operations. Other studies have shown that as the result of existing patterns of public cross-subsidization in many LDCs, existing users of public systems are resistant to extending service to low-income areas even though the prices that low-income water users are currently paying substantially exceed the cost of supplying water from a central system. As a result, through private systems, with fewer cross-subsidies and appropriate pricing, higher quality central system service can often be supplied to low-income residents when it would not have been possible with a public system.

The above examples are particularly interesting in that sole public provision of infrastructure and services often has been based on theoretical justifications (e.g. natural monopoly, externalities, merit goods) set forth in annex A. However, these justifications have often proved erroneous (as is clear in the case of urban transit) and rarely justify a policy of both public finance and supply.

These erroneous justifications and rationales for public provision also characterize a wider range of other state-owned and controlled public enterprises discussed in the section to follow.

4. Government Ownership of Enterprises and the Designation of Monopoly Responsibility

The policies, regulations and programs described above are often used to support not only a specific development strategy, but also a set of government owned enterprises (parastatals) or authorized private monopolies. The rationales used to justify these enterprises are many. While the validity of a public enterprise must be judged in the context of the individual country setting, many of the original rationales underlying their establishment—mostly having to do with self-reliance, equity objectives and the assumed inefficiency of the private market—have been found to be erroneous.

Even today, many LDCs operate public enterprises without having to account for the real costs of operation. Revenues are rarely matched against expenses in terms of full cost recovery. Nor are they ever compared in accounting practices. During the 1970s, because markets for primary products remained reasonably buoyant and development was supported by borrowing from the private capital markets and by the introduction of new technologies, the costs of public enterprises were not an issue. However, in a number of LDCs, deceleration of development, declines in prices of primary products, and failures to adjust to the new cost of energy have led to mounting debt and foreign exchange shortages. Governments have been forced to examine the economic efficiency of current resource allocations.

The poor record of state enterprises has become a drain on scarce resources and a liability to economic growth. However, political pressures have slowed the dismantling of these institutions. Thus, the changing attitudes toward parastatals have been accompanied by interest in mechanisms short of sudden divestiture which might be used to correct their poor performance. In general, the performance of state enterprises appears to reflect the degree to which public authorities have relied on market forces to guide the activities of both public and private enterprise. Studies of the market structure in which many LDC public enterprises operate, have revealed an essentially non-competitive environment, including insulation from both foreign and domestic competition. This insulation is buttressed by wide ranging subsidies as well as tax and regulatory preferences.[9] Indeed, where the market has not been relied upon to allocate resources, the operation of parastatals and government authorized monopolies has resulted in considerable financial and economic costs.

This problem has been compounded by problems of multiple and unclear objectives for these firms which make it easier for

[9]See *World Development Report 1983*, The World Bank.

public enterprise managers to excuse inefficient performance by appealing to conflicting objectives. Furthermore, in many cases these firms are subjected to short-term political pressures and interferences in day-to-day operations. If objectives are multiple and unclear or political expediency determines corporate policy, it is inherently difficult to measure and evaluate performance on any objective scale.

B. Constraints Related to Commercial and Country Risk

Certain constraints to private enterprise development can be attributed to risks associated with a country's level of development. Some stem from government action or inaction but others depend upon the resource endowment of the country. These constraints frequently include inadequate infrastructure, lack of access to technology, underdeveloped human resources, inadequate energy supplies, vulnerability to natural disasters, poor communications, rural, urban and regional disparities and other market imperfections. These contraints affect development through the availability and cost of investment funds, including insurance.

The large increases in LDC debt which occurred during the 1960's and early 1970's demonstrated that many LDCs had not faced a situation where capital was lacking. Today many LDCs still can obtain foreign capital; however, the terms have hardened considerably. Large variations exist, but the costs of foreign borrowing to LDCs are substantially higher than the costs to developed countries, and the higher costs reflect a more sober assessment of risks related to the country's level of development. These risks are viewed by lenders to be of two types—investment risks and country risks. Their relative importance depends on the specific country in question.

1. Investment (Commercial) Risks

The first category of risks relates to the quality of the investment. Many LDCs face serious constraints which limit their ability to comprehensively design, analyze and implement public investment proposals. In embracing a significant development agenda, staff resources of LDC ministries become stretched too thin; important data may be unobtainable; and adequate management resources for implementation may not materialize. Despite potential economic gains, public investment proposals often lack the creditability needed to immediately obtain donor or commercial funds. Five year development plans contain many such investment proposals. The consequence is that donors and international lenders discount the LDC's estimated rate of return on public investments and frequently conclude that even a small investment will exceed the LDC's absorptive capacity. If elements of the proposal have merit from a donor's perspective, the donor will become extensively involved in assisting the LDC redesign the proposal before making funds available. Commercial lenders will not expend such an effort but will look elsewhere, usually to more developed countries, for investment lending.

While an LDC's national pride or its sense of urgency for development may in part explain the quality of public investment proposals, an important cause is the scarcity of trained personnel in the LDCs. In many LDCs, particularly those in the lower per capita income range, a mere handful of trained people relative to the population at large can be found to develop the public sector's investment proposals. A similarly small group of people can be found to manage effectively project implementation.

Private sector investment proposals by LDC firms may also tend to lack realism. Particularly, assessments of indigenous firms' capabilities in terms of meeting production targets, delivery schedules and quality standards may be overstated. More importantly, the success of many investments depends upon the personal relations between the local businessman and key government officials. These are subject to sudden change.

2. Country Risks

The second group of risks which have hardened the terms of capital available to LDCs are the risks associated with the political and economic instability of the country. On the political side, wars, revolutions, coups and civil disturbances will influence the cost of commercial capital and availability of donor assistance. On the economic side, fluctuation in the price and supply of LDC primary commodities has raised foreign lenders' risks.

Besides raising the interest rate of commercial capital, the risks of political and economic instability cause the lenders to reduce the repayment period. In fact, one of the most noteworthy behavior characteristics of both foreign and indigenous investors in

LDCs is the extremely short time horizon expected for an investment payback.

These two risk effects have dramatically restricted investment opportunities in LDCs since rates of return must be very high to cover investment risk interest and very short payback periods (on the order of six months to one year and a half) to hedge the country risk. Given this fact, there is a strong preference among foreign and indigenous investors to finance trade rather than fixed plant and equipment.

IV. A.I.D. Policy to Meet the Challenge

Statement of General Policy

A.I.D. assistance to an LDC should encourage social and economic development that promotes movement toward a democratic, free market society. It is A.I.D.'s view that such societies are most efficient for generating broad based, sustained economic growth and social progress. A.I.D. should program its resources in support of LDC performance towards this objective.

A.I.D.'s private enterprise policy is intimately related to the need to conduct our programs in an environment of policy dialogue with the host country. The essence of this policy dialogue should be to deal with the country's development strategy and related policies as they affect the operation and growth of free markets and private entrepreneurship. However, policy dialogue leading to policy reforms which encourage LDC private enterprise development may not be sufficient to achieve the desired objective. Therefore, A.I.D. should also engage in specific direct program actions to eliminate legal, regulatory and other constraints to private enterprise development, and to assist and promote private enterprises. In this regard, A.I.D. personnel who plan and implement such programs should endeavor to learn as much about the indigenous private sector in their host country as they do about the operation of the ministries and parastatals which are responsible for or involved in the principal sectors of the Country Program Strategy.

The overriding intent of A.I.D.'s private enterprise policy is to promote the establishment of a climate conducive to LDC private sector activity; it is not intended primarily to finance the establishment of individual business entities **per se.** The two-pronged objective, to reach the ultimate goal of growth, is the establishment of viable, competitive markets and the expansion of private enterprise in LDCs. These objectives may not be met by establishment of a particular firm unless the establishment of the firm leads directly towards the development of a competitive market in the LDC or becomes a demonstration project that can readily attract private replication.

A.I.D.'s preference is to build up and rely on the indigenous private sector for the long run economic development of the LDC, rather than to assist continued reliance on parastatals. A.I.D. has a particular interest in exposing productive activities to market forces rather than subjecting them to administrative plans. A.I.D. has a particular interest in reducing and eliminating subsidies. Finally, A.I.D. has an overriding interest in ensuring that activities carried out to develop competitive markets and private entrepreneurship can be shown to benefit A.I.D.'s target group as defined in the FAA.

A.I.D.'s promotion of free markets and the private sector should not be confused with monopoly enterprises, oligarchy or "crony capitalism", which have little to do with the free market. A.I.D.'s effort to encourage competition and entrepreneurial activity is as much a challenge to the limited capitalism extant in some countries as it is to statist economies.

There are no restrictions on the types of funds or modes of assistance applicable to the pursuit of the private enterprise objectives. ESF, DA and PL 480 loans or grants are all appropriate ways to support private enterprise development. Forms of assistance such as studies, short or long term technical advisors, commodities, training or resource transfers can be used either as components of project or non-project assistance in exchange for appropriate policy changes or for support of country performance in areas of significance to private enterprise development. Local currency generated from non-project assistance can also be programmed effectively in support of private enterprise development.

Assistance to promote competitive market conditions and indigenous private enterprises should not be considered as a separate portfolio of activity independent of other sectors of interest to the country assistance strategy, such as agriculture, health, education, etc. The promotion of a democratic, free market economy should underpin and be incorporated in all aspects of A.I.D.'s country programs.

A.I.D.'s private enterprise initiative is directed at the development of the LDC's private sector. A.I.D. will utilize the U.S. private sector to help it achieve this objective. However, the use of U.S. private sector frims to provide technical assistance, commodities and other services does not constitute in and of itself an act which fulfills the intent of this private enterprise policy. In accordance with the F.A.A., the use of U.S. firms on projects to the maximum extent possible is standard operating procedure for all projects. Skills, commodities and services available in the U.S. private sector are valuable to help solve almost all of the problems confronting development. However, their use on a project does not automatically mean that the outcome of the project will be the direct improvement of the LDC private sector or the furtherance of an open, free market economy. Therefore, 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.

Similarly, the implementation of the private enterprise initiative need not be exclusively through firms in the U.S. private sector. While such firms are often the most appropriate source of expertise, U.S. universities, PVO's and government agencies may also be suitable resources particularly in helping LDCs establish a policy environment conducive to the growth of indigenous private enterprises.

As LDCs develop more market oriented and open economies, U.S. private enterprise should benefit from new markets for inputs to higher levels of LDC economic activity and more opportunities to enter into mutually profitable business relationships with LDC entrepreneurs.

V. Specific Components of the A.I.D. Policy

The following specific policy guidance reflects A.I.D.'s experience in designing, reviewing and implementing project and non-project activities in support of private enterprise development. A specific mission program to carry out this policy will depend on the policy, institutional and legal conditions which prevail in the country. Therefore, this policy paper will not set specific Agency program priorities indicating which A.I.D. supported activity should take precedence. These decisions are to be made at the mission strategy, program and project levels.

A. Agency Target Group

The FAA states in Section 101 and 102 that one of the four principal goals of U.S. foreign economic assistance is "...the alleviation of the worst physical manifestations of poverty among the world's poor majority...". It further declares "...that the principal purpose of the United States bilateral development assistance is to help the poor majority of people in developing countries to participate in a process of equitable growth through productive work and to influence decisions that shape their lives, with the goal of increasing their incomes and their access to public services which will enable them to satisfy their basic needs and lead lives of decency, dignity, and hope." Projects which implement A.I.D.'s private enterprise policy should clearly demonstrate the linkages between the activity which is to occur on the project and progress toward this primary FAA objective.

B. Policy Dialogue

1. Before entering into discussions with the host country representatives on specific project activities, missions should have a firm knowledge of the macroeconomic policy environment including the overall development strategy of the host country and how this affects the emergence or operation of the LDC's private sector. The mission's program should concentrate on macroeconomic or sector policies as appropriate in the specific country circumstance. Efforts to reform policies considered subsidiary to the country's development strategy more likely will be successful when the overall strategy

is complementary (or not an impediment) to the reform of these subsidiary policies. However, pursuit of a policy dialogue within a specific sector may be a valuable way to help LDCs overcome political difficulties associated with macroeconomic reforms. "Experimental" reforms within a sector may be more politically palatable to the LDC and may become a model to be applied to other sectors and the economy at large. From our experience, the policies most damaging to the indigenous private sector are those discussed in Section III above.

2. Project and non-project assistance which is primarily aimed at reforming policy should include complementary actions which institutionalize the reforms in the form of revised laws, regulations, or procedures. In addition, projects should seek to institutionalize the capacity to carry out policy analysis to support continued reforms.

3. Each project which provides assistance to stimulate specific activity within the indigenous private sector must recognize the policy environment and its effects on the outcome of the project. Insofar as the policy environment is not conducive to sustaining the outcome of a proposed project after the A.I.D. resources have been expended, the mission should not proceed with the final design of the project until it can demonstrate that the appropriate policy reform will take place when it is needed. Such reform may be undertaken by the host country as part of the project design or implementation effort (learn-by-doing approach) or it may result from other A.I.D. or other donor activities. However, the project documentation must show that there is a reasonable expectation that the appropriate policy reforms will occur.

4. A.I.D. believes that the operation of the heterogeneous, dynamic and largely unregulated informal economy provides a powerful argument in favor of eliminating uneconomic controls on the formal economy. In countries amenable to policy dialogue and related reforms, direct A.I.D. assistance to enhance the importance of the informal economy is a valuable complementary program to policy dialogue with the LDCs governments. In countries which are reluctant to discuss policy, assistance to productive activities carried out in the informal private sector may be the only effective way to stimulate broad-based growth and development—such assistance is, in any case, highly cost effective in terms of meeting A.I.D.'s mandated target group who are found in great numbers in this labor-intensive, capital-saving sector. A.I.D. has a strong interest in programs which support the informal private sector.

C. Legal and Regulatory Constraints

The expansion and efficiency of the private sector depends upon a supportive legal structure and a positive regulatory environment. The existence of an adequate structure of property rights—including patent and copyright law, contract law and judicial arrangements which facilitate adjudication are essential.

1. Each project which provides assistance to the indigenous private sector must describe and analyze the relevant legal and regulatory structure which affects the outcome of the project. The project must also show how changes in this structure will occur as necessary for the project to achieve its purpose.

2. It may be that individual country circumstances will require a significant institutional development effort to build appropriate legal and regulatory institutions conducive to private enterprise. Specific projects or sub-project activities which provide assistance for studies or advisory services to review or reform legal and regulatory barriers, are encouraged.

D. Assistance to the LDC's Private Sector

A.I.D.'s purpose in these policies covering assistance to the indigenous private sector, is to stress management improvement and technology transfer through advisory services and training. In addition, A.I.D. believes it is essential to avoid creating fictitious (non-market) conditions for the indigenous private sector through the offering of highly concessional terms for A.I.D. financial capital. A.I.D.'s highly concessional terms will not be the cost of capital required by the indigenous private sector to sustain and expand production and services. Consequently, A.I.D. agreement to highly concessional terms postpones the need for the

recipient firm to manage its resources and make its decisions on the basis of market forces. It also relieves pressures to institute essential reforms in financial markets such as the introduction of positive interest rates for savings and lending. Finally, concessionality is, in essence, a grant of capital to the owners of equity of the firm and, therefore, generally an inappropriate use of U.S. funds.

1. A.I.D. resources should be channeled through the private sector rather than the public sector, when host country conditions make this possible. In many cases, it may be feasible to contract with a private sector firm to provide what might have been provided through a government ministry.

2. Recognizing that concessional assistance to a private sector firm is, in essence, a grant of capital to the owners of equity of the firm, its appropriateness must be based upon the unusual innovations or developmental risk assumed. That is, the loan or grant must be based on the externalities of the project which go beyond the business itself (examples: development of a new, easily replicable technology, introduction and marketing of new services, etc.).

3. If an indigenous private enterprise is to receive and manage A.I.D. resources to accomplish a specific development objective, and several LDC firms are capable of carrying out the activities, the firm to be used should be selected by an appropriate competitive process or evaluation.

4. A.I.D. may use grants or loans with concessional terms to finance direct training of and technical assistance to LDC private enterprises. Concessional assistance is particularly useful when:

a) Training and technical assistance has as its direct objective the improvement of competition in the industry.

b) New technology is transferred to the country. In this case A.I.D. should take care that its use of concessionary finance is proportionate to the transfer of technology (not the normal commercial risk) and does not hurt the marketing of such new technology by the U.S. private sector through normal commercial channels.

5. A.I.D. will not take an equity position in a private enterprise. However, long term or subordinated debt or convertable debentures may be permitted where it is appropriate that A.I.D. share in the risk or the growth of a new operation.

6. A.I.D.'s provision of financial capital to an LDC private enterprise will be subject to the following conditions:

a) **When its purpose is to provide financial capital to a financial institution so that it can increase its current on-lending to a specific A.I.D. target group:** In this case A.I.D.'s resources should be channelled only to development activities which are 1) consistent with A.I.D.'s country development strategy and 2) unable to attract the full amount of required financial capital from commercial sources. A.I.D. is willing to assume the risks associated with a country's political or economic situation, which may be impairing institutional access to commercial credit.

The on-lending of the financial institution to the A.I.D. target group should be at LDC market determined terms (interest and repayment period). If interest rates or repayment periods are artificially set by the government, the rates agreed to under A.I.D. projects should be part of a planned effort to achieve market terms in the LDC's capital market. As a minimum, it should be at positive rates to prevent decapitalization and economic misallocation of resources.

In situations in which foreign exchange risks make it inappropriate for private borrowers to assume a dollar debt, A.I.D.'s financing may be passed through a host country's government entity (e.g. central bank), the discount rate charged to the financial institution by the government entity should reflect the real cost of capital within the LDC.

A.I.D. funds provided to financial institutions should avoid introducing government ministries or parastatals into the on-lending approval process where such involvement does not now exist. Furthermore, such projects should seek to extract government ministries and parastatals from the process if they are now so involved.

b) **When its purpose is to initiate an entirely new venture or activity in the LDC's private sector to reach a target group previously not served.** In this case, concessionality may be warranted to finance the extraordinary start-up costs associated with introducing the new venture or activity. (Extraordinary costs are costs which would not be incurred by subsequent investors who enter the market on the basis of the success of the initial enterprise.) In this case, the concessionality may be linked to project components such as advisory services and training. Concessionality may also be warranted to finance special costs arising from the newness of the venture or the requirement of direct benefit to a specific AID target group. These special costs could include the need to hedge certain risks and provide for normal profit.

In developing such projects, missions are encouraged to consider alternative methods of providing concessionality in order to avoid distorting sound business management practices which may follow from the offer of up-front concessionality as a hedge against losses.

c) **Detailed guidance on A.I.D. Loan Terms will be provided in a forthcoming Policy Determination.**

E. Private Sector Participation in the Provision of Traditional Government Services

A.I.D. encourages an expanded role for the private sector in delivery of services and supports the development of a multiplicity of channels for services. The private sector is an important factor in allowing consumers to have truly free choice and A.I.D. will continue to support its growth.

1. With regard to population, the flexibility and innovativeness of the private sector, both voluntary and for-profit, are a vital component of an effective system for the distribution of contraceptives. Where supplies are sold through the commercial market, either at full price or at subsidized prices, cost recovery can be maximized and dependence on external sources of support is decreased. In many developing countries, there is not a nationwide government structure for the delivery of services. But in almost all towns there are market outlets through which contraceptives can be sold along with other common commodities. AID support for social marketing of contraceptives has expanded proportionally more than any other type of delivery system over the last few years, and we will continue to support such programs.

2. With regard to improving health care, a variety of opportunities should be pursued to harness private resources. First, private funds (i.e., client fees or payments in other forms) should be encouraged to pay for services for which there is existing demand. Fees-for-service, fees for drugs, and prepaid cooperative or insurance schemes have been implemented successfully in different settings. Second, private channels (radio, advertising media) can be used to stimulate demand for services. Third, private sources can be used to manufacture drugs and medical supplies, and private channels employed for their distribution, thereby eliminating costly and inefficient duplication between public and private sources.

3. In education, A.I.D. encourages the diversification of school providers so that parents have a choice in determining the type and quality of their children's education. For many LDC's this implies an expansion of private education and community based schools. A.I.D. supports a shifting of more costs of education to the private account, particularly at the higher levels of education. Finally, A.I.D. assistance should engage the private sector in a wide variety of schooling related services from construction of facilities to the provision of instructional materials.

4. In agriculture, A.I.D. supports a substantial transfer of responsibility to competitive markets and private enterprises. In particular, the market should have primary responsibility for determining the price of agricultural commodities and inputs. Similarly, the private sector should have principal responsibility for the provision of agricultural inputs and credit. For example, irrigation offers opportunities for an expanded private sector role in activities such as on-farm development and systems design. In addition, A.I.D. should seek creative ways to increase the involvement of the private sector in traditional government programs such as agricultural research and

extension. In particular, A.I.D. encourages the development of new arrangements between input suppliers, farmers and marketing firms such as "contract" or "satellite" farming.

5. In energy, A.I.D. encourages private sector development of fossil fuel resources where there is a potential for equity investment or for private operation and management. Energy conservation activities should tap private engineering capabilities rather than government owned or controlled organizations. For renewable resource development, especially for applications for rural development, the private sector should be viewed as the primary dissemination mechanism for providing new technologies for cooking, heating, irrigation, mechanical power and lighting.

6. A.I.D. supports programs to involve the private sector in a wide variety of public service activities through such techniques as contracting for management, operation and maintenance of facilities. This is particularly important in the transportation sector.

F. Parastatals and Government Authorized Monopolies

1. A.I.D. assistance to or through a parastatal should be given in the context of exposing the parastatal to market forces and scheduled divestiture of the government interest. This objective is more likely to be achieved through an evolutionary process rather than as a result of an A.I.D. insistence on the immediate and complete divestiture by sale to the private sector. A.I.D. resources should start a policy dialogue which initiates the process even if there is no initial commitment from the LDC on eventual divestiture. AID resources should assist the process as LDCs indicate interest in reducing the financial and management burden accompanying state ownership of companies. The experience of a number of LDCs which have divested parastatals suggests that measures to improve the management and operational efficiency of a parastatal has helped the divestiture process. A.I.D. projects designed to improve parastatal performance must have identifiable benchmarks upon which substantive progress towards divestiture can be measured. However, the burden of proof rests squarely with Missions proposing such activities to demonstrate that the proposal can achieve meaningful objectives, and that the selected benchmarks represent substantive evolutionary progress in moving the parastatal towards market-based operations and divestiture.

2. A.I.D. encourages the introduction of employee stock ownership plans (ESOPs) as a method of transferring a parastatal to private ownership.

3. In assisting an LDC through the divestiture process, A.I.D. should explicitly consider the consequences to the parastatal's employees of transferring all or part of the parastatal's activities to the private sector. In this regard A.I.D. resources could be used to assist those employees who may be adversely effected by the firm's transition from state to private ownership by job retraining or job placement assistance.

G. Capital Saving Technology

Decisions on what technologies are promoted by A.I.D.'s private sector related activities should be based on a rational assessment of the particular economic and financial circumstances in which the specific private sector effort is taking place. Where appropriate in terms of capital and labor availability, capital saving technology should be encouraged.

Capital saving technologies of interest include tools, production processes and delivery systems. Capital saving technologies should in general have the following characteristics: (1) they should be compatible with the local cultural, economic, environmental, political and social context in which they are imbedded and in which they interact; (2) they should involve the local community or be otherwise physically and financially accessible to the poor; (3) They should be able to be maintained and repaired by relying on locally available labor skills, spare parts and organizational capacity; (4) They should be widely replicable; and (5) they should be economically efficient. Generating employemnt and increasing income for the poor is a fundamental objective of AID's development efforts. Accordingly, a project which uses

more local labor and less capital goods without substantially increasing project costs or entailing a loss in output quality is to be preferred to alternative projects with a more capital intensive nature.

H. Training Activities

A.I.D. should promote and assist in training LDC indigenous entrepreneurs in business related topics. Such training could range from very short training sessions for small, independent entrepreneurs in both the formal and informal private sector, to more substantial efforts utilizing participant training and advisory services. A.I.D. will encourage public and private efforts to develop the human resources of the host country consistent with our policies as stated in the **Basic Education and Training Policy Paper** and the **Participant Training Policy Determination.** This is especially important in countries with low literacy rates.

I. Infrastructure

The infrastructure systems most relevant to improving competitive markets and private enterprise are reliable power, transport and communications.

A.I.D. is willing to assist in the development of these facilities under the following terms:

- A.I.D.'s first priority is the provision of technical assistance and training toward institutional development defined as improved management so that services are reliable, well maintained and managed in a businesslike manner in terms of cost recovery and capital growth.

- A.I.D. is willing to cooperate with other donors in parallel efforts to improve these types of infrastructure. However, where possible, A.I.D.'s involvement should be focused on the institutional development aspects of the project rather than the finance of capital development.

- When budgets permit, A.I.D. is willing to finance capital costs of infrastructure systems when it can be demonstrated that such finance is an essential complement to the institutional development objective and no other funds are available. However, the long-term financing of infrastructure is a matter of critical concern to A.I.D. Where possible, the costs of infrastructure (particularly operation and maintenance) should be covered by user fees. Where infrastructure is provided as a public good such that user fees cannot be introduced, costs must be recovered through some other mechanisms such as the use of community funds, special assessments or general tax revenue. Where charges or other revenue sources do not cover the cost of at least maintaining the infrastructure, A.I.D. will not, in general, support a major investment in infrastructure.

J. Research and Studies

A.I.D. is willing to assist in research and studies which provide a better understanding of the importance of competitive markets and private entrepreneurship to LDC policy makers. Such research and studies should be results oriented in support of policy dialogue. These activities could be carried out with direct A.I.D. sponsorship or by building up the capability of host country institutions to carry out such research and studies.

VI. The Responsibilities of Missions and Regional Bureaus

The principal responsibility within A.I.D. to carry out the private enterprise policy rests with the A.I.D. field missions and their respective regional bureaus. As noted above, the promotion of competitive markets and private enterprise in LDCs is not a sector or an add-on to the project. Rather, it is a fundamental objective of A.I.D.'s assistance to LDCs. It is firmly based in both economic theory and successful development experience.

ANNEX A

Natural Monopolies: Until recently, the concept of a natural monopoly was not controversial. The generation and distribution of electric power, telecommunications and some forms of transportation were assumed to be natural monopolies. However, today's technological advances make it more difficult to define a natural monopoly. Activities which are site-specific and require heavy investments in infrastructure to achieve the least cost in the production and distribution of goods have been considered as natural monopolies. However, applying this definition to specific situations usually provokes debate among different political and economic interests within an LDC and different countries have reached different conclusions in similar situations. However, even when a domestic political consensus exists that a particular activity fits a definition of a natural monopoly, there is considerable room in most LDCs to manage the function in a profitable or at least a cost-minimizing fashion. The implementation, construction and management of the public good can often best be undertaken by the private sector with public oversight, as in the case of regulated public utilities.

Goods With Externalities: An externality is associated with particular goods or services when individuals or groups cannot be excluded from benefiting from (or being harmed by) the provision of the goods or services to another intended group. Furthermore, no pricing mechanism can be established to compensate (or charge) the supplier comensurate with the additional recipients' estimate of the benefits received (or costs incurred). For example, when some children in a village are immunized against an infectious disease, those who are not immunized still receive some benefit because their chances of infection have been reduced. Even in situations in which there is a significant demand for immunization, free riders can take advantage of a competitive market's inability to charge them for the benefits they have received by virtue of the consumption of others. If the prevalence of free riders threatens the existence of the market, the good or service may be declared a public good and non-market procedures introduced to ensure that the supply continues.

Merit Goods: Merit goods are goods which society (often paternalistically) argues are good for the individuals and should be consumed in a greater amount than the individual would purchase in a free market.

For example, at a market determined price an individual may not consume an amount of education that society believes he or she should. Consequently, society, acting through government policy, may interfere with the market by lowering the price of education through a subsidy. However, a developing society also benefits in that the general level of competence has risen. Consequently, it is in society's interest to try to expand the supply and consumption of such a merit good for the benefit of all.

Many activities in the fields of public health and education provide good illustrations of externalities and merit goods. For such services a government may provide a higher level of service or set a lower price than that which would result from purely competitive market forces. However, many LDCs have identified natural monopoly situations, externalities and merit in a wide variety of other goods and services and have abrogated the market to provide an administratively determined quantity of goods and services at an administratively determined price. In most LDCs the list of public goods or quasi-public goods includes such items as food, clothing, energy, transportation, agricultural inputs, construction materials, and communications equipment.

A.I.D. Policy Papers and Policy Determinations

The following reports have been issued in a series. These documents with an identification code (e.g. PN-AAM-323) may be ordered in microfiche or paper copy. Please direct inquiries regarding orders to:

A.I.D. Document and Information
Handling Facility
7222 47th Street
Suite 100
Chevy Chase, MD 20815

Title—Policy Paper	Date	'Fiche #
Domestic Water and Sanitation	May 1982	PN-AAM-323
Food and Agricultural Development	May 1982	PN-AAM-322
Nutrition	May 1982	PN-AAM-321
Recurrent Costs	May 1982	PN-AAM-319
Population Assistance	September 1982	PN-AAM-320
Private and Voluntary Organizations	September 1982	PN-AAM-318
Women in Development	October 1982	PN-AAL-777
Pricing, Subsidies, and Related Policies in Food and Agriculture	November 1982	PN-AAN-373
Approaches to the Policy Dialogue	December 1982	PN-AAM-431
Basic Education and Technical Training	December 1982	PN-AAM-190
Health Assistance	December 1982	PN-AAL-817
Institutional Development	March 1983	PN-AAN-108
Co-Financing	May 1983	PN-AAN-457
Local Organizations in Development	March 1984	PN-AAQ-157
Energy	July 1984	PN-AAQ-160
Urban Development Policy	October 1984	PN-AAQ-158
Shelter	February 1985	PN-AAQ-162
Private Enterprise Development (Revised)	March 1985	PN-AAQ-163

Title—Policy Determination	Date	'Fiche #
PD #1—Narcotics	August 5, 1982	PN-AAM-443
PD #2—Mixed Credits	September 29, 1982	PN-AAM-444
PD #3—Voluntary Sterilization	September 1982	PN-AAM-445
PD #4—Title XII	October 5, 1982	PN-AAM-446
PD #5—Programming PL 480 Local Currency Generations	February 22, 1983	PN-AAM-591
PD #6—Environmental and Natural Resources Aspects of Development Assistance	April 26, 1983	PN-AAN-375
PD #7—Forestry Policy and Programs	May 16, 1983	PN-AAN-376
PD #8—Participant Training	July 13, 1983	PN-AAP-273
PD #9—Loan Terms Under PL 480 Title I	September 27, 1983	PN-AAN-753
PD #10—Development Communications	February 17, 1984	PN-AAP-616
PD #11—Using PL 480 Title II Food Aid for Emergency or Refugee Relief	July 26, 1984	PN-AAQ-159
PD #12—Human Rights	September 26, 1984	PN-AAQ-161