

THE TREATMENT OF COUNTERPART FUNDS IN THE DEVELOPMENT ASSISTANCE COMMITTEE'S PRINCIPLES FOR PROGRAMME ASSISTANCE

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1 INTRODUCTION

The Development Assistance Committee (DAC) of the Organisation for Economic Cooperation and Development (OECD) was established in 1961 with the mandate 'to secure an expansion of the aggregate volume of resources made available to developing countries and to improve their effectiveness'. DAC is a forum where donors exchange views and changing perceptions of the development process. Increasingly in recent years DAC has adopted guidelines and statements on good practices. They are on a 'best efforts' basis, whereby DAC Members undertake to review and adapt their current practices against the new standards. In some cases they imply a significant re-orientation of current aid practices. Through feedback mechanisms, such as the DAC Aid Reviews and continuous discussions proceeding on a consensus basis, the DAC has tried to establish a collective view within the donor community on the requirements of a well managed and effective aid programme.

Because programme assistance has become an increasingly important instrument of economic cooperation with developing countries, particularly in the light of policy reform and structural adjustment, the DAC began discussing Principles for Programme Assistance (PPA) over two years ago. The issue of counterpart funds is one of those discussed under this head. The PPA were approved by the DAC High-Level Meeting of December 4, 1991 and thus entered the catalogue of measures that DAC Members recognise as ingredients to the effective management of aid programmes. Three other sets of principles for effective aid covering technical cooperation, evaluation, and project aid have been adopted by the DAC. The text of the DAC PPA relating to counterpart funds is found in Chapter X of the DAC PPA and is reproduced as Annex I to this article.²

The DAC PPA define programme assistance as all contributions made available to a recipient country for general development purposes, i.e., balance-of-payments support, general budget support and commodity assistance, not linked to specific project

activities. However, the entire definition is intricate and broken down into several categories. Annex II reproduces the definitions which should help to improve statistical reporting by DAC Members.

Programme assistance is of current interest not only because of the role it plays in structural adjustment and economic reform programmes, but also because of the perception that it has increased in recent years as a share of donors' aid programmes. But, how important is programme aid? And how important are counterpart funds? Unfortunately, data on the flow of programme aid are hard to obtain; and data on counterpart funds even more so.

With regard to programme aid, problems have arisen perennially about how to catalogue various types of assistance. Sector aid, for example, may be for sector adjustment, policy related sector assistance or general sector support, and donors may have reported some sector aid under the sector itself (agriculture, social, economic infrastructure) rather than as programme assistance. Hybrid commodity import/project programmes are difficult to categorize and may often be misreported. Similarly, there is no clear financial breakdown between programme and other types of food aid. The DAC PPA should help to cure the statistical reporting problems, but analysing past statistics is problematic.

In preparing for the PPA, the OECD Secretariat made some estimates of programme assistance of all types by DAC Members which suggested that in 1988 it was in the order of \$10 billion or 25 per cent of DAC Members' bilateral aid, although there were many uncertainties in that calculation. The uncertainties stemmed from the fact that programme aid, as such, was seriously under-reported. The estimate of \$10 billion was reached by adding elements which seemed to be programme assistance but had been reported in other categories. In addition to DAC Members, the World Bank provided \$4.7 billion and the EEC \$0.9 billion of programme assistance in 1988.

Bearing in mind the uncertainty of the reporting, one

¹ The opinions expressed in this article reflect the views of the author and not of the OECD or its Member governments.

² The drafting of the counterpart provisions of the DAC PPA guidelines benefited greatly from work that was presented at the IDS workshop on commodity aid and counterpart funds in Africa in

January 1991 and the World Bank led Special Programme of Assistance for Africa (SPA) Working Group chaired by the EC, which prepared guidelines for that group and which are described elsewhere in this symposium. Copies of OECD publications can be obtained from the OECD Publication Service, 2, rue André-Pascal, 75775 Paris CEDEX 16, France. Telephone (33-1) 45.24.82.00.

could take these data, with all customary precautions, as a general order of magnitude for the purpose of establishing a trend line. If one assumes that the reporting of general programme assistance was as continuously under-reported in previous years as it was in 1988, programme assistance would have doubled as a share of DAC Members' bilateral ODA from a level of about 12 per cent of DAC bilateral ODA (1975-1980) to about 25 per cent (1982-1990). To calculate total programme assistance by all donors one would have to add the contributions of the World Bank, EC, regional development banks, and World Food Programme.

DAC does not keep statistics on counterpart funds nor do DAC statistics reflect what percentage of programme assistance generates counterpart funds. Obviously, certain types of aid such as programme food aid, commodity import programmes and cash grants tend to generate counterpart funds, but there is no breakdown of projects or statistical base along these lines. A guess based on discussions with a number of aid practitioners would be that a significant share of programme assistance, in a range between one eighth to one half, would generate counterpart funds. However, there is no statistical basis or firm information on which to base this guess. The Club du Sahel (Club du Sahel/COBEA-ORSAY) has done work on this issue which indicates that counterpart funds in several Sahelian countries vary between 7 and 20 per cent of the value of total ODA provided to those countries.³ In any case, if programme assistance has doubled over the past 15 years, as the foregoing analysis suggests, counterpart funds would presumably have increased by roughly the same amount.

2 ALTERNATIVE VIEWS ON COUNTERPART FUNDS

Despite the uncertainty of the data, the discussions of programme assistance among donors have proceeded on the implicit assumption that counterpart funds constitute a substantial amount of money. Given the growth of programme assistance it is an increasingly important issue that has not received much attention until recently.

Donor practices vary with respect to the treatment of counterpart funds. Some donors have a policy of exerting little or no control over counterpart funds, only requiring that they be put into the recipient government's budget. Other donors impose more or less stringent controls over the creation, accounting and use of counterpart funds, including how they are to be generated (exchange rates to be applied and deposit procedures) and programmed (often earmarked for

specific projects and programmes).

As discussions about programme assistance proceeded, there were varying opinions expressed among donors about how best to approach the treatment of counterpart funds against the reality of donor practices and about how to reach a consensus on what good practice in counterpart fund management should be. Sometimes programme assistance is provided by donors with the unexpressed intention of creating counterpart funds which could be used to complement the local currency needs of externally financed projects. This is particularly prevalent in sub-Saharan Africa where experience has shown that countries with weak budget procedures are often unable to make good on their pledged contributions to donor financed projects. Generating counterpart funds through programme assistance is a backdoor way of assuring that donor financed projects are not stalled for lack of the host country local currency contribution. In other cases, donors like to create counterpart funds to provide what they view as needed flexibility.

Often counterpart funds are accounted for outside normal government budget and accounting procedures, which are viewed as cumbersome, bogged down in red tape, and unreliable. Having counterpart funds available in a flexible manner, outside of normal government budget structures, sometimes enables donors to support programmes that would otherwise be difficult, if not impossible to implement. An example might be a country-wide irrigation repair and maintenance programme. To send local currency funds to many different local jurisdictions responsible for carrying out small maintenance repairs of irrigation systems might pose an almost insurmountable problem if one were operating within normal government budget and expenditure procedures. With counterpart funds, one might place the local currency in a commercial bank account with national branches and be able to move rapidly and flexibly forward on a number of local projects.

Thus, donors have had operational reasons for earmarking counterpart funds and there are some redeeming features about the manner in which counterpart funds have been and still are managed. Many field practitioners of development aid feel that, from a practical standpoint, it is better to earmark counterpart funds rather than to see them folded into the budget where they seem to lose their effectiveness. In addition, some donors have stringent accounting requirements, calling for the funds to be accounted for without being intermingled with other funds. Often the easiest way to do that is to put them in a separate,

³ The statistical questions concerning the amount of programme assistance donors provide and the size of counterpart funds generated would deserve research. The CILSS/Club du Sahel network would

be one source on this question since it has already produced relevant quantitative and analytical information.

special account, which in many cases is outside the normal government budget controls.

Against these practices and, in some cases, legal requirements for treating counterpart funds, there are those who argue that it is not good development policy over the long term to multiply special accounts and to encourage disparate methods of handling counterpart funds. Not only do these practices result in skirting standard government budget and accounting procedures, but the sheer proliferation of different methods and requirements is bewildering and confusing to the recipient governments. Moreover, there is concern about the macroeconomic effects of counterpart funds and the possible inflationary impact they could have if allowed to accumulate.

Without intending to do so individually, donors as a group are in effect undermining the recipient governments' budget discipline, which in other venues the donors are trying to strengthen. Obviously, there is a problem of coherence between what donors are doing in reform programmes and the collective impact of counterpart funds, which in addition to tending to undermine budget discipline, can create or exacerbate macroeconomic problems. Ironically, the very tool designed to help recipient countries reform their economies, namely programme assistance, can also hinder the reform process.

3 THE DAC CONSENSUS

Out of these considerations, a consensus emerged in the DAC that donors should try to take the high road in support of reform and improved budget discipline. This did not mean that earmarking would be strictly taboo, but donors would try to avoid earmarking as far as possible, strive to reduce the administrative burdens counterpart fund management impose on recipient governments, and work towards a time when all counterpart funds will be accounted for within the government budget and spent in accordance with an approved expenditure plan, consistent with adjustment programmes agreed upon by the recipient country and the World Bank/IMF where these exist.

These latter two points (i.e. on-budget, and in accordance with the World Bank/IMF adjustment programme) are surprisingly controversial and made it difficult to reach a consensus. Some donors believe it is too simplistic to say 'if budget and expenditure programmes agreed upon by the recipient country and the World Bank/IMF are well prepared, managed and adhered to everything will be fine. Therefore, donors should stop earmarking or permit counterpart funds to be put in special, off-budget accounts'. They think that the supposition in that statement is not realistic, particularly in Africa, and will not be realistic for some

time. Therefore they prefer a progressive, transitional country-differentiated approach to the requirement that counterpart funds be on-budget. Basically, they think they have better accountability control with off-budget special counterpart fund accounts than on-budget, and certainly more leverage to do what they think needs to be done. These may be debatable points, but they represent views held by some donors. This discussion also highlights the low opinion that some donors have of recipient country accounting and control systems which curiously seems to surface more in counterpart fund discussions than in those about normal aid programmes.

The second point making consensus difficult relates to a widely held donor view that donors are not consulted sufficiently by recipient countries and the World Bank/IMF in preparing budgets and expenditure plans and thus donors need to earmark counterpart funds in the interests of their own programme. Although donors are assured that 'their' projects will be taken care of in budget discussions, they think they are insufficiently consulted and have too little influence on the outcome of budget discussions. So, they are better off to earmark their counterpart funds thus ensuring that 'their' projects and concerns are covered. Often the two issues, off-budget and earmarking, go together since it may be easier to earmark funds when they are off-budget.

In view of these concerns the DAC PPA provide for a progressive approach during an undetermined transition period. During that period donors can differentiate between countries in which they have confidence and where they will try to ensure that counterpart funds are put on-budget, with minimal or no earmarking, and other countries where they feel the accounting safeguards are lacking and where they feel it necessary to maintain more control through earmarking, and in some cases off-budget special accounts. The PPA also call on the World Bank/IMF to take into account the views of the donor community in helping recipient governments to prepare budgets and public expenditure programmes.

A number of other points which are part of the conventional wisdom on counterpart funds were included in the DAC PPA. These include the notion that counterpart funds should be put into a planning context and an attempt made to eliminate starts and stops in providing them which could be harmful to the development process. Also, such technical points as the need to credit counterpart funds promptly, disburse them as soon as practicable to avoid the possible inflationary impact from excessive accumulation, and value commodities and food aid on the basis of import parity prices or a pricing policy agreed under a policy reform programme were included in the DAC PPA.

The DAC PPA guidelines apply, not only in Africa, but worldwide.

Effective policies in recipient countries are essential for sustainable growth and development, but donors must also strive to make their own policies as coherent as possible. The DAC PPA guidelines are a step in that

direction. As donors integrate them into their procedures with respect to counterpart fund management, they should contribute to making the counterpart fund aspect of programme assistance more coherent and supportive of recipient government economic and policy reform programmes.

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Annex I — Extract from the DAC Principles for Programme Assistance

X. Counterpart Funds

44 Local currency proceeds generated by programme assistance (through the sale of commodities or foreign exchange) are frequently subject to special agreement on their use between the individual donor and the recipient government, involving the application of particular management arrangements, including the creation of special accounts. These counterpart funds differ from local currencies bought to finance local costs, in that in the latter case, the donor retains ownership and control of the local currency up to the point of disbursement, normally in the framework of a project.

45 In programme assistance, the real resource transfer is represented by the commodity or financial aid inflow, not the counterpart funds which are generated from such programme assistance. Counterpart funds thus do not constitute further additional resources for the recipient country. Their existence on any significant scale therefore raises important issues both for macroeconomic management (the inflationary potential) and for public expenditure management (transparency, consolidation of public budgets, and conformity with overall expenditure priorities).

46 Effective programming of public expenditure and its implementation according to budgeted priorities within a developing country's overall budget is a key objective. It is closely related with the concern to foster good governance and increased self-reliance in recipient countries. To be consistent with this objective, donors should make efforts to adapt their mechanisms and practices for delivering aid, including the use of counterpart funds, to facilitate the consolidated, rational and effective management of public expenditures, including overall allocation of expenditures which reflect established development

priorities emerging from the policy dialogue. Counterpart funds should therefore be integrated into the national budget of the recipient government under well-functioning budget formulation, accounting and evaluation procedures.

47 Donor and recipient practices concerning the creation and use of counterpart funds have a considerable history, including a legislative dimension in some cases. Some donors impose controls based on their own legal requirements. Other donors, including multilateral institutions, do not impose controls. The objective set out in paragraph 46 and the guidance in paragraphs 48-52 may therefore have to be approached in an evolutionary manner. In the transitional phase, the recipient country should make continued efforts to improve budgetary priorities and control, and public expenditure allocation and accountability; and donors should work to make the best use of counterpart funds in a way which, collectively, minimizes the administrative burdens for both donors and recipients and supports effectively the recipient country's macroeconomic and development objectives and rational financial management.

48 In this transitional phase, counterpart funds should be managed in a way which minimizes the distortions they cause and advances the objectives set out in paragraph 46. Accordingly, in operational terms they should progressively be:

a planned in advance, preferably in the context of a rolling, multi-year agreement, covering all types of aid that generate counterpart funds, linked to other types of aid, and provided subject to adequate policy performances;

b credited promptly within an agreed time, if possible, to a single government-controlled, interest-bearing account;

c disbursed as soon as practicable from the counterpart currency account(s), without endangering macro-

economic stability, and in particular, in accordance with a time frame that would avoid the inflationary impact of spending from excessively large past accumulations of counterpart funds;

d used to finance on-budget expenditures, avoiding insofar as possible earmarking to individual outlays.

49 Commodity and food aid should be valued on the basis of import parity prices or on the basis of a pricing policy agreed under an existing policy reform programme.

50 Bilateral donor-recipient agreements on counterpart fund management must be consistent with the objectives of external adjustment, non-inflationary growth and the priority public expenditure programme agreed between the recipient country and the World Bank/IMF, taking into account the views of the donor community in accordance with paragraph 34 above. Donors should give priority to supporting reform policies, including budgetary policy and effective and accountable management of public funds generally, when seeking agreement on counterpart fund management.

51 The effectiveness of adjustment assistance depends on the policies and institutional reforms implemented, including those related to public expenditures. The recipient country, with the assistance of the donor community and the World Bank/IMF, should closely monitor use of counterpart funds to ensure that they are consistent with public expenditure programmes, both investment and recurrent, to ensure that public sector resources are channelled in accordance with the priorities defined in the budget. Effective procedures for monitoring budget implementation should be ensured through provision, where appropriate, of technical assistance.

52 Where counterpart funds have accumulated over past years, it is important to ensure that their subsequent use is compatible with macroeconomic stabilization objectives and developing countries' broader budgetary expenditure priorities. The appropriate treatment of any outstanding balance in counterpart fund accounts at the end of a fiscal year and new counterpart fund creation projected for the following fiscal year will need to be considered when formulating each year's budget and priority expenditure programme. To be consistent with the objectives of non-inflationary growth and external adjustment under terms agreed with the World Bank/IMF, as appropriate, it may be necessary to sterilize the past accumulations of counterpart funds or the creation of new counterpart funds.

Annex II — Extract from the DAC Principles of Programme Assistance

Definition of Programme Assistance

Considerable efforts have been made by DAC to clarify the concept of programme assistance and its various categories. The general characteristic of programme assistance is that it is not linked to specific project activities. Four major sub-categories of programme assistance have been identified:

1 General Programme Assistance. Programme assistance made available to a developing country, without specific sector allocation, for general development purposes, i.e. balance-of-payments financing, general budget support and commodity assistance.

of which

Structural Adjustment Assistance with World Bank/IMF. Programme assistance whose provision is explicitly linked to a World Bank and/or IMF coordinated Structural Adjustment Programme. Examples are contributions under the World Bank Special Programme for Africa (SPA).

2 Sector Programme Assistance. Programme assistance directed to a specific economic or social sector, such as agriculture, education, community development and transportation.

of which

Sectoral Adjustment Assistance with the World Bank. This is programme assistance explicitly linked to World Bank Sectoral Adjustment Loans (SECALs) or sectoral assistance linked to World Bank Structural Adjustment Loans.

3 Programme Food Aid.

4 Debt Relief.

Disaster relief, although it often has programme aid characteristics, is of a special nature and should not be reported as programme assistance.

The conceptual framework set out above will form the basis for a revision of the more specific statistical reporting directives currently in process.

Statistical delineation of policy-related programme assistance from other programme assistance

There is an important conceptual and policy distinction between policy-related programme assistance (i.e. programme assistance designed primarily to encourage policy reforms in a recipient country) and various types of general economic support, which do not aim specifically at policy reform or structural adjustment programmes, even though in extending this assistance

Members may be guided by the existence of IMF/World Bank programmes. Experience has shown, however, that it is not feasible to obtain reasonably comparable statistical reporting of various types of bilateral policy-related programme assistance which is not explicitly linked to World Bank and /or IMF coordinated Structural Adjustment Programmes. For statistical purposes therefore only 'Structural Adjustment Assistance with World Bank/IMF' as defined above, will be shown as policy-related in DAC reporting.

Statistical delineation of programme assistance and programme approach

As pointed out in the Principles, a broader definition of

programme assistance would include all assistance given in support of a given well-defined programme of a developing country, especially a sector programme, including a package of interrelated project assistance and technical assistance as well as programme assistance. However, this concept has been considered too broad and open for statistical reporting purposes and the sector assistance concept as defined above is being retained for the time being for statistical reporting purposes. Grants or loans which combine a package of technical assistance and/or investment project financing and programme assistance in a single transaction should be recorded as 'Sector Programme Assistance'.