

# PROGRAMMING AND MANAGING COUNTERPART FUNDS TO ENHANCE ECONOMIC DEVELOPMENT: A US PERSPECTIVE

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## BACKGROUND

On July 30, 1991, the US Agency for International Development (AID) issued new policy guidelines governing the generation, programming, and accountability requirements associated with host country-owned local currency, or counterpart funds (AID 1991b). This article summarizes the historical background leading up to the development of the new policy; indicates in quantitative terms the general magnitude of counterpart funds generated by the US foreign assistance programme; and outlines key elements of the new policy.

AID 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 generally encouraged such participation. But in 1972 the policy was changed: no longer would AID participate in local currency programming. In 1976 the policy was changed again, this time to make it obligatory for AID field missions to 'consider the merits' of participation in local currency programming. In 1983 AID policy was clarified to require more active involvement in local currency programming (AID 1983), and by 1987 greater AID involvement had led to increased AID accountability requirements (AID 1987b).

In recent years, the Agency has been increasingly criticized for the way in which local currency is managed. The management problem is most visible in countries where a relatively large proportion of US economic assistance is provided in the form of programme (as distinct from project) assistance. In addition, the problem tends to be most serious when the local currency is used as budget or sectional support rather than as support for discrete projects where the impact of the funding is easier to document. The new 1991 local currency policy was developed in recognition of the need to handle legitimate accountability concerns more effectively, but without jeopardizing the potential developmental impact of these resources.

## MAGNITUDE OF COUNTERPART FUNDS

The amount of local currency generated by AID's foreign assistance programme is substantial.<sup>2</sup> In fiscal year 1990 (ending September 30, 1990), over \$1.3 billion of local currency was expended in 48 developing countries. Of this, about \$954 million (71 per cent) was generated from non-food aid sources, and \$385 million (29 per cent), from food aid sales; see Table 1.

Table 1 also shows that about 32 per cent of these expenditures took place in the Near East region (in four countries); 30 per cent occurred in Latin America and the Caribbean (11 countries); 20 per cent in Asia (six countries); and 18 per cent in Africa (27 countries).

Ten of the 48 countries is accounted for 75 per cent of all the local currency expended in fiscal year 1990. This skewed distribution reflects the fact that a disproportionate share of programme assistance, which is the primary source of local currency, is provided to relatively few countries.

Almost 44 per cent of the local currency was used to support discrete projects (often donor-funded projects); 30 per cent was used to help fund specific sectors of the government's budget; 22 per cent to help reduce the government's debt or finance its deficit; and 4 per cent was used to help fund AID's in-country administrative costs or to monitor the use of the local currency; see Table 2.

The government of any country that receives foreign assistance must know the magnitude of counterpart funds generated from all external assistance sources, not just a few donors, in order to estimate their potential macroeconomic impact. For example, the estimated CIF value of non-emergency cereal food aid provided to Mozambique by all donors in 1989 equalled approximately 22 per cent of total government revenues (Riley and McClelland 1990), which is large enough to have a substantial impact.

<sup>1</sup> This paper reflects the views of the author and not necessarily those of the US Agency for International Development. Jessica Graef provided research assistance in the preparation of this paper.

<sup>2</sup> Data included in this section were compiled from the fiscal year 1993 annual budget submissions which were submitted to Washington by each AID field mission in June 1991. These reports show that in fiscal year 1990 local currency was expended in 48 countries; 75 per cent of the expenditures occurred in the ten countries highlighted in

bold: Botswana, Burkina Faso, Burundi, Cameroon, Cape Verde, Chad, Congo, The Gambia, Ghana, Guinea, Kenya, Lesotho, Madagascar, Malawi, Mali, Mozambique, Niger, Rwanda, Senegal, Seychelles, Sudan, Swaziland, Tanzania, Uganda, Zaire, Zambia, Zimbabwe, Bangladesh, Indonesia, Pakistan, Philippines, Sri Lanka, Thailand, Belize, Bolivia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Haiti, Honduras, Jamaica, Peru, Egypt, Jordan, Tunisia, Yemen.

Table 1: Local currency expenditures, by region and source, fiscal year 1990, \$000

Region	Sources			
	Non-food Aid	Food Aid	Total	Per cent
Africa	154,321	89,238	243,559	18.2
Asia	106,149	168,434	274,583	20.5
Latin America	294,435	104,930	399,365	29.8
Near East	398,926	22,578	421,504	31.5
Total	953,831	385,180	1,339,011	100.0

*Source:* Data were compiled from the fiscal year 1993 Annual Budget Submissions provided by 48 USAID field missions, June 1991.

Table 2: Local currency expenditures, by region and use, fiscal year 1990, \$000

Region	Uses			
	Project Support	Sector Support	Deficit/Debt Reduction	Admin. Costs
Africa	138,554	55,614	31,280	18,111
Asia	87,636	186,943	0	4
Latin America	182,895	154,034	38,950	23,486
Near East	173,504	7,000	234,000	7,000
Total	582,589	403,591	304,230	48,601
(Per cent)	(43.5)	(30.1)	(22.7)	(3.6)

*Source:* Data were compiled from the fiscal year 1993 Annual Budget Submissions provided by 48 USAID field missions, June 1991.

## POLICY

AID local currency policy closely parallels the legislation governing the bilateral economic assistance programme and the food assistance programmes (US Senate and House of Representatives 1991a, 1991b, 1991c). The local currency requirements under the various statutes are not the same. Local currency generated under the Foreign Assistance Act (FAA) is often viewed as a by-product of the assistance. It is typically programmed by AID and the recipient government in an effort to move toward an overall host country budget that represents a sound development

oriented allocation of budgetary resources. In contrast, the legislation governing US food aid programmes treats the generation and use of local currency as a statutory end in itself, and not just as a by-product of the sale of the food aid. Indeed, unlike the FAA, the statutory objectives of monetised food aid programmes would not be satisfied unless the local currency proceeds were used for their intended purposes.

Local currency generated from US assistance is usually owned by the recipient government, and as such the recipient government is normally expected to assume primary responsibility for allocating its own budgetary

resources. At the same time, Agency policy encourages the integration of host country-owned local currency with external resources to help achieve specific programme and policy objectives and to enhance the developmental impact of the external resources.

Therefore, AID field missions must make an initial judgement and reach agreement with the host government on:

- a) whether or not the dollars disbursed under a cash transfer programme or the commodities financed under a commodity import programme will result in the generation of local currency;
- 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. Each of these three elements — generating local currency, programming local currency, and managing local currency — is discussed below.

### **GENERATING LOCAL CURRENCY**

Local currency is generated under commodity import, cash transfer, and sector assistance programmes in one of two ways: first, when the use of the dollar assistance results in the receipt of local currency by the recipient government; and second, in the absence of such a receipt, when AID requires a deposit or set aside of local currency by the recipient government as a condition of the assistance agreement.

For example, local currency is generated when the dollar assistance is used for private sector imports under a commodity import programme or a cash transfer programme. Likewise, public sector imports generate local currency if the recipient government sells the imported commodities to the private sector or to a quasi-private entity, such as a self-financing parastatal body. In contrast, local currency need not be generated when the dollar assistance is used to service external public sector debt or when commodities are imported by, and for the use of, the recipient government. Similarly, an intra-governmental transfer of the commodities would not generate local currency. In these cases, however, the US may require a deposit or set aside of local currency.

When recipient governments are required to set aside local currency as a condition of the assistance agreement, budgetary resources should be available for such a set aside. Otherwise, the recipient government would need to reduce expenditures for activities that have already been included in the budget, increase revenues from taxation or borrowing, print money, or undertake a combination of these measures.

### **PROGRAMMING LOCAL CURRENCY**

When local currency is generated, it must be programmed to support the economic development objectives as defined in current legislation. Under the FAA rules governing cash transfers and commodity import programmes, there are four basic options for programming host country-owned local currency. First, local currency may be invested in developmentally sound projects, including AID-funded projects and activities funded by other OECD and multilateral donors and private voluntary organizations. Projects selected for local currency funding must meet acceptable technical, financial, administrative, and accounting standards.

Second, local currency may be used to help meet the budgetary requirements of particular sectors or ministries of the recipient government, say, the Ministry of Agriculture. Under this option, the quality of the overall sectoral activities and the technical and administrative capability of the implementing entity must be judged satisfactory.

The third programming option is to use local currency 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 these funds available for private sector borrowing) or to reduce domestic debt owed by the government to the banking system or to another government (or parastatal) entity. This option (which is equivalent to supporting the government's overall budget) is normally appropriate only in countries implementing an IMF-sponsored stabilization programme and/or a World Bank-sponsored Public Investment Programme, under which the domestic money supply and credit ceilings (for both public and private sector borrowing) are firmly established.

Finally, AID has authority to establish local currency trust funds which are used primarily to help meet the administrative costs of its field missions overseas. Under exceptional circumstances, trust funds may also be used to finance discrete projects or activities, in which case the project must be designed, implemented, and monitored as if it were funded with appropriated dollars.

The statutorily mandated requirements and prohibitions associated with monetised food aid programmes are more numerous and more complex than the FAA provisions summarized above. This is partly because the legislation establishes multiple objectives for food aid (such as promoting economic development or providing emergency assistance to needy people), and the local currency requirements vary depending on the particular objective.

An important objective of PL 480 Title III food aid, for example, is to promote economic development in the 'least developed' countries, and the legislation identifies 13 specific economic development purposes for which local currency proceeds generated under the Title III programme may be used.<sup>3</sup>

At the same time, the food aid legislation imposes certain prohibitions. For example, local currency generated from the sale of food aid may not be used for abortion-related activities; or to finance the production for export of agricultural commodities that would compete in the world market with similar items produced in the US if such competition would cause substantial injury to US producers; or to help fund AID administrative expenses. These and other requirements that govern local currency generated under all of the various food aid programmes are described in the legislation (US Senate and House of Representatives 1991a and 1991b) and summarized in the new policy (AID 1991b).

In general, local currency should be disbursed as quickly as possible — consistent with sound programming practices and prevailing economic conditions in the recipient country. When this is not possible, the local currency may be placed in interest-bearing accounts in deposit-taking institutions, with any interest programmed as if it were principal. When it is appropriate to programme local currency so it disburses relatively slowly, an endowment may be established, the earnings of which would be designated to support development programmes of non-governmental organizations or other appropriate entities. The local currency used to establish an endowment is typically invested in government bonds, which has the effect of demonetising the currency and reducing its potential inflationary impact on the economy.

## MANAGING LOCAL CURRENCY

Current legislation clearly intends that AID will not only be responsible for programming local currency, but also will bear increased responsibility for accounting for local currency.

When local currency is generated, or when local currency set asides are required, AID normally must establish separate accounts, monitor the implementation of local currency-financed programmes, ensure that there is appropriate reporting and auditing of the

special accounts and the local currency-financed programmes, and develop programme performance indicators with the recipient government to assess the results of the programmes.

AID's involvement in monitoring local currency is normally greater (and more staff-intensive) when the local currency is programmed to support individual projects than when it is programmed as sectoral support. Therefore, prior to entering into an agreement with the recipient government, AID must perform a general assessment of the government's overall accountability environment, including its systems of financial management and contracting. This assessment helps determine which kinds of activities (for example, specific projects or more general sectoral support) are most appropriate for a particular accountability environment; it will also help to identify possible accountability problems before they arise.

In June 1991, AID issued implementation guidance (AID 1991c) defining three distinct aspects of accountability for host country-owned local currency: first, the special account must be managed to assure that the local currency is deposited and disbursed as agreed upon; second, once disbursed from the special account, the local currency must be monitored to assure that it is used for the intended purposes; and third, once the purposes have been achieved, the impact of the local currency must be evaluated.

## SUMMARY

The amount of host country-owned local currency that is generated by AID's foreign assistance programme is large and growing larger. In fiscal year 1990 over \$1.3 billion was expended in 48 developing countries; of this, 71 per cent was generated from non-food aid sources and 29 per cent from food aid. These resources were jointly programmed by AID and the recipient governments to help fund development projects, to support specific sectors of the budget, to reduce the public sector debt or help finance the deficit, and to help defray AID overseas administrative costs.

In recent years, the Agency has been increasingly criticized for the way in which local currency is managed. In 1991, AID developed new policy guidance, together with supplemental implementation guidance in order to clarify the conditions under which local currency is generated, to indicate how local currency

<sup>3</sup> These 13 economic development purposes include: (1) promotion of policy reforms to improve food security and agricultural development; (2) establishment of development programmes, projects, and activities that promote food security and various child survival objectives; (3) promotion of increased access to food supplies; (4) promotion of free and open markets; (5) support for US PVOs and development of indigenous NGOs; (6) purchase of agricultural commodities produced in the recipient country to meet

relief requirements or to build emergency food reserves; (7) purchase of other goods and services to meet these relief requirements; (8) support of the farmer-to-farmer programme; (9) private sector development activities; (10) agriculture related activities of the Peace Corps; (11) development of rural infrastructure; (12) research on malnutrition; and (13) research, education, and extension activities in agriculture. Each of these purposes is defined in greater detail in the legislation.

generations may be used to enhance economic development, and to describe the management responsibilities associated with each use. In general, the policy guidance permits greater flexibility for

determining how local currency may be programmed, but the implementation guidance is somewhat more rigid with respect to how local currency must be managed.

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