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# A FRAMEWORK FOR ALLOCATING AID

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# A FRAMEWORK FOR ALLOCATING AID


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# A FRAMEWORK FOR ALLOCATING AID

## I. INTRODUCTION

Economic development of LDCs serves a variety of legitimate U.S. foreign policy interests: (a) specific U.S. strategic, political and economic objectives in individual countries; (b) long-term U.S. political and humanitarian objectives deriving from the recognition that interdependence between rich countries and poor requires efforts by the former to assist in the realization of development aspirations of the latter. The U.S. has an array of economic instruments which can be employed in pursuit of these multiple objectives in LDCs.

LDC needs and capacity to use effectively various forms of economic assistance vary widely country by country, and for the same country over time. Similarly the degree of concessionality in the various policy instruments available to the U.S. varies considerably; e.g., the terms vary from pure grants to concessional loans to near commercial Ex-Im, CCC or HIG credits.

The present paper is designed to provide a conceptual framework for relating various U.S. instruments of assistance to the economic circumstances prevailing in various LDCs with a view to promoting the attainment of overall U.S. objectives in these countries. In the absence of a framework policy decisions may be made on an ad hoc basis and could result in an ineffective use of U.S. resources.

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Specifically, the objective of developing a framework is threefold: (a) Determine the proper mix of policy instruments that the U.S. and AID should use in pursuit of its objectives, in light of varying LDC circumstances and needs. (b) Enhance the ability of the USG and AID to make decisions in allocating concessional economic assistance in light of changing LDC economic circumstances in a planned, integrated and rational fashion. (c) Examine existing allocation of concessional economic assistance in order to determine whether reallocation in existing country programs is desirable. It is not intended that this framework be directly applied to determine actual levels of concessional assistance to individual countries. Rather, it is intended to provide general guidelines within which such decisions may be made as well as reach policy decisions on the flow of resources to broad groups of LDCs. It would be primarily useful in making decisions to initiate, and phase out, different policy instruments varying from highly concessional assistance to resource flows on commercial terms rather than indicate the level of aid to specific LDCs.

The need for developing such a framework is of particular importance at present for several reasons: (a) The energy and food crises have had a dramatic but differential impact on LDCs, increasing differences in their need and capacity to use economic assistance, and there has been considerable international pressure for the U.S.

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and other DCs to increase assistance to low income LDCs affected by the energy crisis. For most of the poorest countries -- already growing relatively slowly and facing long years of struggle under severe resource constraints, a need for creation of basic institutions, modernization of agricultural technologies, and slow building of human capital -- the current crisis is adding a heavy additional burden onto what already was a not overly encouraging long-term prospect. The development needs of these poorest countries were being inadequately met before the energy crisis, and will remain the core of the world's poverty problem after the current crisis has passed or has been accommodated. (b) In the past, with most LDCs being "under-funded" in relation to their needs and absorptive capacities, and few appearing to face absolute deterioration (disasters aside), skewed distribution in allocation of U.S. bilateral aid (including PL 480) did not result in disparities between allocation and relative need so great as to constitute a major issue. Given the present country concentration of U.S. concessional aid (See Table 1) skewness between need and allocation is now glaring in the face of the vastly expanded requirements of the poorest countries. (c) The new directions of the AID program and the strong Congressional mandate in pursuit of the objectives embodied in the program pose significant questions on country aid allocations which would maximize the effectiveness of the overall program and its acceptability to Congress. Several Senators and Congressmen have expressed concern

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TABLE 1

AID RECIPIENTS
($ millions)

| | 1974 3/ | | | | 1975 4/ | | | |
|---|---|---|---|---|---|---|---|---|
| | AID | PL-480 | Total | % | AID | PL-480 | Total | % |
| INDOCHINA 1/ | 524 | 502 | 1026 | 48.6 | 919 | 238 | 1156 | 38.5 |
| SA 3/ | 126 | 51 | 177 | 8.1 | 491 | 40 | 531 | 17.5 |
| LOW INCOME 0-300 of which MSA | 260 | 276 | 536 | 24.7 | 451 | 192 | 643 | 21.2 |
| | (144 | 184 | 328 | 15.1 | 279 | 137 | 416 | 13.7) |
| Middle Income able to Finance 300-500 of which MSA | 111 | 114 | 225 | 10.3 | 158 | 210 | 368 | 12.1 |
| | ( 1 | 8 | 9 | .4 | 4 | 2 | 6 | .1) |
| High Income/ Financial Surplus 500 + | 127 | 48 | 175 | 8.0 | 151 | 170 | 321 | 10.5 |
| TOTAL | 1148 | 991 | 2139 | 100 | 2170 | 850 | 3020 | 100 |

1/ Vietnam, Cambodia, Laos, E.A. Regional
2/ Egypt, Israel, Jordan, Malta, Spain, Mid-East Fund
3/ Derived from AID flash report, June 30, 1974
4/ FY75 Congressional Presentation

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over FY 1975 proposals to continue aid to the excess reserves countries, even Nigeria where the proposed aid is only technical assistance. Ignoring this sentiment could have serious consequences for the AID bill and for domestic support of the concept of foreign aid.

## II. POLITICAL VS. DEVELOPMENT OBJECTIVES

It is recognized that specific U.S. strategic, political or economic interests (political in short) in individual LDCs may dictate the allocation of resources to such countries far in excess of amounts that would have been deemed appropriate had U.S. assistance been motivated solely by long-term development or humanitarian objectives (development in short); furthermore, that the amounts allocated to such countries may fluctuate widely over time in light of changing political circumstances. In light of these considerations it is almost impossible to design a complete allocation framework within which decisions pertaining to politically motivated concessional assistance can be examined or compared systematically on a country by country basis to allocations based predominantly on developmental motivations. The purpose of the framework developed here is to guide allocation of the various assistance instruments in light of LDC economic conditions. Should U.S. political interests dictate allocations of concessional assistance which clearly depart from economic development criteria, such allocations can be justified on that basis and the political grounds demonstrated.

Allocation of concessional assistance to countries in which the U.S. has legitimate political interests should not be considered an

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aberration or limited exception to the general framework. Certain country programs, e.g., Indochina, Mid-East, where the political interests have been explicit and paramount, have been treated separately both administratively within AID and in seeking Congressional funding. In such instances the rationale is relatively clear if not always explicit. Problems often arise when programs are justified on ostensibly development needs while the true and legitimate motivations are highly political.

Actual allocation of U.S. concessional assistance among LDCs reflects the influence of these complex and interacting U.S. aid objectives, whose relative impact is difficult to determine in the case of individual LDCs. Allocation is also influenced by (a) historical political relationships (which themselves may affect the U.S. perception of longer term political interest), (b) LDC need for concessional assistance -- conditioned in part by the levels of concessional assistance LDCs can obtain from other sources, as well as the type of assistance the U.S. can provide under existing legislative mandates, (c) effectiveness of foreign assistance, as determined by LDC absorptive capacity, self-help efforts.

## III. ECONOMIC ALLOCATION GUIDELINES

In determining allocation of assistance and the proper mix of instruments to be used with a view to maximizing LDC development objectives, two broad criteria can be used: (a) relative LDC need

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for different types of resource transfers, (b) relative ability of LDCs to use aid productively.

A. LDC needs for foreign resource transfers arise from (1) requirements to add to domestically generated savings; (2) requirements to obtain foreign financing due to constraints in LDC ability to use own resources to generate earnings in foreign exchange through trade; (3) needs for transfer of technology and knowhow and to enhance LDC institutional and organizational capacities to use domestic and/or imported resources more effectively. The requirement for concessional economic assistance derives from the limited capacity of LDCs to finance, or access to, foreign capital inflow on commercial terms. There are various gradations of relative need as well as LDC capacity to obtain and finance non-concessional capital flows. In any case many LDCs may continue to have needs for transfer of technology and knowhow as well as assistance to overcome institutional bottlenecks despite a demonstrated capacity to finance resource flows from abroad on non-concessional terms. In such instances the appropriate U.S. policy instrument of assistance in support of development should be non-concessional.

It has been argued that only if resource flows are highly concessional will the LDCs be induced to make the domestic efforts and commitments required for a specific development objective to be achieved, and that hence highly concessional assistance must be extended irrespective of financial capacity to pay. The lower the ratio of

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external resources to domestic ones needed for the attainment of specific development objectives, the smaller the validity of this argument. It is hard to believe, for example, that the difference in concessionality of a sector loan which provides 10% of total resources required to achieve program objectives will be critical to an LDC commitment in support of the program objective. If it is, then the LDC commitment itself must be seriously questioned.

B. Productivity of assistance, in the sense of general effectiveness of aid in achieving development objectives or overcoming development obstacles, is determined in large part by the absorptive capacity and self-help efforts of the recipient as well as the type of assistance program extended by the U.S. In many respects these factors interact; e.g., absorptive capacity is itself in part determined by the type of the aid program.

In recent periods, as the total size of AID's resources shrank, both in absolute terms and relative to LDC needs, the importance of need as a guideline for allocations of concessional aid has been downplayed, particularly as it pertains to needs for aggregate concessional transfers. It has been argued that given the limited size of the AID program, it cannot be expected (with the exception of some SA countries) to play a significant role in fulfilling individual countries' needs; further, that strong efforts should be made to increase the quality and effectiveness of the assistance.

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To improve the effectiveness of assistance, AID's programs are being directed to address LDC problems in key development sectors with emphasis on such programs as would benefit, in particular, the lowest income groups in recipient LDCs.

Were allocation of resources as between recipients to be made entirely on the basis of one or the other criterion, need, or effectiveness of aid, undoubtedly serious distortions would arise, and the resulting allocation pattern would diverge greatly from that which best serves U.S. interests in the overall development of LDCs; e.g., if effectiveness was ignored and need was the sole criterion, concessional assistance may be wasted in efforts to help countries which either could not absorb foreign transfers effectively or undertake the requisite self-help efforts to overcome development obstacles. Conversely, sole emphasis on effectiveness regardless of need may well result in concessional aid resources to those countries that need them least, because they may very well be the ones that have the institutional framework and can devote the largest domestic effort in support of foreign concessional assistance programs.

Concentration on key development problems cannot be made irrespective of the need for concessional assistance of the countries in which the problems are tackled. To take an extreme example, ignoring concessional assistance needs may imply that efforts to solve the problem of food production should center in providing extensive concessional assistance to land rich Argentina, Brazil or even developed

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countries. Nor is it enough to argue that the sector/problem focus under the new legislation enables us, or intends us, to ignore the relative resource position of recipients. The poor in the poorest LDCs and the oil-rich countries can no longer be viewed as homogeneous groups, even if some of the oil-rich countries persist in policies that leave out large numbers of their poor from income possibilities generated by the vast improvement in the prospects of their economies.

Finally, it has been argued that AID is no longer in the "business" of resource transfer -- nor are resource transfers the objective of the AID program. These statements are only partly correct. While the main objective in AID's programs may not be in seeking to increase the volume of resource transfers received by LDCs on concessional terms*, the instrument used to attain whatever objectives are pursued is in many instances highly concessional economic assistance. And where there is no need for such assistance, the instrument is inappropriate. Further, that where concessional assistance is inappropriate, legitimate LDC development efforts should be supported through other means; and if such means are not readily available or effective through existing programs, new instruments should be devised or different mixes of existing instruments should be utilized. Thus it is proposed that AID policy on allocation of concessional assistance be based on the following general assumptions and propositions:

*That may itself be debatable; it may be no more than a rationalization in light of Congressional unwillingness to enlarge the aid program.

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(a) It is assumed that AID's own programs will continue in the majority of the LDCs to account for a small proportion of total concessional resource inflows.

(b) In deciding whether a given LDC receives concessional economic assistance from AID or not, and in determining the proper mix of aid instruments employed, as well as in related decisions on phase-over to non-concessional instruments, the dominant and overriding consideration is need for such assistance.

(c) In countries where it has been determined that concessional assistance is an appropriate instrument, the level of AID assistance would be determined by considerations of effectiveness of such assistance in addressing specific development programs and taking into account:

(1) constraints pertaining to overall funding availability

(2) constraints pertaining to the minimum program level considered likely to be effective in addressing specific development problems

(3) funding by other donors and organizations.

(d) Where questions arise pertaining to the inter-LDC allocation of multilateral assistance, the U.S. should urge multilateral organizations and other donors to (1) relate the concessional resources allocated to individual LDCs to their need, and (2) promote programs that address key development problems and sectors with special emphasis to programs that benefit the lower income groups within the LDCs.

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## IV. LDC CLASSIFICATION CRITERIA

The need for concessional assistance derives, as noted above, fundamentally from an incapacity to pay for or obtain inflows of needed foreign resources, whether these resources are required to augment domestic savings, foreign exchange availabilities, technical or managerial knowhow, institution building, etc.

Per capita income is perhaps the most common and broad indicator of need for concessional assistance. It is a deciding factor in obtaining concessional IDA funds (no country in excess of per capita income of $3[illegible]5 qualifies), in determining the classification of the least developed of LDCs (under $100 per capita, plus low industrial development and degree of literacy).

Per capita income should be modified as a criterion of need for concessional assistance on two counts: (a) some LDCs, <u>despite relatively low per capita income</u>, have abundant and rising foreign exchange resources, which are projected to continue to expand at a rate far in excess of what they may reasonably need to finance projected development imports. By this we do not mean LDCs which due to a variety of circumstances may have simply achieved an improvement in their balance of payments; rather that the improvement be large and expected to continue well into the future. At present, these LDCs are primarily the oil exporters, but there are others which have fit this description in the past, e.g., Malaysia. Still others may benefit from other highly favorable external circumstances in the future. Such LDCs

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would not need concessional resource transfers despite low per capita income. (b) Some LDCs, despite relatively high per capita income, may suffer temporary but dramatic reversals in their development prospects due to factors outside their control. In this group one might classify higher income countries or others that may have suffered natural disasters in the form of earthquakes, floods, etc.. or been affected by the energy crisis. The need for concessional financing in such cases is obviously of a temporary nature and when such financing is extended it should also be temporary in order to enable the country to adjust.

It is proposed that for purposes of analysis and classification of relative need for concessional assistance LDCs be divided first into three groups on per capita income basis: Group A, up to $300; Group B, $300-500. Group C, in excess of $500. Second, that LDCs irrespective of per capita income which are in financial surplus position are placed in group C. Third, that a fourth group, D, is established to include LDCs facing unforeseen needs for concessional assistance due to natural calamities, including a catastrophic shift in the terms of trade.

Any classification of countries relative to need of financial assistance is bound to be somewhat arbitrary. The per capita income indicator can lead on occasion to obvious anomalies, e.g., if a country maintains a persistently overvalued exchange rate, its per capita income in dollars would be biased upwards by comparison to a country whose rate is not overvalued. Thus on a per capita income basis Paraguay in 1972 ranked higher than Korea. Yet, the ability of Korea

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TABLE 2
AID RECIPIENT BY INCOME GROUP
($ Millions)

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0-300 per capita income

| | 1972 | 1974 | | | 1975 | | |
|---|---|---|---|---|---|---|---|
| | Per Capita GNP | AID | PL-480 | Total | AID | PL-480 | Total |
| LATIN AMERICA | | | | | | | |
| Bolivia | 146 | 38.4 | 16.0 | 54.4 | 22.2 | 7.1 | 29.3 |
| Haiti | 113 | 8.7 | 1.9 | 10.6 | 8.1 | 2.6 | 10.7 |
| Honduras* | 271 | 24.5 | .8 | 25.3 | 22.0 | .6 | 22.6 |
| ASIA | | | | | | | |
| Afganistan | 90 | 12.3 | 1.3 | 13.6 | 14.4 | 1.7 | 16.1 |
| Bangladesh* | 70 | 27.1 | 41.4 | 68.5 | 65.2 | 39.4 | 104.6 |
| India* | 98 | | 50.5 | 50.5 | 75.5 | 38.0 | 113.5 |
| Nepal | 85 | 2.2 | .8 | 3.0 | 5.7 | .4 | 6.1 |
| Pakistan* | 97 | 51.9 | 38.0 | 89.9 | 78.7 | 43.2 | 121.9 |
| Philippines | 202 | 41.8 | 14.9 | 56.7 | 49.8 | 26.0 | 75.8 |
| Thailand | 194 | 6.1 | 28.1 | 34.2 | 6.0 | | 6.0 |
| Sri Lanka* | 165 | | 7.4 | 7.4 | 8.0 | 10.7 | 18.7 |
| Yemen, A.R. | 110 | 2.1 | 2.7 | 4.8 | 11.4 | 2.0 | 13.4 |
| AFRICA | | | | | | | |
| Botswana* | 220 | | 1.5 | 1.5 | | 1.3 | 1.3 |
| Burundi | 64 | | .4 | .4 | | .4 | .4 |
| Cameroon* | 348 | | .7 | .7 | | .4 | .4 |
| Chad* | 85 | | 2.9 | 2.9 | | .0 | .0 |
| Ethiopia | 86 | 20.6 | 3.3 | 23.9 | 25.0 | 1.2 | 26.2 |
| Gambia | 145 | | 1.0 | 1.0 | | .1 | .1 |
| Ghana | 266 | 2.2 | 1.7 | 3.9 | 13.7 | .6 | 14.3 |
| Guinea | 100 | | 3.6 | 3.6 | | .3 | .3 |
| Kenya* | 155 | 11.6 | .3 | 11.9 | 7.4 | .2 | 7.6 |
| Lesotho* | 93 | | 1.5 | 1.5 | | 1.6 | 1.6 |
| Liberia | 260 | 2.7 | .5 | 3.2 | 7.2 | .4 | 7.6 |
| Mali* | 70 | | 12.5 | 12.5 | | .8 | .8 |
| Mauritania* | 175 | | 6.3 | 6.3 | | .2 | .2 |
| Niger* | 120 | | 13.8 | 13.8 | | .8 | .8 |
| Rwanda | 72 | | .3 | .3 | 2.5 | .4 | 2.9 |
| Sierre Leone | 190 | | 1.0 | 1.0 | | .9 | .9 |
| Senegal* | 285 | | 6.9 | 6.9 | | 1.2 | 1.2 |
| Sudan* | 114 | | 8.6 | 8.6 | 10.8 | 5.0 | 15.8 |
| Swaziland | 270 | | .1 | .1 | | .1 | .1 |
| Tanzania* | 113 | 6.1 | 1.5 | 7.6 | 10.6 | 1.3 | 11.9 |
| Togo | 170 | | 1.2 | 1.2 | | 1.0 | 1.0 |
| Upper Volta* | 70 | | 7.9 | 7.9 | | 1.7 | 1.7 |
| Zaire | 122 | 1.0 | .3 | 1.3 | 6.0 | .3 | 6.3 |

* indicates MSA as identified by AID Review.

TABLE 2 (cont.)
($Millions)

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| | 1972 | 1974 | | | 1975 | | |
|---|---|---|---|---|---|---|---|
| | Per Capita GNP | AID | PL-480 | Total | AID | PL-480 | Total |
| **300-500 Per Capita Income** | | | | | | | |
| AFRICA | | | | | | | |
| Ivory Coast* | 424 | | .6 | .6 | | .6 | .6 |
| Morocco | 286 | 1.2 | 21.0 | 22.2 | 15.2 | 17.7 | 32.9 |
| Tunisia | 430 | 2.2 | 13.9 | [illegible] | 5.8 | 10.5 | [illegible].3 |
| LATIN AMERIC | | | | | | | |
| Colombia | 335 | 40.1 | 17.9 | 58.0 | 21.9 | 9.9 | 31.8 |
| Dominican R. | 426 | 12.5 | 4.3 | 16.8 | 5.4 | 7.8 | 13.2 |
| El Salvador | 305 | 7.6 | 1.2 | 8.8 | 11.5 | .8 | 12.3 |
| Guatemala | 387 | 2.5 | 1.4 | 3.9 | 17.0 | .7 | 17.7 |
| Guyana* | 360 | .1 | .1 | .2 | 3.5 | .1 | 3.6 |
| Nicaragua | 463 | 12.3 | 2.6 | 14.9 | 27.8 | .6 | 28.4 |
| Paraguay | 318 | 4.2 | .1 | 4.3 | 4.7 | .1 | 4.8 |
| ASIA | | | | | | | |
| Korea | 294 | 26.7 | 21.0 | 47.7 | 25.1 | 154.9 | 180.0 |
| Turkey | 459 | 1.8 | 4.0 | 5.4 | 23.0 | 4.4 | 27.4 |
| **500+ Financial Surplus** | | | | | | | |
| LATIN AMERICA | | | | | | | |
| Brazil | 495 | 4.0 | 4.8 | 8.8 | 2.8 | 2.1 | 4.9 |
| Chile* | 795 | .3 | 3.5 | 3.8 | 26.0 | 37.1 | 63.1 |
| Costa Rica* | 623 | 8.9 | .4 | 9.3 | .8 | .2 | 1.0 |
| Ecuador | 309 | 2.5 | 4.5 | 7.0 | 2.0 | 3.3 | 5.3 |
| Jamaica | 683 | 9.6 | 1.1 | 10.7 | 8.4 | 1.5 | 9.9 |
| Panama | 839 | 10.5 | .7 | 11.2 | 21.3 | .3 | 21.6 |
| Peru | 525 | 12.1 | 5.2 | 17.3 | 13.5 | 2.5 | 16.0 |
| Uruguay | 618 | .9 | | .9 | .7 | | .7 |
| ASIA | | | | | | | |
| Iran | 542 | | 7.9 | 7.9 | | | |
| Indonesia | 84 | 74.0 | 17.9 | 93.9 | 71.4 | 120.9 | 192.3 |
| AFRICA | | | | | | | |
| Nigeria | 150 | 3.4 | 1.8 | 5.2 | 3.6 | 2.3 | 5.9 |

TABLE 2 (cont.)
($Millions)

| | 1972 | 1974 | | | 1975 | | |
|---|---|---|---|---|---|---|---|
| | Per Capita GNP | AID | PL-480 | Total | AID | PL-480 | Total |
| INDOCHINA | | | | | | | |
| Cambodia* | 90.0 | 93.0 | 194.0 | 287.0 | 110.0 | 77.0 | 187.0 |
| Laos | 65.0 | 34.0 | 3.6 | 37.6 | 56.0 | .3 | 56.3 |
| Vietnam* | 150.0 | 384.0 | 304.7 | 668.7 | 751.0 | 160.5 | 991.5 |
| E.A. Regional | | 13.0 | | 13.0 | 1.5 | | 1.5 |
| SUPPORTING ASSISTANCE | | | | | | | |
| Egypt | 243.0 | 8.7 | 3.3 | 12.0 | 250.0 | 3.1 | 253.1 |
| Israel | 2199.0 | 50.0 | 39.5 | 89.5 | 50.0 | 26.4 | 76.4 |
| Jordan | 286.0 | 53.2 | 7.5 | 60.7 | 78.0 | 10.2 | 88.2 |
| Malta | 940.0 | 9.5 | .3 | 9.8 | 9.5 | | 9.5 |
| Spain | 1331.0 | 3.0 | | 3.0 | 3.0 | | 3.0 |
| Mid-East Fund | | | | | 100.0 | | 100.0 |

SOURCES:

Per capita GNP - Selected Economic Data for the Less Development Countries, AID, July 1974

FY 74 Aid - Flash Report, AID, June 30, 1974

FY 75 Aid - FY 75 Congressional Presentation

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to obtain non-concessional financing is higher and its need for concessional assistance relatively smaller. The classification proposed here is based primarily on per capita income but with some flexibility to allow for other factors, especially financing considerations.* We feel the classification is in most respects independent of the oil crisis and broad enough to be of considerable use even in the unlikely event that, for example, the oil price is rolled back to pre-September 1973 levels.

Group A - Low Income

The countries in this group include approximately 33 currently receiving concessional assistance from the U.S. It is expected that the resource needs for this group will rise dramatically in the near future. The World Bank's latest review of the outlook for LDCs for the rest of the decade concludes that "most of the countries with per capita income levels below $200 are likely to have only negligible growth in per capita incomes for the remainder of the decade unless there is a substantial increase in the volume of concessional lending to them. At the most probable level of concessional flows, the per capita income of the 800 million inhabitants of these countries would rise by less than 1% per year." The development needs of these poorest countries were being inadequately met before the

*A different limit for the poorest LDCs could be $375, the same as IDA. Although the official cut-off for IDA funding is $375, in practice IDA lends only very limited funds to countries in the $300-375 group and especially to those in the group with relatively strong financial positions. It should also be pointed out that the IBRD, for analytical purposes, considers the much lower $200 per capita as the limit for the poorest LDC group.

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energy crisis, and will remain the core of the world's poverty problem after the current crisis has passed or has been accommodated.

An important subcategory under Group A are the 25 least developed countries. This very poor group (under $100) has been recognized to need special measures in light of their particularly low level of development. Their needs for resource transfers have been increased further by the Sahel drought.

The overwhelming majority of the countries in the group considered as most seriously affected by the energy crisis (MSA's) have incomes under $300 and include many of the least developed group. It is estimated that this MSA group will need additional concessional financing of at least $1.5 billion in 1974 and probably in excess of $2 billion in 1975. (For detailed analysis of the additional resource needs of this group see Annex II.) But the problem is not one of covering short-term balance of payments deficits. The long-term unmet need for concessional aid for this group is so great that failure to find a set of responses is certain to result in virtual cessation of growth in per capita income for several years, if not actual decline. The largest needs for additional financing in this group over and above what they were previously obtaining will be faced by Bangladesh, India, Sri Lanka and Tanzania.

As can be seen from Table 1, three Indochina countries and five SA countries received 48% of total bilateral aid (AID plus PL 480) in FY 1974 and are programmed for 48% in FY 1975. Excluding Vietnam

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and Cambodia, 33 countries of the low income group (of which 19 are MSAs) were allocated 25% in FY 19 4 and 21% in FY 19:5. It could be argued that since the Indochina countries are low income they should have received some U.S. assistance even if the U.S. did not have as strong political interests in their development. How much they would have received is a moot point. As noted above, the level of concessional assistance to a given country is and should be based on many factors whose influence is almost impossible to separate ex post.

Group C - High Income/Financial Surplus

At the other extreme are countries with per capita incomes in excess of $500. These countries by and large have reached a level of internal development which should enable them in most instances to generate adequate growth through their own resources or -- and this is important in terms of the present -- through borrowing in the international financial markets. A number of such countries, e.g., Argentina, Brazil, will have to pay large additional oil import bills. Yet they are expected to meet such payments in large part through borrowing in the Euro-dollar market without recourse to concessional financing. (There are two exceptions to this: Chile and Costa Rica -- see Group D below.)

In addition there are several countries which as a result of the oil price increase have experienced dramatic improvements in their foreign exchange prospects. These countries fall into two sub-groups: First, the largely Middle East countries with small populations. They cannot avoid accumulating huge surpluses because their capacity

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to import is severely limited in the short run, despite the maximum efforts they are expected to make to increase their absorptive capacity. These countries should be providing large concessional assistance to other LDCs, will be lending enormous sums to the industrial nations to help finance their deficits, and can be set aside from the standpoint of this paper as countries which do not now receive U.S. bilateral aid, and which can have no claim on U.S. aid (reimbursable technical assistance aside). Any current low-population aid recipient that in future develops exports on a scale that puts the country into this category of major financial surplus and capital exporting should be eliminated from the aid program as soon as practicable. Second, other oil exporters expected to earn substantial surpluses for the next few years beyond their capacity to absorb, but for whom this position is expected to be only medium-term. That is, they either have large-population economies whose import absorption capacity can be raised very substantially, and/or their oil reserves position appears likely to be able to support relatively few years of exports at current levels. Whatever the mix of these factors, the countries in this category are expected to accumulate large excess foreign exchange reserves for the next few years. They will also be lending to the industrial countries as they accumulate dollar and other foreign financial assets, although this accumulation may then be needed for drawing down, perhaps in the 1980s, to support high levels of real capital imports. The

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position of these countries derives from the price actions of OPEC, of which they are members, and includes some income transfers from oil importing LDCs adversely affected by the monopoly pricing of the former. This second sub-group also has large needs for foreign technology imports, but will also be in position to pay for it, the cost of the technical assistance they are receiving under aid programs in particular being miniscule in relation to their financial surpluses.

Under these economic circumstances, there is no economic justification for the countries in this category receiving concessional aid. Since the U.S. dollar has been the major reserve currency since World War II, all aid recipients have held dollar assets as part of their foreign exchange reserve holdings. Even this type of "lending" to the U.S. has occasionally raised a question on the Hill, where AID has been lending to an LDC at a low concessional rate during a period when the LDC has been accumulating USG obligations, as part of its reserve holdings, paying a higher return. The large-surplus oil exporters will be de facto lending for a time to the U.S. (and other developed countries).

Even if they face the possibility or likelihood of absorptive capacity catching up and drawing down these reserves in the 1980s, their period of certain, large-scale excess accumulation during the next five years coincides with the period of maximum strain for oil-importing LDCs while the latter are making structural

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adjustments to higher energy costs and heavy oil import bills. As noted, some of this accumulation represents a tax on other, oil-importing LDCs. The reserve accumulation deriving from income transferred from other LDCs may be only a small fraction of the total accumulation for any one LDC oil exporter, but it does serve to dramatize the fact that the changed international circumstances have divided the LDCs into groups which now have some sharply conflicting economic interests.

Countries in the oil exporting category now receiving U.S. bilateral aid are Indonesia, Nigeria, Ecuador.

Group B - Middle Income/Able to Finance

In between the two extremes lies a considerable group of countries, whose needs for concessional assistance are less than those in Group A but which have not fully established themselves in international markets to be able to borrow on non-concessional terms, nor have yet reached that level of development which will enable them to do without concessional assistance immediately.

A few of these countries are included in the MEA group. Most are expected to be able to meet the financing problems raised by the energy crisis. In order to cover the additional costs, these countries will be required to draw down their reserves and increase their borrowing on the capital markets. An increase in borrowing will increase future debt service payments. The financing of deficits from reserves and borrowings is a short-run expedient and those countries in this group

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which over time cannot offset the rapidly rising import costs by other means are bound to encounter increasing difficulties in the future. The modalities for financing their borrowing must in fact be adequate to their requirements; there is reason to believe they are not for many of the countries; the debt servicing problem being created for many of these countries several years from now argues strongly for a shift to longer term debt on more favorable terms than the Euro-currency market, their major recent source, has been providing. Provision for substantial capital inflow for these countries remains a basic requirement of their economic development. But compared with the countries in Group A, they need not rely on the relatively small portion of capital flows that is highly concessional. These countries have demonstrated capacity to obtain non-concessional financing, although the future quantity and quality need strengthening.

For some, entering into long-term foreign private capital markets has been difficult, and they may well require assistance either to enter or obtain more favorable terms. However, concessional assistance programs in such countries must be viewed as a transitional device. The period over which the transition will have to take place will by necessity have to vary. A critical element is the development of alternative instruments which will allow the U.S. to continue to support development and other U.S. interests after concessional assistance is ended. It obviously cannot be so long that the end of the concessional program is placed to after 1980.

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The process of reducing or eliminating concessional aid often presents political problems because of the relationship of the aid program to the total relationship between the U.S. and the recipient government. It appears now that the process of phasing down or developing non-concessional modalities will be easier in some countries, more difficult in others where bilateral aid is said to be interpreted by the government as a fundamental sign of U.S. "presence" and continued U.S. interest in the whole range of joint interests we are pursuing with that country. On the other hand, we have gracefully phased down and out of concessional aid relationships with several countries in the past (e.g., Iran, Taiwan) without the bilateral relationship being disturbed (and of course there have been cases where the continuation of aid was not sufficient to prevent deterioration in the relationship, e.g., Turkey).

Group D - Disaster Cases (Mid-High Incomes)

This group simply classifies the countries which for truly unforeseen economic reasons should be viewed as exceptions to the above allocative categories. It should exclude political categories, and include only a few cases which can be truly considered to be due to economic emergencies. Examples of such countries at present may be Chile, and perhaps Costa Rica. Nicaragua and the Philippines could have been included in this group on a temporary basis in the past. For this group, concessional assistance should also be viewed as a temporary measure, to prolong otherwise terminating programs, or

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to establish new ones, in case of emergency. Assistance should be terminated when the emergency is over and/or the economy has adjusted to it. For the whole effort in classification to be meaningful, this group should not at any point in time include more than two or three countries.

Summarizing the classification, the following four groups of LDCs are identified:

Group A: The low-income LDCs. They should be the major beneficiaries of increased concessional aid availabilities. Many can be expected to need concessional resources transfers for many years to come. Some few are much further along the development scale. During the adjustment period of the next few years the latter should be able to move toward a harder mix of aid and other resource transfers. Others, such as the group of 25 LDCs determined by the UN to be the least developed, have large needs for particular types of concessional resource transfers extending long into the future.

Group B: Middle income LDCs. Countries which are potentially able to finance most of their requirements from non-concessional sources. Many countries in this category have already demonstrated capacity to raise money in the Eurocurrency market in volumes very greatly exceeding U.S. bilateral aid levels. The ability of these countries

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to finance their needs from commercial and quasi-concessional (hard windows of IBRD and regional bank sources) reflects the basic strength of these economies, i.e., the indications (from recent export performance, reserve accumulation, investment levels, etc.) that they appear to be on a secular growth track they can sustain without concessional inflows. Private capital inflows have been important for these countries. The U.S. should encourage this source further, including where feasible assisting these countries to gain access to the long-term U.S. capital market. Where countries wish to sustain some types of technology transfers through the AID technical assistance program, the activities can be either on a reimbursable basis, or loan or grant basis, depending on the subject and circumstances.

However, in contrast with the financial surplus countries, to which concessional assistance should be phased out as rapidly as possible, Group two countries generally should be phased down gradually, with special provisions to dovetail reduced availability of concessional aid with increased availability and dependence on alternative financing.

Group C: High income and/or financial surplus (i.e., capital exporting) countries, e.g., Iran, Ecuador, Indonesia, Nigeria, Panama, Brazil; they should be ineligible for concessional aid of any category. If still receiving such aid now, they should be phased out as quickly as possible.

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## V. AID INSTRUMENTS AND COUNTRY CATEGORIES

A framework for matching countries with aid instruments appropriate to their economic position is laid out in Table 3. The array of aid instruments is listed in the left-hand column. The lines in the columns under each country category indicate the mix of instruments, some or all of which might be appropriate for countries of each category. They reflect the desirability of relating the degree of concessionality of our assistance to the country's need for such concessional terms; this would then concentrate the most concessional forms of assistance on those that need them the most. Dotted lines indicate that the instrument should be available only for a transitional period. This would apply to short-term adjustment to the oil situation or other disasters and, where there are countries now receiving concessional loans and grants which do not require such concessionality, would allow an orderly transition to less concessional assistance (e.g., from concessional loans to borrowing guarantees). This is not to say that such countries do not have unresolved sectoral and income distribution problems. But given the long-term trend in Congressional appropriations, and the large gap between the aid needs and availabilities of the low income LDCs, we should be increasingly concentrating our concessional assistance on sectoral and income distribution problems of the low income

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TABLE 3

Appropriate Assistance Instruments by Country Groups

| | A. Low Income | B. Middle Income/ Able to Finance | C. High Income/ Financial Surplus | D. Disaster Cases (Mid-High Incomes) |
|---|---|---|---|---|
| Reimbursable Tech. Assistance | | _____ | _____ | |
| Loan-Financed Tech. Assistance | | ------ | ------- | |
| Grant-Finance Tech. Assistance | _____ | | | ------ |
| Ex-Im Bank Loans | _____ | _____ | _____ | _____ |
| Borrowing Guarantee For Access to U.S. Bond Market | | ------ | | ------ |
| OPIC | _____ | _____ | _____ | _____ |
| HIGS | _____a | _____ | ------ | _____ |
| Captial Assistance--Grant | _____ | | | ------ |
| Capital Assistance--Loan | _____ | ------ | | ------ |
| PL-480 -- Title I | _____ | | | ------ |
| PL-480 -- Title II | _____ | ------ | ------ | ------ |
| CCC | | ------ | _____ | ------ |
| IBRD | _____ | _____ | | _____ |
| IDA | _____ | b | | |
| Regional Banks: Hard Window | _____ | _____ | | _____ |
| Regional Banks: Soft Window | _____ | ------- | | ------- |

a - In exceptional areas only

_____ type of assistance generally acceptable

--------- transitional devise

b - IDA official upper limit is $375 but in practice most countries in $300-375 range get only limited IDA funds.

LDCs. This would require increased emphasis on project development in these countries, in view of their well-known problems in this area.

To take some examples from Table 3, capital loans and PL 480 Title I should be available to high-income MSAs only during the transitional few years in which they are adjusting to high oil import costs and during which the lack of such financing could result in very serious disruption to their economies. Loan or grant financed technical assistance should be available to a Group Three country only as a transitional form of assistance during a short period of orderly phaseout. The same applies to Group Two countries (those able to finance their import requirements), although the phaseout period may be longer depending on the circumstances of each case. The "best" concessional aid is directed at the low income countries alone. Title II programs should be retained in a phaseout position only to allow time for Volag's and their local counterparts to find alternate sources of support, except in low income countries. HIG terms are too severe for most low income countries, which tend to have severe limitations on debt servicing capacity, and should be offered only on an exceptional basis; HIGs to Group Three countries should be viewed as a brief transitional mechanism. For Group Three countries all AID instruments should be phased out except for reimbursable technical assistance. While Ex-Im Bank loans are listed as applicable to all categories, allocations should take account

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both of need, for the surplus countries, and debt service capacity for the poor countries. One new instrument is proposed in Table 3 - a borrowing guarantee which would assist potentially creditworthy LDCs gain access to the long-term U.S. capital market. Such access appears to be feasible for a number of middle and higher income LDCs whose private international borrowing has thus far been limited to the short-to-medium term U.S. and Eurocurrency banking systems credits.

Access to the U.S. capital market would open up financing sources much greater in volume than these countries can reasonably hope to obtain from concessional aid. The proposal described in a separate document distributed to the AAC would enable a country to enter this market at the same time as its eligibility for concessional aid was being phased out. Thus the guarantee is shown as a phaseout instrument in all cases where it would be applied (although to retain flexibility in its use, exceptions would be permitted).

Table 3 omits some multilateral instruments in which the U.S. has an important actual or potential role, and which could be included if the scope of this paper were extended further, especially to develop some orders of magnitude of need and potential finance by country group. Measures like creation of new "recycling" modalities for developing a longer-term Eurobond market, the IMF Special Oil Facility and Extended Facility, or trade measures comprise potentially important financial sources for LDCs. The conditions and terms of these measures vary widely in their usefulness for LDCs in different economic situations.

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## VI. IMPLICATIONS FOR AID PROGRAMS

1. Program Emphasis and the Congressional Mandate - Applying this framework to existing AID programs has only very limited implications for the substance of AID programs in terms of sectors of concentration, or emphasis on the poor. The framework only implies that these programs be more heavily concentrated than at present to countries in the low income brackets. The substance of the programs in these countries should remain basically unchanged, only there should be more concentration in these countries and less in countries with higher incomes, which are able to finance resource flows in non-concessional terms.

The emphasis on the low income countries does not rest on the additional short-term balance of payments needs of many of these countries due to the energy crisis, but on their long-term needs for concessional assistance.

In those instances where low income countries face dire balance of payments needs, some attention should be given to shifting to programs in AID's existing areas of concentration which disburse more rapidly. But this does not imply wholesale shift of programs. Rather this should be considered the bare minimum of response that the bilateral programs can make to address the needs of the MSAs. The bulk of the additional resource needs should be financed by different instruments, of which PL 480 might be an important one for the U.S. In any case, improvement of the rate of disbursement should be an important objective of AID irrespective of country or program.

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Increased emphasis on the low income countries within the context of existing programs may pose some problems of absorptive capacity. These problems are more likely to be present in the least developed countries than in others in the group. Absorptive capacity constraints are in part a function of the conditions of the recipient and in part a result of the fact that given AID's areas of concentration and program emphasis there are limits to the volume of effective programs that can be adequately developed with existing staff. To raise the absorptive capacity of these countries should be an objective of the AID program itself.

2. High Income/Oil Exporters - At present the U.S. extends concessional economic assistance, estimated to total $321 million in FY 1975, or 10% of the total, to ten countries -- not in the SA group -- Indonesia, Nigeria, Ecuador, Brazil, Jamaica, Panama, Peru, Chile, Costa Rica, Uruguay. Several of these, either due to oil price change or due to other circumstances (high income, capacity to borrow abroad) do not need it. The framework implies that concessional assistance to thosecountries be terminated as soon as possible. In particular, continuance of concessional assistance to the oil rich in this group,

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Indonesia, Nigeria and Ecuador, can lead to serious adverse Congressional repercussions which would be to the detriment of the whole AID program. For this purpose it is necessary that the decision to terminate be taken at the earliest possible time (if not taken already), particularly since, given existing pipelines, even a decision to terminate today will result in disbursements of concessional assistance to these countries in the future. At the same time these countries could use further assistance, to build up their human and technological infrastructure. New programs should be initiated for this purpose but on a non-concessional basis.

3. Phase-down of Concessional Assistance - Application of the framework would imply decisions to phase down of concessional assistance in a number of countries over the next few years. The timing for such decisions obviously must be made on a case by case basis and pari-passu with the development of new approaches designed to continue U.S. assistance to these countries but on a different basis.

For 1975 the proposed aid program includes approximately $368 million for countries in which the framework postulated phasedown. These countries still need technology transfers and technical assistance from the U.S.; the question posed for some of them is why they should not pay for it, either by acquiring it themselves in the market, or through AID on a reimbursable basis. This implies that for these countries AID should start exploring alternatives to existing programs which would involve eventual hardening of terms of existing instruments or devising of new, less concessional programs.

4. Hardening of terms is an obvious device, which, however, has potential pitfalls. The danger may be that establishing a differentiated interest structure would soon result in most AID programs becoming less concessional. In the past AID has been under constant Congressional pressure to harden terms on AID loans even in instances where such harder terms would be clearly inconsistent with LDC capacity to repay. It could be argued that this Congressional pressure stemmed in part from the fact that some highly concessional AID assistance went to countries with obvious capacity to repay on hard terms. Furthermore, if AID relies only on terms hardening as an instrument of reducing concessionality, there is a danger that scarce AID resources will continue to be channelled to higher income countries and only the overall terms of the program would be hardened. It is a moot question whether a more rational, graduated terms structure can be established, but this is certainly an approach that could be applied on a case by case basis.

5. The new instrument proposed essentially for the middle income group of countries is the establishment of a borrowing guarantee for LDC long-term bank flotations in the U.S. market. Some of these countries have difficulties in entering the long-term private capital market and obtaining funding except in the stiff terms prevailing in the Eurodollar market. It is for this purpose that the new borrowing guarantee program has been proposed. This program may well not be enough. Other initiatives, especially in the technical assistance and/or the private sector, may well be needed, and an Agency-wide

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effort for such new approaches seems in order.

6. For disaster cases, in the mid to high income range, it is obvious that the assistance should be geared to the particular need, or problem resulting from the calamities that justify assistance to them. Thus it may seem inappropriate to propose a long-term education sector project in a country suffering from floods or earthquake destruction simply because no alternative project to channel funds to them could be found within the context of present program emphasis. This implies that special assistance programs would have to be designed in each case to address the needs. These could well be outside the context of present program emphasis. But given that this group of countries will by assumption stay small, the resulting deviations from AID's main program emphasis should also be minor.

7. Terms Renegotiations - Under AID's standard loan language, borrowers agree, upon AID request, to renegotiate the repayment schedule in the event of a substantial improvement in the economic position of the borrower. Given the dramatic improvement in the position of some former and present aid recipients compared with their situation at the time they were deemed eligible for highly concessional aid, it appears appropriate to strengthen this provision, allowing for some hardening of terms and/or prepayment in the light of fundamental change. In the event of extraordinarily favorable change -- as indicated (say) by (a) foreign exchange reserve growth surpassing 18 months imports, and (b) per capita income of $500 or higher, provision for hardening terms on outstanding loans should be made mandatory.

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Annex I

CRITERIA FOR PHASEOUT

In general, phaseout will be considered when an LDC has achieved the capacity to grow at a satisfactory rate and to meet external obligations without bilateral US concessional assistance. However, no set of criteria can serve as absolute, automatic guidelines, with one or another country being propelled into "graduate" status as it fulfills certain mechanical criteria. In cases where there are questions about the extent to which economic criteria for phaseout have been met, judgments will be required to determine whether phaseout is appropriate in the light of historical evidence and prognoses for the future.

Termination of concessional aid should not be postponed until uncertainties have been reduced to the point that development success is guaranteed. General experience to date is that countries, once launched on a successful development track, tend to continue in that direction even as concessional assistance dwindles. In case serious unanticipated reversals occur which threaten continued development progress, the need for renewed concessional assistance can be reassessed.

General Criteria

A. Development Performance and Prospects for the Future

Obviously a variety of factors determine future development prospects in the absence of AID concessional assistance. Recent development performance and the factors responsible for it must be given significant weight in determining future prospects. In addition, an effort must be made to assess

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prospects that such performance will be maintained with non-concessional transfers (or at least no further US concessional transfers -- in some cases concessional assistance might continue to be available from other sources).

Development performance and prospects without concessional assistance will be determined by factors affecting the foreign sector and factors affecting the domestic sector. While these factors are conceptually distinct, there are obvious interrelationships which should be considered in evaluating overall development prospects.

1. The Foreign Sector

An assessment of the foreign sector should include an analysis of the following factors. Clearly, a good performance in one or more of these factors may well offset poor or average prospects in some of the others. Thus, an overall assessment should bring together current trends and medium-term prospects for all the variables discussed below.

(a) Rate of Growth of Exports of Goods and Services and Prospects for the Future

Exports typically provide the bulk of import financing, and it has been demonstrated that a good export growth performance is highly correlated to GNP growth. Thus, a good past export growth and good prospects are one of the prime indicators of viability in the foreign sector.

(b) Degree to which Stringent Import Restrictions have Curtailed the Level and Growth of Imports

In assessing import growth, it is important to determine whether past growth has been kept down by stringent restrictions. If it has, payments projections must be adjusted to reflect the increase in payments likely to result from desirable liberalization measures (while also allowing for the dampening effect of devaluation, if any, on import demand).

(c) The Adequacy of Reserves

The most common indicator of reserve adequacy is the reserve/import ratio. In assessing this ratio both its level and trend over time should be analyzed. The optimal ratio of reserves to imports will vary among LDCs depending on such factors as: (i) fluctuations in export earnings; (ii) access to short term financing from private or public sources; (iii) compressibility of payments (which itself is affected by the debt/service ratio). Thus, no general criterion is possible which is applicable to all LDCs; nevertheless, an assessment of general reserve adequacy is still feasible on a case-by-case basis.

(d) The Debt Burden

A good indicator of the debt burden is the debt/service ratio.

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The debt/service ratio can be measured both at the current period and, on a projected basis, for the future. The debt/service ratio should be interpreted with great care. A high debt/service ratio involves limited flexibility in payments and potential problems in servicing non-concessional transfers. On the other hand, in some LDCs a high debt/service ratio is both the result and evidence of capacity to undertake extensive borrowing in the private capital market.

(e) Access to Non-Concessional Borrowing from Private Sources, Including Direct Foreign Private Investment, Long-Term Portfolio Borrowing, and Short and Medium Term Commercial Credit.

A capacity to borrow and service from private sources is also obviously of crucial importance in determining the viability of development efforts without US concessional assistance but it is also a function of the factors previously noted.

(f) Access to Concessional Borrowing from Other Sources

It is conceivable that some additional concessional borrowing would provide a safety factor, but that such assistance would be available from a regional development bank or a bilateral lendor with a special interest in the country.

2. Domestic Factors

(a) Relationship to External Factors

It is not enough to look only at the foreign sector, because it is possible to have a healthy foreign sector at low growth levels. In practice some countries experience for a variety of reasons short to medium term reserve growth beyond what outside analysts consider desirable in the face of slow or moderate growth performance. In general, except perhaps in higher income countries, AID's response should not be phaseout *per se* but rather encouragement of more rapid growth, in concert with other donors, with appropriate reduction or suspension in capital assistance levels until the recipient demonstrates the ability to translate more aid into more growth rather than more reserves. On the other hand, sustained export growth, particularly when based primarily on exports of manufactures, almost never seems to occur in the absence of domestic growth performance because of the two-way causal flows between exports and overall growth and because some of the same key policies (particularly factor price policies) tend to have a similar salutary impact on both the foreign and domestic sectors. Less than optimal growth (or, more broadly, development) or suboptimal performance with respect to some elements of domestic development is not in itself a sufficient condition for concessional assistance. Concessional assistance--particularly capital assistance--provides external resources. Unless the recipient can find ways to turn these external resources into an *incremental* balance of payments (import) requirement, the net effect will be an increase in reserves

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(or substitution for other external or domestic financing) no matter how slow the growth or how large the "savings gap." In considering whether additional AID assistance leads to additional development, it is obviously not sufficient to show that AID's particular funds were used for imports, not reserves; the question is the net effect on imports (or on other development financing).

(b) Measurement of Domestic Performance

A variety of domestic self-help indicators can be devised depending on the country and alternative hypotheses posited about the various domestic constraints on development. It is neither possible nor necessary to devise an exhaustive list of criteria that should be met before assistance is phased out. It is only necessary to reach a judgment that the rate of growth will remain high--say, 6-7 percent or better--in the absence of US concessional assistance. It can be argued that the various internal performance indicators (such as the levels and trends of the marginal rate of savings, the rate of government saving, or generally the effectiveness of government policy design and implementation) are all reflected in the achievement of a certain GNP growth rate. Thus, if the rate is high and expected to continue so, it may not be necessary to be excessively concerned about the detailed criteria that must be met before concessional economic assistance is phased out. Still, it is useful to examine these more detailed criteria of growth to determine the likelihood that such growth can be sustained.*

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*In examining such criteria it is important to judge a country against what a similarly situated country would be expected to achieve, rather than against an average rule of thumb that may or may not be applicable. The IBRD has done extensive quantitative work on "normal" levels for such criteria under differing income and other circumstances, which is available on request from PPC/PDA. The IBRD analysis pertains to external sector as well as domestic indicators of development. However, such indicators, derived from cross-country comparisons, must be used with great caution. At best they can provide only an educated rule of thumb that can form a part of a more detailed qualitative or quantitative analysis. If growth has been slow, then it is, of course, necessary to look carefully at such criteria to help ascertain the reasons for slow growth.

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There is a dilemma between allocation on the basis of need as compared with allocation on the basis of self-help performance. Should AID terminate capital assistance to a country which, even though it enjoys a satisfactory external position generally, nonetheless makes good use of US assistance as well? Clearly, performance as well as need should be taken into consideration in our allocation criteria. Yet the need for concessional external resources should be a prerequisite for their allocation.

B. Per Capita Income

This criterion is relatively easy to define quantitatively. However, it is most difficult, and perhaps undesirable, to set a simple per capita income standard for LDC aid recipients beyond which they will be ineligible for concessional assistance. At the least, the criterion should take into account the mean per capita income of the countries in the same region. In both choice of countries to receive concessional aid and in allocation of such aid, it follows from our concern with improving the quality of life of the poor that we should concentrate on poorer countries. While there are many poor people in better off countries because of income distribution problems, there are many more poor people in poor countries; and poverty in a country of $600 per capita income is much different, in terms of such basics as life expectancy, from poverty in a country of $150 per capita.

As Agency funding becomes increasingly scarce in relation to requirements it becomes necessary to review very stringently assistance to richer LDCs, which comes, implicitly, from funds that would otherwise have been available for poor LDCs.

C. Relation to Unresolved Social and Sectoral Problems

If a country has the resources to pursue its development objectives, then unresolved social and sectoral problems do not by themselves justify continuation of AID concessional assistance. There are several reasons: Such unresolved problems will continue to exist in developed as well as developing countries. As indicated above, aid appropriations have declined sharply in the past decade. While certain AID-financed programs continue outside Agency priority areas, these programs generally are either related to political commitments or are in the process of transition to Agency priority areas.

And, above all, if a country is not strongly committed to addressing its own equity problems, AID can at best have limited long-run impact on these problems. For example, AID efforts over a relatively long period of time to channel assistance into certain disadvantaged regions of countries in Asia and Latin America to help achieve employment and income distributions goals have had only marginal effect in the absence of a major government commitment. Conversely, an LDC government which is both committed to attacking equity problems, and able to attack these problems with its own resources (and with available technical and financial assistance from other donors) does not require AID funding.

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Thus, except where political considerations dictate otherwise, continued concessional aid can be justified only when an LDC requires outside concessional resources to deal with significant unresolved development problems which it seriously wishes to confront. In order to improve allocation of scarce AID resources, our development assistance must be limited to such cases. However, phasing down US bilateral concessional assistance in individual recipient countries does not exclude the possibility of centrally-funded technical assistance and research activities on a limited basis nor does it mean that these countries cannot continue to receive assistance in addressing equity-related and other development problems from international institutions and organizations assisted by AID. AID can also assist such countries, particularly through its Office of Special Technical Services (TA/STS), to locate needed technical assistance for which they are willing to pay.

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Annex II

# ADDITIONAL RESOURCE NEEDS OF THE LDCs IN LIGHT OF THE ENERGY CRISIS

## Most severely affected countries

The MSA countries are those LDCs expected to suffer serious economic dislocations as a result of the increase in oil and other prices. They import most or all of their petroleum. Many do not export commodities that have enjoyed the recent commodity price rise. Most have neither large foreign exchange reserves nor the ability to finance additional imports through greatly increased foreign borrowing. It is important to stress that the MSA concept as used by ourselves and the UN is a very limited one. It refers to the extra balance of payments burden imposed (mainly) by the oil price rise during a relatively short-run period of structural adjustment to higher energy costs. For most of the MSAs, this extra burden is a severe compounding of their underlying longer run need for substantial concessional assistance. Our estimates of MSA extra financial needs assume no growth in import volume; thus if the entire MSA "gap" were filled, most of these countries would still be left in a position of little or no growth in per capita income. Filling this gap will merely put these countries back up on the low-growth track from which they are now in danger of being bumped.

The MSA group is shown in the following table, including the projected basic balance deficit and the amount of additional concessional financing required.

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1974 Additional Resource Needs of the Most Severely Affected LDCs[1/]

($ Million)

| | Basic Balance | Additional Concessional Financing Needed |
|---|---|---|
| Bangladesh[2/] | - 225 | 187 |
| Cameroon | - 61 | 42 |
| Chile | - 141 | 94 |
| Costa Rica | - 59 | 49 |
| Honduras | - 60 | 45 |
| India[2/] | -1093 | 411 |
| Ivory Coast | - 103 | 73 |
| Kenya | - 130 | 54 |
| Pakistan[2/] | - 196 | 71 |
| Senegal | - 40 | 25 |
| South Vietnam | - 50 | 50 |
| Sri Lanka | - 225 | 196 |
| Tanzania | - 120 | 92 |
| Uruguay | - 60 | 0 |
| Sub-total | 2563 | 1389 |
| Botswana | | |
| Cambodia | | |
| Guyana | | |
| Lesotho | | |
| Sahel: | | |
| Chad | | |
| Mauritania | | |
| Niger | | |
| Upper Volta | | |
| Sudan | | |
| Swaziland | | |
| Sub-total | - 300[3/] | 300[4/] |
| Total | 2863 | 1689 |

1/ In preparing individual country estimates, certain assumptions had to be made with respect to future commodity prices and possible capital flows. Projections of commodity export and import values were taken from AID Mission and IBRD data. Reference was made to the recent World Bank projections of commodity prices for 1974 in specific cases where major export or import items were involved. In two specific cases the price estimates of a particular commodity were considered to be of particularly critical importance to the balance of payments and thus were the subject of extended discussion. Indian expenditure for food imports is based on a price of $135/ton f.o.b. (or c.i.f. of $170/ton). The World Bank has been using a c.i.f. price of $210/ton. An average f.o.b.

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price of 90¢/lb. for 1974 was assumed for Chilean copper exports. This price is lower than the current f.o.b. price obtained by Chile but it appeared to be a reasonable estimate of the average price for the full year.

2/ Refers to fiscal year, India: April 1, 1974 to March 31, 1975; Bangladesh and Pakistan: July 1, 1974 to June 30, 1975.

3/ The sum of basic balance deficits for the last ten LDCs is calculated on the basis of increases in basic balance deficits but the sum does not include the basic balance deficits which would have occurred regardless of price increases.

4/ It is not feasible to estimate the financing need for each of the ten LDCs in the second group. However, it is useful to have some idea of order of magnitude. The $300 million figure is composed of $150 million for higher cost petroleum imports and $150 million for the additional costs for fertilizer, food, and capital goods. The estimate of $150 million for petroleum assumes that petroleum prices will have increased from $3.40 per barrel to $9 per barrel and possibly to as high as $12.00 per barrel, the amount of increase depending on the particular LDC. It is further assumed that the volume of petroleum import will remain at the 1973 level.

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Column 1 in the table presents the sum of the projected deficits in the basic balance of the 25 LDCs. The basic balance is the sum of the current account balance plus the projected net flow of medium- and long-term capital. These estimates include such expected financial resource flows as the 1974 Chile debt rescheduling and the Indian-Iranian oil agreement.

The increased petroleum import bill for the 25 MSA countries is projected to be $2.8 billion in 1974 while these countries will experience an aggregate $2.9 billion basic balance deficit. Thus, the major part of the MSA financial problem is due to the increase in petroleum prices. Taking all MSA's together, substantial price increases in other imports have been mostly offset by increased export earnings.

As noted earlier, some of the LDCs have at least a partial means of financing a portion of this gap. It was assumed for 1974 that they could borrow their gold tranche as well as one credit tranche from the IMF. For countries which have already drawn their gold tranche, it was assumed that they can borrow one more credit tranche in 1974. Similarly, it was assumed that countries would use up their reserves at a rate which would result in their holding, at the end of 1974, a minimum amount of reserves equivalent to two months' imports (of goods only).

After taking account of these possibilities for financing, the <u>total remaining</u> amount to be financed is $1.7 billion. Financing of this

remainder must be undertaken on concessionary terms, because both the overall credit worthiness of the countries and their precarious financial position almost certainly preclude their being able to obtain funds on commercial terms.

The application of the same rule of thumb for reserve drawdowns to all countries, however, distorts the actual maneuverability of some countries. Other assumptions regarding reserve usage which could be argued to be equally reasonable have in fact been used in other studies. A three month reserve holding figure would more closely reflect a level which would be a minimum desired level on the part of policy makers in many LDCs. Using a three month criterion, the estimate of additional financing needed would increase by approximately $500 million to $2.2 billion. A 20% use of existing reserves regardless of level, which has been used in some World Bank calculations, would increase the $1.7 billion gap by only $40 million but would yield a slight shift in the distribution of need between countries.

The assumptions used in this analysis appear to be fairly drastic, including those for reserve drawdown. The drawdown of reserves to a two month level represents a major reduction in the countries' financial resources. While this action reduces the immediate short-term problem, such actions place these countries in an extremely vulnerable position from which to manage the problem in the future. In fact, simply maintaining their present reserve levels would

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constitute a deterioration, since the rapid increase in import costs will call for an increase in the minimum level of reserve holdings deemed acceptable. Given the predicament that these countries might find themselves in, however, it is expected that the LDCs will take all of the possible measures at their disposal to address the financing problems they face.

These estimates of additional concessional financing required by the MSAs probably understate the magnitude of the problem faced by these hardest hit LDCs for a number of reasons: first, most of the country estimates assumed a major reduction in growth rate, placing the per capita performance on the margin between gain and loss. Second, some countries are drastically reducing imports through import controls and have thus reduced the apparent financing gap by sacrificing needed imports. Third, in the important case of the Indian Subcontinent, the estimates implicitly assume average harvests. If significant adverse climatic conditions develop, the ensuing needs for large-scale imports would increase these estimates radically. Fourth, there are undoubtedly countries not included in the sample which will also be in need of additional concessionary financing. Because of the understatement implied in these figures, they should in all probability be regarded as <u>minimum</u> estimates.

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It is not feasible to obtain precise quantitative estimates of the financing needs for 1975. Rapidly changing prices coupled with the wide array of other unknowns greatly reduces one's ability to forecast beyond the very short-run. It is widely assumed, however, that the balance of payments performance of the LDCs is unlikely to improve in 1975 particularly if important LDC export commodity prices fall back from their current highs. Assuming the same trade performance in 1975 as is estimated for 1974, but recognizing that reserves were depleted in 1974, one arrives at an order of magnitude estimate of additional financing need, after an additional IMF drawdown of $2.4 billion.

The largest financing difficulties will be faced by Bangladesh, Chile, India, Sri Lanka and Tanzania. These countries are likely to account for up to 60% of the total additional financing needed in 1974 by the 25 countries reviewed above.

LDCs affected but able to finance

The countries included in the moderately affected category are oil-importing LDCs which, although adversely affected by the current international economic situation, should be able to obtain the necessary financing to cover most of the increased import costs either through reserve drawdowns or increased borrowing or a combination of both.

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LDCs which can Finance Projected Basic Balance Deficits in 1974 ($ million)

| | Basic Balance Deficit | Reserve Potential 2/ |
|---|---|---|
| Brazil 1/ | 0 | 4649 |
| Dominican Republic | 17 | 26 |
| Korea | 528 | 196 |
| Nicaragua | 37 | 59 |
| Panama 3/ | na | na |
| Paraguay | 15 | 20 |
| Peru 3/ | na | na |
| Philippines | 60 | 812 |
| Thailand | 100 | 1242 |
| Turkey | 221 | 1168 |

1/ Over the last few years Brazil has borrowed relatively large sums while simultaneously making large additions to its international reserves. It is expected that in 19,4 Brazil will continue to borrow on the same scale but reserves will not increase as they have in the past. Thus, in a particular sense, Brazil will not take extraordinary steps to finance the increase in its oil import costs nor will it draw down reserves, and therefore Brazil could instead be included in the borderline group. That is, based on past performance, Brazil probably would have borrowed about the same amount in 1974 regardless of petroleum prices. Thus, a rigorous argument would hold that the petroleum price increase is not causing Brazil to borrow to pay the petroleum increment because the country would have borrowed anyhow. But a narrow interpretation is misleading because Brazil is, nevertheless, borrowing some amount to pay the petroleum import increment (instead of increasing its reserves) and therefore, should properly be placed in the second category. Thus, Brazil is included in this intermediate group.

2/ The reserve potential noted as "Total" in the summary table is the sum of the country's IMF gold tranche, one IMF credit tranche and "foreign exchange" (1d" in International Financial Statistics) less the gold tranche (to avoid double counting) and less a two month import equivalent. The two month import equivalent, that is the value of two months average expenditure for imports, is by international financial standards considered to be a minimum reserve level and is, therefore, subtracted from the overall reserve figure.

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3/There are not enough data available to allow estimation of the basic balance and reserve potential for Panama and Peru and, therefore, it cannot definitely be stated that they belong in this intermediate group. The general indications are, however, that these two countries probably will incur deficits on basic balance but that the deficits will be within reach of their reserve and foreign borrowing capacities. Therefore, even though there are no specific data available to indicate the size of deficits and reserves, Panama and Peru are placed in the intermediate group at least until more complete data can be obtained.

The fact that these countries are believed to be able to cover the increase in import expenditure for 1974 and possibly for 1975 does not mean that this increase will not adversely affect their international financial position. In order to cover the additional costs these countries will be required to draw down their reserves and increase their borrowing on the capital markets. An increase in borrowing will increase future debt service payments. The financing of deficits from reserves and borrowings is a short-run expedient and those countries in this group which over time cannot offset the rapidly rising import costs by other means are bound to encounter increasing difficulties in the future.

The borderline LDCs

Finally, there is a group of LDCs whose resource position is not expected to be significantly affected by recent economic developments, either because their export earnings are expected to match increases in their POL import costs, or because very favorable commodity price movements or increases in domestic oil resources are expected to provide them with moderate improvements in their balance of payments positions. The countries expected to experience

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only moderate gains are in the borderline category because these gains could be subject to erosion and in any case (barring major oil or other bonanzas) will not put these countries into the major capital-exporting class of the major oil producers.

These countries are: Afghanistan, Bolivia, Colombia, El Salvador, Ethiopia, Ghana, Guatemala, Jamaica, Morocco, Nepal, Tunisia, and Zaire.

The borderline countries will also require capital imports for many years. They are a mixed group. Some have sufficiently high income or favorable growth record and prospects that they should be able to meet these capital requirements without concessional aid, or might be helped to improve their position with respect to non-concessional flows. Others have very low per capita incomes; although the recent changes in the world economy have left them about where they were before, that position was a low income situation that needed concessional aid before, and still needs it now.

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