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SIXTH SENIOR SEMINAR IN FOREIGN POLICY

Foreign Policy Study

TIED AID AND U.S. TRADE UNDER THE ALIANZA

BY

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I PREFACE

A. Purpose of this Study:

This subject was selected under the assumption that much of the resources and effort put into United States and programs over the next five - ten years will be focussed on the Alliance for Progress or its successor(s) for Latin America.

Our current policy with regard to the financing of imports with aid funds is to tie them to the fullest extent possible (80 percent) to purchases of American-made goods.[1] It is assumed that this policy will be in effect at least as long as the United States is in balance of payments difficulties and probably beyond that time. One objective of this paper, then, is to examine the techniques and procedures established for tying commodity procurement to U.S. sources of supply and how these have worked in practice in certain key countries in Latin America. United States shipments to that area (see Annex A), long one of our principal regional markets have been falling off, and our share of that market decreasing as German, British, Japanese and other competitors have been recapturing their prewar position there. The study seeks to determine whether our aid has been tied in such a way as to maximize the benefits which can accure to the U.S. balance of payments, and to our longer-term trade prospects in Latin America.

A basic assumption in this connection, which is explored in the course of this paper, is that these benefits can be achieved without detracting from the primary objectives of our programs of economic assistance/ tied aid and economic development need not be incompatible. Moreover, a system of tying aid which will yield the largest possible increase in U.S. exports can greatly strengthen support for continuing large U.S. expenditures for foreign aid. Such a system will, of course, contribute in larger measure to the improvement of the U.S. balance of payments, and thereby lessen pressure to cut back on U.S. spending abroad, including expenditure on programs of economic and military assistance. It will also encourage greater support by the U.S. business community of our aid programs. Such support will be all the greater to the extent it can be shown that these and dollars not only result in an immediate increase in U.S. exports to the recipient country, but also help to build markets for our goods there in the future.

The longer-run market building potential of aid-financed exports merits special consideration, and perhaps greater attention than has been paid to this aspect of tied aid until now. It is generally recognized that when capital goods are financed under economic assistance programs, such exports tend to generate a continuing demand and preference for American-made spare parts, components, and related equipment. However, tied aid can also contribute to the strengthening of trade channels, contacts, and other facets of the local distribution system handling the import of American products in the recipient country. This is because much of the imports financed in this manner are brought in through normal commercial channels. The added business made possible in this manner could provide a much needed spur to local traders and their American suppliers to become more competitive. It could well enable importers, agents, and distributors of American merchandise to assume the additional overhead involved in employing more salesmen, carrying more shelf inventory, doing more advertising, offering better discounts and credit terms, printing technical manuals, and other literature in Spanish, and a myraid of other promotion devices. The increased volume of business made possible by an effective system of tied aid could likewise have a very salutary effect on the American suppliers concerned. These suppliers might thereby be stimulated to reappraise their market in the aid recipient countries and their prospects there. They might be moved by this added business, and the prospect of more, for example, to replace their agents and distributors with more effective and agressive ones, to give better discounts and credit terms, to furnish more advertising literature and technical assistance, and even to redesign their product to conform more closely with local needs and demands.

It was the later aspect which particularly drew me to this subject. Several agencies of the U.S. Government, the Department of Commerce in the forefront, are engaged in promoting U.S. exports abroad. In prime markets, in the rich industrialized countries of Western Europe, Japan and the more developed countries of the British Commonwealth, there are a large variety of techniques and devices which might be used for promoting U.S. exports. Many, if not most, of these aids are not adaptable or appropriate for the less-developed countries. Yet, the U.S. has a large trade stake, potential if not actual in these areas. The opportunities presented by tied aid, for promoting commercial ties and trade prospects in these countries, in the context described above, therefore appear very attractive.

They afford a chance not only to make up the tremendous backlog in demand for U.S. products, but help to assure that demand for the future as well.

B. Focus on Colombia and Chile:

"Tied Aid and U.S. Trade Under the Alianza" is perhaps too ambitious a title for the scope of this paper, since the research was done and the findings mainly relate to only two of the Latin American countries. However, Colombia and Chile (See Annex B), with the giants Brazil and Argentina sidelined until they get their house in better order, happen to be the largest recipients of U.S. economic assistance in that region. They also happen (See Annex C) to be among our principal customers in Latin America, and take a large portion of their imports from the United States. This proportion, as will be noted from Annex A, has been declining over the past few years. Another important consideration in focussing on these two countries was the form that our economic assistance to them takes. It consists mainly of program, or non-project, loans. The importance of this factor is explained later in this paper. Suffice for now to point out that the majority of the imports financed under these programs (approximately 70-75 percent) are made through normal commercial channels; through that part of the distribution system in those countries which handles American goods. This kind of tied aid is therefore of considerable significance to trade development, both in the short and longer run.

I therefore did much of my research on this paper in these countries, travelling to Bogota and Santiago for this purpose. I discussed these matters with the staff of both sides of the mission, AID and the Commercial and Economic Sectors of Embassies Bogota and Santiago. I also had an opportunity to discuss them on a much more limited basis with local businessmen and bankers in these cities. Appropriate officers in AID, Washington, State, and Commerce also gave me much valuable assistance.

I. Summary and Conclusions

1. It becomes quickly apparent from a study of the subject that our economic assistance for non-project aid has not been tied to the procurement of U.S. goods in such a manner as to yield the maximum benefit to the U.S. balance of payments and to American trade; at least not in Colombia and Chile. Statistical evidence is meager, but this conclusion can be reached from a review of the procedures adopted for carrying out the official policy regarding tied aid. These procedures apparently meet the letter of the law, in that they result in the identification of the required proportion of the imports of the recipient country as having been financed by aid funds. However, this "attribution" process does not necessarily result in "additionality", in the increase of imports from the United States over and above what the aid recipient countries might have purchased from the United States in an amount equal to at least 80 percent of the U.S. funds made available for this purpose, as was intended by the Congress in dictating the policy of tied aid for U.S. economic assistance programs.

2. Moreover, in an effort to facilitate this identification or attribution process, there has been instituted what has proven to be an especially awkward and onerous system of documentation which applies to all imports from the United States into these two Latin American countries, whether aid financed or not. This regime has complicated our trading with Colombia and Chile and has caused much frustration and irritation for both the American supplier and his customer. It has therefore led to some diversion of trade to non- U.S.

sources of supply to avoid compliance with these requirements. This documentation procedure has also contributed to delays in payment to the U.S. exporter. Tied aid, as presently administered for non-project aid in these countries, can therefore be said to also have had, to some extent, a negative effect on U.S. exports.

3. It is no great discovery to find out that present tied aid procedures in these Latin American countries are considerably less than satisfactory. While a wide range of opinions as to what can and should be done about this situation exists among the officials closest to this problem, the fact remains that both in Washington and in the field there is awareness and concern over these shortcomings. This awareness is not always accompanied by a sense of urgency of the need to take remedial measures. Mounting criticism of current practices by the U.S. business community and by the Congress may change this attitude. However, the fact remains that while it is easy, if one is so inclined, to become quite indignant about the way tied aid has, i.e., has not, worked in these countries, it is far more difficult to come up with some more satisfactory alternative method of tying the dollars made available through special letters of credit for program assistance loans.

4. Yet, there do not appear to be any overwhelming reasons why an attempt should not be made in the near future to replace the present regime. There are, of course, political problems of the moment which may argue for some delay in instituting such changes. However, the balance of advantage to overall U.S. foreign policy clearly appears to be in favor of such a move. That is, the system of tying aid can be improved so as to yield the maximum benefits for the balance of

payments and the longer-term trade prospects of the U.S. in the Latin American region without hampering the basic objective of economic development, and it can be changed in such a way that need not worsen our relations with the recipient country, or of any other of its trading partners.

5. The problems of technique, of how to change and to administer an alternative system, are formidable. They are greatly complicated by such United States-made obstacles as the 50-50 shipping and marine insurance requirements. A uniform regime for all countries may not be possible. Nor does it appear that any one system would be an ideal one; any alternative may very well bring with it new problems. It is not an objective of this study to perfect an ideal solution. But it is not merely taking the coward's way out to say that it is not beyond the ingenuity and know-how of American bureaucracy to produce a more satisfactory solution for this problem. The advantages and disadvantages of some different ways of doing this job are discussed, along with the mechanics of these schemes, in the body of this study.

6. In any case, there does appear to be a genuine need for more prior consultation and careful review of the procedures and regulations governing the administration of tied and, by all agencies of the government which are charged with promoting and facilitating international trade and have close contacts with those sections of business and banking community involved in such trade. Changes in such procedures and regulations should, in fact, be made as infrequently as possible in order to avoid the confusion which provides an excuse for further delays in payment to U.S. suppliers.

III Statement of the Problem

A. The Program Loan - What it is and Why it is Used in Colombia and Chile.

There are official definitions of program assistance like the one in this footnote.[2] Program loans are one form of such assistance. Their major characteristic is that they are not tied to some specific project(s). They generally are intended to serve two purposes. One is to provide support for the recipient country's balance of payments; to supply dollars which may be used to finance imports of a wide range of commodities in excess of that country's foreign exchange resources. The other is to provide the local currency (which may result from the sale of such dollar exchange by the central bank to importers through the commercial banks) needed to meet project or program local costs which AID has agreed to finance with dollars. Colombia and Chile are showcases for this type of financing.

There are a number of reasons why program loans happened to be the chosen instrument of economic assistance in those two countries:

a) Program loans were considered to be the fastest and most direct way of furnishing these countries with support for their balance of payments, and local currency financing for certain of their development efforts.

b) This type of loan also was considered desirable because, apart from the time required to set up specific projects, it also takes a substantial amount of sophisticated planning and special technical resources to carry through such projects on the same scale as the program loan.

c) Assistance in this form, and this is especially true in Colombia, is believed desirable because it helps encourage a strong and flourishing private sector in the economy.

d) For some countries, like Chile, program loans have proven useful as leverage for applying pressure to adopt better economic policies.

e) Program loans have also encouraged suppliers credits from other countries.

Program loans have constituted by far the largest portion of U.S. economic assistance to Chile. For fiscal year 1963, $60 million of total aid of $93.5 million committed by AID for Colombia was in the four of non-project program assistance loans. As shown in Annex B, program assistance loans made up $35 million of fiscal 1963 AID commitments to Chile totally $41.3 million. During the current fiscal year $15 million and $40 million more of program assistance loans have thus far been committed to Colombia and Chile respectively by AID.

Program assistance (non-project) loans are not restricted to these two countries. They have also been authorized for general imports into the following other aid recipient countries over the period 1958-1963: Greece ($10 million);India ($440 million); Israel ($71.2 million); Pakistan ($142.5 million); Turkey ($35 million); Argentina ($24.6 million); Brazil ($74.5 million); Taiwan ($35 million); Tunisia ($25 million). The dimensions of the problem under discussion may therefore be much greater and widespread than indicated by the findings applying to Colombia and Chile alone.

Though not precisely in the same category as a program loan, one much like it in purpose and in the way it was administered was made to

Chile in the amount of $100 million in August 1961 for earthquake reconstruction and rehabilitation. The results of this loan and the accompanying $20 million grant were subject to audit by the U.S. Government Accounting Office in 1963. Their critical report is cited later on in this paper.

B. How procurement has been tied to U.S. sources of supply under program assistance loans to Colombia and Chile.

As noted in the preface to this paper, if procurement of AID-financed commodity imports is to be limited to U.S. sources of supply, it is because the Congress and also a number of branches of the Executive desire this be done to alleviate the drain on the U.S. balance of payments. A detailed legal analysis of the statutory and policy requirements entailed is set forth in AID Policy Determination No. 22, "AID Financing of Commercial Commodity Imports - Local Cost Financing," issued on July 30, 1963. One such policy requirement relates to "source" and states that,

> "all commodity financing on a loan basis and all commodity financing on a grant basis for the purpose of generating local currencies to meet local project and other program requirements (case 2)[3] shall be limited to commodities of United States source."

1. <u>The Special Letter of Credit</u>:

There are four basic methods of financing such commodity imports used by AID.[4] The one developed over a period of time for use in connection with the economic assistance program loans made to Colombia and Chile, among other countries, is the "Special Letter of Credit" (hereafter referred to as SLC) designed to meet the requirements of of both: a) supplying the country's foreign exchange needs through the financing of commercial imports, and b) providing dollar exchange for the explicit purpose of generating local currencies to meet local project and other program requirements.

The difference between the SLC and other methods of AID financing is primarily in the timing of local currency availability for AID use. Under the letter of commitment (and direct reimbursement) methods of financing, the aid-recipient countries usually cannot make their local currencies available until AID has financed the importation of commodities and related services. Under the SLC method of financing, which is used only for U.S. procurement, the recipient country is normally able to make its local currency immediately available for the project or program in equivalent amount upon the issuance of the SLC. As local currency is needed to meet project or program local costs which AID has agreed to finance with dollars, the government of the recipient country submits an application to the Mission for the opening of an SLC in favor of a specified beneficiary (usually the central bank) by a U.S. bank designated in the application. After appropriate review, AID, Washington, requests the U.S. bank to make this dollar asset available to the central bank in the form of an irrevocable, divisable, and assignable letter of credit. The SLC, when issued, then becomes the basis for the advance deposit by the central bank of the local currency counterpart required. The recipient country normally uses the SLC as dollar foreign exchange which can be allocated or sold by the central bank or monetary authority in the form of subsidiary letters of credit to the commercial banks in in exchange for local currency. The commercial banks, in turn, sell this dollar exchange for local currency to importers. The U.S. bank makes payments under the SLC upon presentation of documentation showing exports from the U.S. to the recipient country which are eligible under terms of the SLC. The U.S. bank passes the documentation on to AID and is, in turn, reimbursed.

How then is aid tied under this SLC procedure? It turns out that this method of financing contains the seed of the problem. Since there normally is a considerable time lag between procurement and payment (a mandatory one of at least 120 days in Chile, for example), the importers use the foreign exchange they obtain as a result of the SLC to pay for goods which may have been procured as much as nine months before. Moreover, the importers involved generally have no way of knowing at the time of their purchase of American goods that AID funds will provide the dollar exchange required for this purpose.[5] Under these circumstances, the SLC method of financing becomes retrospective financing rather than forward or prospective financing as in the case of many other aid recipient countries. In other words, given the nature of the controls on imports, and on exchange transactions in these two countries, and the way in which international business is usually carried on there, the SLC procedure makes it necessary to tie aid through a process of attribution (rather than prior authorization) in which the central bank authorities have to finally select or identify a portion of imports into their recipient country from the U.S. equivalent to the value of their program assistance loan.

The way in which this is done is described below.

2. Requirements for Financing Under Special Letters of Credit:

Mention was made above of the requirement that documentation showing exports from the U.S. be presented to the U.S. bank issuing the SLC in order that payment be made by them. Such documentation is required to prove that the following alternative commodity finance procedure requirements have been met to qualify the export for AID financing under SLC's:

a) Statutory Requirements- these include:

i) Cargo preference rule -the "50-50 shipping" requirement that when available at fair and reasonable rates, at least one-half of the gross tonnage of all SLC - financed commodity imports (computed separately for dry-bulk carriers, dry cargo liners, and tankers) transported by sea be carried on privately-owned American - flag vessels.

ii) Statutory price standards - provides for a reasonable price, meaning one no higher than the market price in the U.S. prevailing at the time of purchase, adjusted, of course, for differences in the cost of transportation to destination, quality, and terms of payment; also no higher than price charged by the supplier in a comparable export sale.

iii) Marine insurance requirement - SLC's may be used to finance dollar premium insurance, at rates competitively arrived at, on commodities shipped under the aid program. But they must be used to finance equivalent, additional dollar premium insurance where the recipient country forces importers of AID-financed goods to discriminate against marine risk insurance issued by any marine insurance company authorized to do business in any state of the U.S.A.

b) AID Policy Requirements:

i) Source requirement - Only commodities which are shipped from the United States may be financed under SLC's.

ii) Eligible commodities - only eligible commodities and related services as mutually agreed between the parties hereto may be financed by Special Letters of Credit (see Annex E).

iii) Cuba shipping rule - no commodities may be financed under SLCs if shipped to importers in the recipient country by any ocean vessel which AID has designated as ineligible because it has been engaged in transporting to Cuba goods embargoed for this purpose by the U.S.

c) AID Administrative Requirements

i) Administrative price standard - (see a) ii above)

ii) Payment to importers rule - invoice price financed by AID shall be net of any discounts given or payments made by the supplier to the importer, including kickbacks, agents' commissions, or special allowances. (The reason for underlining the foregoing will become apparent later on under the discussion of "The Suppliers Certificate")

iii) Origin requirement - only commodities which are mined, grown, or produced through manufactured, processing or assembly in the U.S. are eligible for AID financing.

iv) Freight payment rule - freight paid by AID on U.S. flag vessels only (Ocean and aid freight may be financed only when supplied by U.S. flag carriers).

Other requirements under the alternative commodity financing procedure which governs payments against SLCs cover bank charges involved in their issuance (which can be financed from any unused balance under the SLC); and eligibility dates for payment, these requirements do not include, however, provision for small business notification (of opportunity to sell for export the goods financed), and marking goods (with appropriate AID symbol) as in the standard method of commodity financing which presumes authorization prior to import. Without a prior procurement authorization system, AID and the supplier have no opportunity to comply with these last two requirements.

3. Documentation:

In order to assure that SLCs are utilized in accordance with the above applicable U.S. laws and regulations, all transactions financed by SLCs must be documented to AID by the following customary documents in international trade:

> Supplier's invoice - indicating payment to supplier or his agent.
>
> Bill of Lading - evidencing delivery to recipient country certificate of U.S. source-origin

and, in addition to the above, a Supplier's Certificate. Submission of the supplier's certificate along with commercial documents covering a sufficient volume of eligible import transactions permits the establishment of the alternative commodity financing procedure used in Colombia and Chile. The Supplier's Certificate makes possible verification of the following requirements listed above. Namely, that:

> a) The supplier is the producer, manufacturer, processor, or exporter of, or a regular dealer in, the commodity and has not employed any person to obtain said contract under any agreement for a commission, percentage, or contingent fee, except to the extent, if any, of the payment of commission to a bona fide established commercial or selling agent employed by the supplier.
>
> b) The suppier has not given or received and will not give or receive by way of side payment, "kickbacks," or otherwise, any benefit in connection with said contract, except as is disclosed on the certificate or an adjustment refund or credits as is the custom of the trade.
>
> c) If the supplier is the producer, manufacturer, or processor of a commodity, the contract is not a cost plus-a-percentage-of-cost contract.
>
> d) The purchase price, to the best of the supplier's information and belief does not exceed the export-market price in the source country prevailing at the time of purchase.

e) Likewise, that the purchase price does not exceed the price charged by the supplier in a comparable sale of the same or similar commodity; also that the supplier has allowed all discounts, including discounts for quantity purchase and prompt payment automatically allowed his other customers similarly situated.

The discussion preceding has dwelt at some length, perhaps too long, on procedural requirements involved in the kind of AID financing which is carried on in Colombia and Chile. But it should serve to show how and why the statutory, policy, and administrative requirements which have to be met have complicated doing business with importers in these two countries, and to provide the background for the use of the Suppliers' Certificate in this trade which has been a major problem. For the fact remains that the SLC procedure requires these governments to request that Suppliers' Certificates be supplied for <u>all</u> import transactions with the U.S. in excess of $500 in value. They do this so that their Central Banks will be in a position to select from the total Suppliers' Certificates submitted a sufficient number which meet all of the statutory, policy, and administrative requirements set forth above to cover the value of the program assistance loan to which such imports are to be attributed under the system of retrospective financing in effect. All this means that, regardless of whether an import transaction eventually will be attributed or not to AID financing, <u>nearly every</u> U.S. supplier of imports into Colombia and Chile must furnish his importer with a Suppliers' Certificate containing information, attested to by him, which many suppliers and most importers are reluctant to disclose. Apart from objections to the red tape and additional effort involved, it is not always easy to accept the reasons for this reluctance. Many of these requirements do not appear unreasonable except in the context of the way business happens to be done in that part of the world. For example, take the requirement of disclosing the going price. This becomes difficult in some cases where U.S. parent firms, which have probably conditioned their investment in these countries on this basis, generally bill their Colombian and Chilean subsidiaries at a higher-than-market price in order to get some of their profits out in this form. The Suppliers' Certificate doesn't permit this practice. There is always the possibility that this attested-to document might be turned over, in the process of attributing imports to the program assistance loan, for audit and review by AID-Washington.

On its face, the requirement that importer's commissions be shown on the Suppliers' Certificate seems an even more reasonable one, if Kickbacks are to be avoided. However, this has proven to be the most objectionable feature of the Suppliers' Certificate from the importer's point of view, again taking account of the particular and peculiar way in which business is carried on in Latin-America. Many importers object to this requirement because it forces them to disclose to the Central Bank, and therefore to the exchange control and tax authorities of their country, information regarding their international banking transactions and income which makes it more difficult for them to avoid, or evade, their exchange control and tax liabilities. As a matter of fact, the central bank authorities in both Colombia and Chile welcomed this opportunity to collect this kind of information, and the Central Bank in Chile now requires a similar form to be completed for imports from all sources.[6]

4. Trade Effects of the Suppliers' Certificate:

Whatever the larger issue involved in terms of the right of a sovereign state to enforce its tax and exchange control laws, and, indeed, the desirability of its doing so from an economic development standpoint, it has turned out that the Suppliers' Certificate has made doing business with an American supplier more complicated and costly, and, therefore, all other things being equal, less desirable, than with other foreign suppliers. It has, for this reason, caused some diversion of trade; caused some importers to turn to other sources of supply to avoid this problem.

It has come to our attention, for example, that some American drug firms have been supplying these countries with pharmacutical products from their Panamanian subsidiaries. However, since many of these products originate in the U.S. and may merely be repackaged in Panama, relatively little is lost to U.S. exports in the process. This loss has been greater where the source of supply has been shifted to Western Europe or Japan where similar items are produced. Although many importers have learned to live with these requirements, a number of cases of such trade diversion have been noted by our commercial attaches in those countries who have received scores of complaints about the Suppliers' Certificate.

C. Tied Aid and Trade - Some Conclusions:

Empirical data bearing on the effects of tied aid on U.S. exports to Colombia and Chile, as for other destinations, is hard, if not impossible, to come by. Total U.S. shipments to these two countries have declined since the Alianza got underway. Nor does the U.S. market share provide a clue as to the impact of tied aid on our trade. The U.S. share of the Colombian market has remained about the same while the proportion Chile's imports originating in the U.S. has decreased. Some deterioration of our trade position there was to be expected as Western European and Japanese suppliers, who have reentered the Hemisphere in force, have provided stiff competition as they attempt to recapture their prewar markets in Latin America. However, this loss, some hold, should have been offset to a considerable extent by the substantial amounts of U.S. aid-financed exports made possible under the Alianza and other American financial assistance.[7]

Analysis of trade effects by even broad commodity categories, is hampered by the lack of available data on the kinds of goods which have been retrospectively financed by SLCs. The pipeline for reporting this data is long and this information moves sluggishly through it.[8] The following conclusions have therefore had to be arrived at by supplementing the meager data available with the observations of people involved in these programs - commercial and economic officers, AID mission staffs, bankers, and businessmen; and, by some case histories involving particular items.

1. Tied aid, as presently administered in Colombia and Chile, probably yields only a marginal increase in U.S. exports over what would have been shipped from this country in the absence of such assistance.[9] Tying procurement under aid to U.S. sources of supply has not increased our total exports to these markets. However, it may have saved markets for some commodities which would otherwise

have been lost for lack of dollar exchange. It may have likewise brought about the purchase of some (probably only a few such) goods which would otherwise not have been bought from the U.S. because they were not competitive in price.[10]

2. Tied aid, as presently administered in the two countries, for the reasons mentioned above, has led to some diversion of trade from U.S. to other foreign suppliers. Such diversion, again is probably marginal and little except the broadest estimates are available as to its extent. However, these marginal negative effects detract from whatever marginal gains in exports result from tied aid under the present regime.

3. Another, perhaps more important, diversionary effect of the tied aid described above is impossible to measure. However, there is little doubt that the red tape, irritation, and frustration in meeting the requirements (such as the Suppliers' Certificate) involved in nearly all import transactions with Colombia and Chile, whether eventually AID-financed or not, has not only discouraged some importers from dealing with U.S. suppliers, but some American exporters, as well, from entering or expanding their operations in these markets.

4. Nor are U.S. trade promotion efforts enhanced by the delays in payment to American suppliers which the SLC system appears to have lengthened. Given the tremendous shortage of credit at almost every stage of the importing process which prevails in these countries, the AID-financing in effect tends to force the U.S. suppliers to give involuntary credit; to wait longer for payment than even the customary extended term.[11]

This long drawn-out process can be, and often is, further delayed by errors, of omission or commission, in the documentation required by the SLC procedure. It has been reported that whole groups of applications for payment have been delayed in transmission because one or more of the Suppliers' Certificates, for example, among the documents has been improperly completed. The point is that all of the parties involved in this procedure, except the unfortunate exporter, happen to have a vested interest in this delay.

First there is the importer, who may, however, consider this a mixed blessing. He usually would like to prolong his credit in this fashion, but does have the additional carrying charges (of 9-10 percent) involved in financing his advance or prior import deposit.

For this, and a number of other reasons, the commercial bank may not be prepared to make dollar exchange available to the importer at the prescribed time. Its own credit and resources of foreign exchange are likely to be heavily overstrained at any time.

The Central Bank may welcome, and even abet this delay, in what it considers to be the national interest. For one thing, the Central Bank is thus enabled to stretch out its exchange reserves. Then, too, the Central Bank has not been waiting for the importer's escudos to finance the local costs of certain budgeted development projects. It realizes that these are likely to be late in coming, and issues the escudos with the backing of the dollar yield of its SLCs immediately as these are turned over to them. The Chilean Government therefore has an interest in fostering the delay in payments, or at least in not actively intervening to expedite payments, to American suppliers, in order to extend its dollar reserves over a longer period. It can do so because it doesn't have to wait for counterpart receipts to finance escudo costs during the waiting period.

Another opportunity for delay is afforded by the procedure whereby the documentation is then passed on to the U.S. correspondent bank so that payment can be made by them to the supplier. Even the correspondent bank, it has been reported, may sometimes delay payment in order to make adjustments in its accounts with the Central Bank.

5. Tied aid, of the type under discussion, also frees up at least a portion of the exchange earnings of Colombia and Chile for purchases from other sources than the United States. This is the problem of fungibility of the dollars supplied by any form of economic assistance, which is discussed at some length later on. However, this becomes an even more serious problem when coupled with discrimination, as it has been in Colombia. That country devised a whole arsenal of devices to enable them to direct their importers to other than U.S. sources of supply in order to meet Colombian commitments elsewhere. These bilateral deals, involving in effect swaps of Colombian coffee for manufactures include: special arrangements with England, France, Italy, Japan and Switzerland to take luxury goods; loans by the Coffee Federation to finance imports of mainly manuractures which must be from countries with which there are compensation agreements; and compensation agreements with Eastern European countries.[12]

This form of tying aid has proven to be far more effective for the countries involved (although on a much smaller scale) than the one used by the United States.

6. Experience with tied aid in these two countries has demonstrated the need for tying as well any part of the counterpart funds generated by the dollars provided which may be used for financing imports to procurement from U.S. sources. This is illustrated by what has happened with loans made to private borrowers under Colombia's Private Investment Fund (PIF) which draws its capital from such counterpart funds. These loans are usually used to supplement the borrower's own resources and other financing available in order to carry out industrialzation and other priority development projects (including those designed to save or earn foreign exchange or break supply bottlenecks) undertaken by the private sector. Some Colombian firms have used a part or all of their borrowings from the PIF to finance imports from suppliers outside of the U.S. Others have reserved their PIF financing for local costs utilizing their own resources or other financing (including suppliers credits) to pay for imports from non-U.S. sources. [13] It has been estimated that about 10% of the PIF's outstanding loans have been used in this fashion.

It has also been recognized that a somewhat similar problem exists in Chile. The General Accounting Office in its audit report cited above, noted on page 5,

> "It is incongruous that specific projects financed with U.S. assistance should be allowed to be adversely affected by failure to require the use of a relatively small portion of dollar assistance for those projects. Accordingly, we are recommending to the AID Administrator that, in future agreements providing dollar financing

Washington, and in the field. Some change is necessary; the problem will not go away by itself. However, it is not easy to come up with a more desirable method of tying procurement for non-project aid. These are some of the conditions which determine just how suitable any alternative would be, and some general problems involved in any alternatives.

A. Conditions for a Suitable Alternative:

If the shortcomings of the present regime are to be avoided, and new complications not introduced, any alternative should, to the fullest extent possible, meet the following criteria or desiderata:

1. Not hamper the basic objective of the aid program - assistance for economic development. These program assistance development loans are used to provide the goods and services needed by less-developed countries to build the capital base necessary for economic progress.

The worst possible use that could be made of tied aid would be to force the recipient country to take American goods which were unsuitable, defective, or shoddy. This is not likely to happen. A more sophisticated argument against the practice, however, has to do with resource allocation; the use of tied aid to require the recipient country to take equipment which may be appropriate for developmental projects and well-made, but which is uneconomic because it is high cost relative to competing products available from other sources of supply. This raises the question of whether initial cost, the base price of the equipment alone, determines whether it is economic. It is an accepted fact (though perhaps, not a well-known enough one) that often American capital goods, even when higher priced, often prove to be less expensive over the long-run than competitive equipment. This is because U.S.-made machinery generally tends to hold up better, requires less maintenance and repair, and performs better than similar equipment produced elsewhere. Then too, and this is particularly true in Latin America, American equipment is generally already supported by an established distribution and parts and service organization which not only assures adequate maintenance but also training in the use of such equipment. Moreover, this organization provides the developing economy with various skills and demand, often satisfied from local resources, for corallary skills and equipment. All this, and more, must be considered in establishing whether U.S. goods are uneconomic.

The popularity and pent-up demand for American equipment is attested to by the current backlog of applications for licenses to import such items into Colombia, for example, plus the willingness of the importers involved in both Colombia and Chile to tie up scarce financial resources in prior deposits for from 90-120 days. But, it is true that credit availability has become an important competitive factor for U.S. suppliers in Latin American and other foreign markets. Western European and Japanses producers do frequently offer more liberal supplier credits than their American counterparts which may seem more attractive to the importers involved. However, it must be remembered that even if the government rather than the individual importer is not the beneficiary of such credit, few terms, if any, are as liberal as those on which U.S. development loans are made available to the recipient countries. Our program assistance loans to Colombia and Chile, for example, are for 40 years with 10 year moratorium on repayment, and interest at 1½ percent per year.

A related question in this connection is whether tied aid might not hamper economic development because it would displace supplier credits from other countries, thereby limiting the total amount of development goods which might otherwise be available to the recipient country. This makes a rather fine point of saying that as long as other countries tie their aid (and quite securely) through government-encouraged and government-insured supplier credits, the U.S. should give its economic assistance with no strings attached so as not to hamper the development of the recipient country. One might argue as well that more rigorous aid tying on the part of the United States could lead, or force if you will, other rich nations to switch from suppliers credits, which are given on a relatively shorter-term basis (5 years, usually) to the more generous credit terms on which American aid is provided. Then too, there is real doubt whether the goods provided on such suppliers credits necessarily contribute to the recipient country's development program. This is especially true when the availability of the suppliers credit happens to be, as it is in many cases, the major determinant in the importer's decision (or the government's decision to require him) to purchase the equipment in question. Colombia and Chile, by now, are sprinkled with a wide variety of equipment acquired in this manner. How these will perform or be maintained over time, or what technical backstopping will be provided, remains to be seen. Nor do many items of such equipment fit into any integrated development program. They appear to have been purchased as is certainly the case with Colombia's coffee swap deals, because they were available. Senior officials in the recipient countries have recognized this problem and expressed some concern over these developments.

It is an axiom of international trade that the division of labor is such that no one country can produce all items more cheaply than any other. Quite obviously, this is true of the United States as well. But, we are speaking here of capital goods, a field in which the U.S. has long held the lead. Even so, there must be items of such equipment which can be procured more cheaply elsewhere. However, considering all of the factors which enter into determining whether one source of supply may be more or less economic than another, it can be concluded that the net diseconomies involved in tied aid under these circumstances are small indeed, and need not interfere with or hamper the basic objectives of the aid program, the promotion of trade and of economic development thus need not necessarily be incompatible objectives.[14]

> 2. <u>Not interfere with customary trade procedures, connections, and banking and commercial relations between the U.S. and the recipient country</u> - meaning that any new regime should not make the carrying on of business between the two countries more difficult or burdensome. The example of the Supplier's Certificate is well in mind in setting down this condition.

The major bug-a-boo here is that the recipient country may have to introduce new import controls or intensify existing ones in order to more closely direct importers to U.S. sources of procurement under tied aid. This would have to apply to all imports whether aid-financed or not and therefore complicate importing for all involved. The import control situation is different in Colombia and Chile. Colombia has had an import licensing system in effect for some time. It is the opinion of those familiar with this licensing system that no changes are required in current procedures or practices to enforce tied aid policies more closely. Each import license now indicates the source of supply and the prospective consignor's name. The Superintendency of Imports keeps a running account, by source, of the amount of licenses issued. Moreover, upon the recommendation and urging of the World Bank's economic advisor in Colombia, the government is introducing a detailed import budget which will require a closer watch over the kind, if not the source, of imports. Tighter administration of the Colombian import licensing system is therefore in the cards.

Thus far, there is no import licensing into Chile. But that country uses a number of special devices which have the effect of restricting import demand.[15]

Also to be avoided is any change in exchange and import controls which would have the effect of further delaying payments for imports. The aim should be rather to speed payment to U.S. suppliers.

In any case, any proposal for tying aid-financed imports more closely to U.S. sources, merits careful examination on these points. There are important matters of principle as well as practical reasons why the United States should not be put in the position of encouraging or sanctioning an intensification of import controls. Any alternative should rather, to the extent feasible, be constructed so as to strengthen the private sector of the economy of the recipient country. Such an alternative should not only avoid the institution or multiplication of government controls, on imports, but should also attempt to channel imports to industry and development projects through the regular channels of distribution.

3. <u>Not damage the foreign relations of the U.S. with the recipient country, or other friendly nations; nor be in violation of U.S. commitments to international organizations</u>.

Among the desiderata for any alternative method of tying aid is that it should conform with the general commercial policy objectives of the United States. It would not be in keeping with these objectives for this country to advocate or encourage a form of preferential treatment by the recipient country for U.S. exports which results in discrimination against other suppliers. This raises some basic questions as to whether any form of tied aid is in keeping with such a policy.[16] However, the fact is that tied aid is also a policy objective of the United States. Tied aid, in various forms, also happens to be the policy of every other country furnishing economic assistance to Colombia and Chile, and to other countries as well. The United States is therefore not setting an undesirable precedent, one which would necessarily make it more difficult for this country to continue to fight for the elimination of non-tariff barriers for the bulk of the world's trade. Nor, under these circumstances, would tighter tying of aid lead other supplier countries to take retaliatory action against the United States.

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And, in another section of the same statement,

> "Nevertheless, the Embassy and AID believe that the U.S. aid program should be used in a more direct manner then it has in the past towards assuring better Colombian treatment for U.S. exports."

It is recognized that our relations with these countries are frequently delicate and sensitive ones. There is, for example, the threat of passage of the nationalistic marine insurance legislation pending before the Colombian Parliament, which would further complicate exporting to that country. The tenuous nature of the exchange control and other concessions granted by the government to American mining companies in Chile, is also a factor to be reckoned with in pressing for changes in the manner in which aid is tied in that country. However, as Embassy Bogota has shown, such considerations need not unduly delay changes, but rather call for careful selection and judicious timing of alternative methods so as to minimize political problems.

B. Some General Problems Involved in the Selection and Design of an Alternative:

1. Problem of "additionality" - The objective of replacing the current system of tying non-project aid in Colombia and Chile to U.S. sources of supply is to assure that a larger portion of the aid dollars provided (hopefully, at least the required minimum of 80 percent) will be used for the procurement of American-made goods which would otherwise not have been imported. This raises the problem of determining what is "normal" trade, of deciding what imports would have been made in the absence of U.S. economic assistance; or, stated alternatively, what imports are being made additionally because of aid.

This is a most difficult determination to make, and, admittedly, any estimate of "normal" trade tends to be an imperfect one. Yet, there is room for improvement in the present yield of additional imports made possible by our aid programs for Colombia and Chile, perhaps more so in the latter country, even though the gain may fall short of 100%.[17]

There is room for doubt even in those cases where U.S.-aid is used to finance the import component of specific projects as to whether such imports are additional. Here is a situation where particular items of equipment are being procured in the U.S. for installation in a hydro-electric plant or steel mill, for example. Yet, it is by no means certain that some, perhaps many, such aid-financed projects would not have been undertaken otherwise; that perhaps over a longer period of time, they would not have had priority on foreign exchange resources available otherwise, as inadequate as those might be, providing that the know-how as well as the will to carry these projects out was strong enough. By the same token, it must be assumed that the foriegn exchange freed up for the recipient country by the provision of such U.S. economic assistance, then becomes available to that country to be spent elsewhere, as suits their purpose. If the aid dollars provided for projects are, in this sense, fungible, how much more so are those allocated for program, non-project assistance, i.e., for regular commercial imports, on which aid has been tied until now. The establishment of a base, of some benchmark of "normal" trade, becomes all the more important for the effective tying of program aid.

How, then, is this base to be established, and administered? There are two sets of considerations which must be taken into account. The first has to do with determining what, and/or how much, trade, would "normally" take place in the absence of aid. The other deals with the practice to be followed in releasing the aid, in making the dollar exchange available to the trading community, in such a way as not to disturb the normal pattern of trade. Well, then, what constitutes normal trade? Is it the share of the import market that U.S. traders could expect to capture given the conditions of competition that they may have to operate during the coming aid or calendar year; or, one related to some traditional or historic pattern of trade? Does this mean setting as a target some absolute amount of trade or a specified percentage of total imports? Should the base be established for total imports, or a separate target drawn up for each major category of imports? Other approaches might be keyed to commitments or undertakings by the government of the recipient country to make licenses and/or exchange available for traders wishing to import (or for procurement through government agencies) certain lines of merchandise, which were new to the market, or else had been excluded from the market by quantitative restrictions (particularly ones which discriminated against imports from the U.S.).

Once the base has been established, operating with it encompasses, among others, the following considerations. How should aid be keyed to performance? That is, what safeguards can be employed to assure that aid funds will not in fact be financing imports which would otherwise have been made. Should aid be released to the recipient country, for example, only after periodic, mutually agreed-upon, targets have been reached, say on a quarterly basis? Or, should the provision of aid in the following year be made contingent on performance in the current one? How can this be done without disrupting "normal" marketing; without encouraging traders to delay their purchases, for example, in anticipation of the availability through periodic releases of aid financing for certain imports, or commercial banks to withhold financing for the same reasons? It may, in fact, be the Central Bank or the licensing authorities who seize the occasion to delay or disrupt trade. And, speaking of the government authorities, care must also be exercised, where lists of items to be financed by aid are agreed upon, to see that such gains are not made at the expense of others; that the more liberal licensing of new products does not bring on an intensification of restrictions or discriminatory treatment for others. Moreover, what precautions can be taken to see that the setting of such performance trade does not freeze trade in patterns which are disadvantageous to U.S. traders over the longer run?

It is obvious that there are no easy or perfect answers to these questions; also, that each country case will have to be decided on its own merits. There is also the problem of matching techniques on both the base setting and administration side. It would appear that the market share concept is the best method to use, in most cases, to determine "normal" trade. There also appear to be special advantages to making the market share as general and broad a target as possible - preferably a percentage of total imports into the recipient country. Whatever method is adopted it should preferably be worked out with the concurrence of the authorities of the recipient country. Some of the problems of not only extrapolating past trade into future targets, but also assuring additionality could be resolved during such consultations. In addition, it appears highly desirable to have frequent, if not periodic, reviews of performance under this regime. Such reviews could be used to avoid freezing the pattern of trade as well as to assure additionality.

It is interesting to note, in conclusion, that the problem of establishing orderly marketing patterns so as not to disturb normal world trade in the agricultural commodities involved may also be a formidable one, but it does not appear to have fazed the officials concerned with carrying out our PL 480 programs. Perhaps, there are lessons to be learned from their experience which can be applied to the problem before us.

2. Transitional Problems - These would tend to be most acute if there was to be a complete and immediate switch from retrospective financing to forward procurement. In that case, it has been estimated, in the case of Colombia, that there would be a lag of about nine months before the AID funds allocated would be used; and, that, in the process normal credit and trading procedures would be disrupted. Transition to such a system could therefore have serious implications for the recipient country's balance of payments. This is because the dollar exchange to be made available in the current period through U.S. assistance is needed to pay bills for goods imported many months previous to the allocation of such funds. Under a system of forward procurement, or one like it, the disbursement of the loan made to the recipient country would be delayed until goods

ordered after the loan is signed have been imported into the recipient country and after the normal substantial suppliers credit had expired and the importer had paid into the Central Bank the required local currency for his purchase. Thus a switch to a system of forward procurement might cause a delay of as much as nine months in the actual disbursement of U.S. aid to the recipient country. This situation, therefore, calls for phasing or staggering a shift in the method of financing. There would have to be a period of transition to ease the impact of the change.

The situation might also require an additional amount of aid during the transition, but this might, strange as it seems, cause additional problems for the recipient country in that it would be inflationary. In Chile, for example, an increasing amount of program loan assistance is directly tied to procurement of capital equipment for the public sector. The danger of inflation arises from the fact that there is a continuing need for local currency to finance these projects but a large proportion of the annual capital budget has no long term assured revenue source. The Government therefore may need to create the local currency required, and this addition to the money supply adds fuel to the existing inflation. The circumstances may differ somewhat, but a comparable situation exists in Colombia. The resulting inflationary impact will place additional pressure on these governments to take highly desirable but politically very difficult anti-inflationary measures.

It is generally believed, however, that these problems can be overcome through careful phasing and some increases in aid.

3. American-made obstacles - shipping and marine insurance requirements:

Some complications, which make for problems, have to be built into any alternative procedure for tying procurement to U.S. sources under non-project aid because of statutory requirements concerning cargo preference and marine insurance.

P.L. 664 (83rd Congress) amended Section 901 (b) of the Merchant Marine Act of 1936 to require at least 50 percent U.S. flag ocean shipping for all U.S. Government-financed cargo. This law requires the appropriate agency to take such steps as may be necessary to assure that at least 50 percent of the gross tonnage of such equipment, materials, or commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) which may be transported on ocean vessels shall be transported on privately owned U.S.-flag commercial vessels, to the extent such vessels are available at fair and reasonable rates for U.S.-flag commercial vessels of U.S.-flag commercial vessels in such cargoes by geographic areas.

It is, from many points of view, highly desirable to require Aid-type documentation for only aid-financed goods, as would certainly be the case for forward procurement and most alternative methods which call for specifying the shipping agent in advance. Such is not the case with the present regime of attributing aid financing to past shipments. This system has the somewhat perverse virtue of providing the authorities in Colombia and Chile with the whole range of imports into those countries from the United States from which to choose the required gross tonnage, by category as specified above, instead of restricting them to a more limited amount. Since imports from the U.S., for example, comprise such a relatively large amount of Colombian imports, this gives the Colombian authorities considerable leeway to meet this requirement. They would be reluctant to agree that their government be put in a position where they would have to advise any importer that he had to use U.S. bottoms to meet the cargo preference requirement. Nor, they claim, would they be in a position to do so under any existing Colombian law. An attempt to remedy this shortcoming by seeking new legislation, it is held, could well force the issue in favor of the more restrictive nationalistic Colombian shipping policies which have been under consideration for some time in the legislature.

U.S. officials closest to this problem consider this requirement - and the one for marine insurance[18] which carries similar complications - as among the most formidable obstacles which have to be overcome; but not insurmountable ones.

C. How Other Countries Tie Their Aid:

There may be need for a more intensive review and survey of the manner in which other countries tie the economic assistance which they provide to Colombia and Chile, and to other countries as well. There does not appear to be much detailed information readily available on this subject, but certain general observations can be made.

1. This aid generally is not given on a government-to-government basis, but rather in the form of supplier credits. Such credits,

though offered by private firms to the recipient country, are often encouraged, and usually underwritten by the supplier's government.

2. Such suppliers credits generally take the form of medium term (i.e., five year) loans. It is the government of the recipient country, through its Central Bank which gets the credit; which has five years to pay. The importers who purchase the commodities thus financed usually have to pay for them, in local currency, within six months or whatever period between shipment and payment, is customary. The United Kingdom, France, Belgium, and Sweden are among the countries which are providing aid on this basis.

3. Many of the lines of merchandise and equipment whose import is financed by these suppliers credits are tiems which may not previously have been imported by the recipient country. Moreover, the credits are usually tied to purchases of specific items. Other supplier countries, under these circumstances, therefore are not likely to experience the same difficulties in tying their aid so as to produce additional exports, as the U.S. has with its non-project, program assistance loans.

V. Alternatives - Some Suggested Methods:

The catalogue of difficulties just reviewed in the previous chapter is not intended to indicate that an alternative method of tying aid is neither feasible nor desirable. There are better ways, though none of them ideal, of aid-tying. What follows are not detailed operational and procedural schemes, they are suggestions rather than proposals. Some of these suggestions, it will be recognized by those who have had experience in this field, are not purely academic by any means. They represent proposals which have been advanced, explored, and perhaps even rejected before. However, they are catalogued because they provide useful examples of techniques, or portions of techniques, which merit consideration in tailoring a particular system of tying aid to a particular country. As has been previously noted, it is not likely that a uniform method can be developed which will equally suit the situation in all recipient countries. It is for this reason, and because it is not one of the objectives of this study, that no attempt has been made to arrive at a net, overall evaluation of each of the proposals which follow. Rather, there is a listing of advantages and disadvantages which come to mind in considering each proposal as to whether it or any part of the technique described can be put to good use in maximizing "additionality" under any particular aid program.

The problem would be mitigated, but not dissolved, if the United States under its aid programs financed only those imports required for approved specific projects. But there would still be difficulties in maximizing the U.S. trade yield from the aid-tying process. Moreover, for the reasons outlined in Chapter III (A), it must be assumed that it will be in the overall best interests of this country to continue making program assistance loans to a number of countries for some time to come.

A. Forward Procurement:

The normal, it may even be called the traditional, procedure applied to the procurement of commodities and commodity-related services eligible for AID financing is called "forward procurement."

This is the standard method of commodity financing used if a country's regular method for the management and control of imports and foreign exchange permits. Any import or foreign exchange control system under which the importer receives prior authorization for each import transaction from a government office or bank will permit operation of this system. In general, the method of extending such assistance is for the United States to open letters of credit in the U.S. which may be used by the recipient country when placing orders in the U.S. for essential commodities. This method of extending assistance relates U.S. aid directly to particular commodities at the time orders are placed. The system may involve import licensing, foreign exchange allocations, or similar arrangements, through which the importer and supplier can be informed in advance that their transaction will be financed by AID, and therefore must satisfy such AID requirements as 50/50 shipping, marine insurance, and the Supplier's Certificate.

Imports on this basis can be made in accordance with a prior agreed-upon schedule of specific items or determined on an ad-hoc consultative basis with the authorities of the recipient country.[19]

Forward procurement procedures were developed in the early days of the United States economic assistance (largely non-project) programs under the Marshall Plan. These procedures produced a high degree of additionality for U.S. exports. They did so mainly because each of the European countries concerned had a very comprehensive and effective system of import and exchange controls through which they could direct procurement to U.S. sources of supply. Also, the U.S. was in most cases, at least for manufactured goods, certainly the capital equipment so badly needed, the only, if not the principal, source of supply.[20] These circumstances, especially the latter one, do not apply to the situation in Colombia and Chile. This may make it all the more important that restrictions on imports and exchange transactions be tightened in order to be able to assure that their importers will be procuring AID-financed goods and related-services in the United States. Such a move is likely to be viewed with something less than enthusiasm by the local traders and their American suppliers who carry on most of their business outside of the aid program.

Nevertheless, an AID Washington team which looked into this matter in mid-1963 reportedly concluded that a regime under which the importer is notified at the time of registration that he is to receive AID financing would be best for Colombia. They believed that such a system of forward purchasing could be established without requiring a major and unacceptable change in that country's normal foreign exchange control practice, which would be contrary to AID policy and therefore make this type of regime unacceptable. Embassy Bogota, on the other hand, concluded that the balance of advantage was against such a system.

The following gains have to be weighed against the disadvantages of adopting a system of forward procurement in arriving at the balance of advantage:

a) Aid financing can be reserved for categories most likely to yield additional exports for the U.S. Additionality could be maximized through careful prior selection of these categories.

b) A related trade effect has to do with the fact that prior authorization of aid-financing for imports can provide for ample notification to prospective American suppliers to give them lead time for design and production in accordance with specifications as to what is demanded in a particular market. The forward procurement procedure provides for "Small Business Notification."

c) AID documentation, including the Supplier's Certificate, need only be required for aid-financed shipments - and these can readily be identified.

d) Tying aid financing at the registration point also limits the required placing of marine insurance in the U.S. (if there is a decision by the U.S. that the recipient country is discriminating in the matter of marine insurance) as well as the 50-50 shipping requirement to aid-financed shipments.[21] It may be possible, under forward procurement, to speed up payment to the American supplier.[22]

At the same time, forward procurement could create a number of problems, including the following:

Forward procurement requires perhaps the maximum amount of cooperation from the recipient country. This may generate two sets of difficulties.

a) Obtaining assent from the host or recipient country to the institution of a forward procurement system instead of the one currently in use. This is not likely to be easy in Colombia and Chile where in addition to the cutting down of some supplier's credits, as set forth in footnote 22, forward procurement is not likely to be popular because it means delays in the receipt of local currency counterpart financing.[23] Moreover, a system of forward procurement requires a considerable degree of know-how and honest and effective administration in addition to a willingness on the part of host government to carry out such a regime.

b) Then, too, the successful carrying-out of a forward procurement system requires that the recipient country program in some detail the kinds, as well as the overall amount, of imports it plans to finance with AID funds. In order to make certain that such imports will be made, the recipient country may have to introduce or to intensify controls on all imports, with all the problems such a move entails for the bulk of U.S. exports to the area, which is not aid-financed.

c) In addition, the programming of imports to be made under the system of forward procurement may lead to pressure from both U.S. suppliers and local importers and "log-rolling" for the inclusion of certain commodities on any list of specific items to be imported under aid financing.

Given these requirements, the direct pressure and greater intervention in the operation of the recipient country's operation of its import licensing and exchange control system, necessitated by this form of forward purchasing, might become an irritant in our relations with that country, and carry over into other areas than commercial relations.

B. <u>Adjusted Line of Credit</u>:

Under this system, the recipient country undertakes to take imports from the United States, over and above normal imports in the amount of the aid made available. In other words, the host country gives a commitment to take from the U.S. an agreed upon percentage of the total imports it finances from its own resources, plus an additional amount of American exports equal to the value of the aid financing. In return, the United States would make such aid available in the form of an adjusted line of credit for development goods imports. The aid dollars involved would become available to the recipient country subject to its performance in meeting the targets set for normal trade. Their performance in this regard could be subject to review on a quarterly or some other periodic basis; or, the availability of aid for any one year could be conditioned on the overall success of the recipient country in meeting its commitment in the previous year. The first of these alternatives would appear to be the more desirable one in most cases.

This technique involves, in the first instance, calculating "normal" imports with all of the problems detailed in Chapter IV, section B(1), under the discussion of additionality.[24] It also calls for the development of a method of making the aid financing available, for adjusting the line of credit, in such a way as not to disrupt or to delay the usual or "normal" timing and method of doing business with U.S. suppliers.

The objective of this method is to maximize the trade benefits of tied aid without interfering with the economic development of the host country, or introducing a complicated and rigid system. The adjusted line of credit approach affords an improvement over the forward procurement by offering the following advantages in addition to those outlined above:

a) Under this regime, the choice of the particular commodities which are to be financed by aid can be left to the recipient country. Providing that the total amount of the import commitment is reached and that discrimination against U.S. exports is eliminated or reduce to the absolute minimum, this system should avoid the log-rolling pressures for tying aid to specific items described above.

Flexibility is a major advantage of this system. Its administration, in Colombia, for example, requires only the reporting of quarterly totals of licenses issued by source procurement. This policy requires only a more friendly approach by the Superintendency of Imports of applications for imports from the U.S.

b) The recipient country, to the extent they discriminated against some American goods, would be forced to favor U.S. procurement on other goods, in order to meet their import targets. This technique therefore would probably lessen overall discrimination against U.S. by providing positive incentive not to discriminate. It permits the maximum use of resources for development from all sources, yet assures that U.S. assistance will yield the maximum increase in American exports to the host country.

c) This procedure might, for much the same reasons, force our European competitors to put their aid on the same long term basis as the United States. Under the present regime, American program loans, it can be considered, in fact help to refinance the shorter-term European supplier credits.

d) The adjusted line of credit provides for periodic progress reviews of performance which help measure the recipient country's capacity to absorb such development assistance.

The adjusted line of credit technique does, however, present some fairly awkward and formidable problems of administration. These are among the difficulties involved:

a) The problem of establishing a base for normal trade.

b) Also previously mentioned, the problem of avoiding disruption to the timing and pattern of "normal" purchases through delays on the part of the import and banking community in placing orders for American goods and making payment for such shipments in anticipation of releases of the adjusted line of credit. The recipient country may, as well, in certain situations such as where their quota is met before the end of the quarter seek to delay the issuance of licenses to importers at the end of the line.[25]

c) This technique, in addition, may intensify the transitional problems discussed in Chapter IV, B(2), and require special measures to expedite the transfer of local currency counterpart to the authorities of the recipient country in order to have these funds available for local cost development projects.

d) The uncertainties involved for the host country in receiving such local currency counterpart may hamper their development program. At the same time, however, it must be recognized that this regime could spur the recipient country to take every measure, including the removal of disciminatory controls on imports from the U.S., in order to merit additional releases from its adjusted line of credit.

e) Another set of administrative problems would arise from the need to meet the 50-50 shipping and marine insurance coverage requirements. This procedure makes uncertain the total volume and also may further narrow the range of transactions the authorities of the host country have to choose from in order to meet these requirements. By the same token, it increases the difficulties (also discussed in greater detail above) involved in persuading, or directing, importers in these countries to use American bottoms and American brokers for some aid-financed shipments.

f) In view of the difficulties set forth in (e) this technique, like forward procurement, may also neccesitate more stringent controls on imports and exchange transactions affecting non-aid as well as aid-financed shipments.

C. Importer's Credits:

This technique is another variant of forward procurement in that it is intended to make the proceeds of government-to-government program, or other non-project, loans available only for prospective purchases of a broad range of American development goods. It would do so by providing for the relending of these proceeds to importers of such goods. Such loans could be made through commercial banks in the recipient country, which would borrow these funds from the Central Bank.[26] The commercial banks, in this instance, would be acting as lenders of last resort, reserving these earmarked funds for qualified importers who were unable to obtain credit elsewhere for approved transactions. These short-term loans would provide importers with the foreign exchange required to pay for their imports as well as the credit needed to finance any prior import deposit or other intemediary requirements. These loans, both those by the central bank to the commercial banks and by the latter to the trade, would be made at the going rate of interest for such transactions. Releases of these funds to the banking system would have to be made in successive tranches, and like the adjusted line of credit technique, on the basis of the overall performance of the program, and the individual bank in securing the additional trade desired.

The loans would be repaid by importers to the commercial banks and in turn to the Central Bank in local currency. This would provide the counterpart funds required for development projects. The counterpart, in fact, would exceed the amount of the program loan dollars by the amount of the interest charged by the Central Bank on its loans to the commercial banks. This additional sum could be a substantial one considering the spread in interest rates involved in such transactions.

ADVANTAGES:

a) Like the adjusted line of credit, under this technique aid is not tied to specific commodities - the composition of such aid-financed imports, providing, of course, they meet the criteria established for capital goods, is essentially determined by the market for such items which in turn is shaped by the development plan of the recipient country. Pressure for "log-rolling" in favor of a particular item is minimized; non-discriminatory treatment for U.S. imports is encouraged.

b) This system also maximizes, especially when the commercial banking system is involved, the participation and the strengthening of the private sector of the economy. It facilitates and therefore encourages the import of American goods.

c) It also increases the local currency counterpart available for financing local cost development projects. The recipient country earns additional counterpart by such relending at the going rate of interest the funds generated by the program loan from the U.S. at concessional rates of interest.

d) This method is less likely than the two mentioned above to require an intensification of import and exchange controls.

All this in addition to the advantages afforded by limiting the need for supplier certificates and other required documentation to only aid-financed shipments; speeding up payment to the American supplier; and, the bolstering of private trade channels.

DISADVANTAGES:

a) But this is not an easy system to administer, despite the fact that normal commercial and banking channels are utilized to their fullest. It requires close and frequent review to determine that it is operating in the manner intended; that it is yielding additional imports without disrupting normal trade.

b) It is liable to create resentment within the local banking community, first, with regard to the allocation of funds for these "importer credits" among the commercial banks; and, also because these banks would be put in a position of having to discriminate among their customers with regard to these loans (see footnote 26).

c) There are transitional problems in this procedure as well in that the recipient country has to wait, as much as 120 days in some cases, until repayment of the outstanding loans to the Central Bank for the necessary counterpart. This situation can be relieved over time, in addition to the methods prescribed in the Chapter IV discussion of transitional problems, by the accrual of the additional counterpart generated by interested charges to provide a fund to take up some of the slack until the outstanding loans are repaid.

D. Public Sector Procurement:

This technique is of particular application in those recipient countries, like Chile, for example, where the government's capital investment budget provides for a substantial component of capital imports through government procurement. It provides for devoting an increasingly larger proportion of aid financing to the purchase of equipment for the public sector. This is not project-aid but comes close to it, since this equipment is generally required for budgeted improvements or development programs.

A great deal of such government procurement, if not all of it, is likely to be done through normal commercial channels, thus retaining many of the benefits, longer-term as well as immediate, to U.S. trade of bolstering that part of the private sector which handles American imports. However, this technique also makes possible the establishment by the recipient government in the U.S. of a purchasing mission, if the size of the aid and other circumstances warrant such a move. The establishment of a purchasing mission could very likely remove the private sector in the recipient country from direct participation in the aid program. Whatever other disadvantages this step may have as well, a purchasing mission could perhaps most easily expedite payment to the American suppliers, and thereby the deposit of counterpart funds to the recipient's account.

ADVANTAGES:

a) This method provides for the most direct kind of control, administrative control, over the procurement of aid-financed imports. It also provides for the forward procurement of capital development goods. The use of this technique should therefore yield the optimum additionality possible within the limitations of the additionality concept.

b) Adoption of this system could expedite payment to American suppliers, especially if, as noted above, a purchasing mission could be established. In that case American suppliers could well be paid upon delivery to the Mission, or its agents, in the U.S. A purchasing mission could also facilitate meeting the 50-50 shipping and marine insurance requirements. This development might also eliminate the need for special documentation such as the supplier certificate.

However, even if a purchasing mission is not established, and it has been noted before that such a mission would be a mixed blessing, payment to American suppliers should be speeded-up. This is because several layers will have been removed in the payment process.

c) The procurement undertaken under this regime will generally be for government development programs which are considered by our USOM in the recipient country to have a high priority. A shift to this form of aid-financing, therefore, could make a more immediate and more tangible impact on economic development in the recipient country than the more random composition of imports under present program loans.

d) Moreover, the import of the kind of development goods likely to form the major portion of the total procured in the manner can build a continuing demand for a wide range of corollary equipment. In some countries, the trend is for public demand to exceed that of the public sector.

e) This system is perhaps less likely than the others discussed in this chapter to disrupt the normal timing and pattern of imports or to profit one category of imports at the expense of another.

DISADVANTAGES:

a) This technique tends to promote the growth of the public over the private sector of the recipient country. This is undesirable in terms of one set of objectives of the aid program, but it should be noted that in too many countries the private sector lacks the capacity and initiative to undertake many of the development projects and programs otherwise carried on by the government.

b) But there may likewise also may be limitations on the type and volume of items of imported equipment that the government of many countries can include in their capital development programs. This may be due to deficiencies in planning know-how and administration, and the need to have sufficient lead time for putting such plans into effect.

c) Moreover, in many recipient countries, particularly for capital development programs in the infra-structure field, the equipment available from the U.S. under tied-aid financing is technically incompatible with basic equipment already installed which may have been supplied by other countries (e.g., French signal equipment for railroads, or, Swedish-made telephone equipment).

This, too, may result in a dearth of adequate projects for the capital development budget.

d) There is also the possibility, because of the matter of technical compatibility and the way in which most other countries tie their aid that tying aid in this manner may tend to displace suppliers credits from other countries. This would cut into, and reduce, the total flow of assistance and thereby hamper the progress of economic development in the recipient country. This problem has been discussed more generally in Chapter IV (A). It may be that this possibility would not necessarily be an undesirable development for many recipient countries which finance too large a portion of their investment on short term credit since they believe that the availability of economic assistance is so uncertain, and the need so great, that they have to accept whatever credit is offered them. Their economic development programs might better be financed on an integrated project basis, on longer-term credit. Some authorities believe, in fact, that a U.S. move in the direction of tighter aid tying might force Europe to offer longer term assistance.

e) There is a debate, too, about how inflationary a move towards devoting an increasingly larger portion of the loan to the purchase of equipment for the public sector is likely to be. Inflation is a serious problem in many, if not most, of the recipient countries, to which the expansion of credit in the public sector has been a leading contributory factor. The inflationary impact of this technique would arise, some say, from the fact that there was no assured source of revenue collection to finance the local cost component of the project for which the aid-financed import of capital goods was intended. Other authorities hold that, as is the case of Chile, there usually are enough uncovered projects in the budget which can be picked up for this purpose.

Here then are four proposals which may provide some clues on how to solve this problem. It will not go away by itself; it cannot be wished away. The time has come to develop a more satisfactory way of tying aid. These proposals are admittedly, perhaps obviously, not the final solution. However, if the will is there, I have no doubt that a better way can be found.

ANNEXES:

A. Table Showing Latin - American Imports, Total, and from the United States, 1960-1963.

B. Table Showing U.S. AID Commitments to Latin America Under the Alianza, Fiscal Years 1960-1963.

C. Table Showing U.S. Exports to Latin America by Leading Countries, 1960-1963.

D. Definition of Commodity Financing According to AID Policy.

E. Negative List - Illustrative List of Commodities Ineligible for AID Financing Under Special Letters of Credit..

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ANNEX B

US AID Commitments to Latin America Under the Alianza, Fiscal Years 1960-63.
(Millions of Dollars)

Country	Cumulative Fiscal Years 196-1963	Fiscal Year 1963				
		Total	Loans	Grants	Program Assistance (Non-Project)	Project Assistance
Total Latin America	1368.9	556.0	400.5	155.5	187.2	361.2
Argentina	129.4	99.7	96.4	3.3	20.0	79.7
Bolivia	107.8	35.6	18.3	17.3	9.9	25.7
Brazil	190.2	86.5	62.9	23.6	25.5	61.0
Chile	233.1	41.3	35.0	6.3	35.0	6.3
Colombia	162.0	93.5	87.2	6.3	60.0	33.5
Costa Rica	26.0	13.0	10.6	2.4	—	13.0
Dominican Republic	55.9	29.6	2.1	27.5	23.8	5.8
Ecuador	55.9	18.2	13.3	4.9	7.0	11.2
El Salvador	26.4	19.5	16.6	2.9	—	19.5
Guatemala	34.8	3.3	.7	2.6	—	3.3
Haiti	33.3	4.9	2.8	2.1	—	4.9
Honduras	19.5	7.3	4.1	3.2	2.0	5.3
Mexico	22.6	0.3	—	0.3	—	0.3
Nicaragua	18.7	3.5	1.0	2.5	—	3.5
Panama	38.4	8.8	6.0	2.8	—	8.8
Paraguay	16.2	3.0	—	3.0	—	3.0
Peru	66.0	2.9	—	2.9	—	2.9
Uruguay	8.4	7.9	6.0	1.9	—	7.9
Venezuela	59.5	33.1	30.0	3.1	1.1	32.0
Regional	49.4	17.1	—	17.1	—	9.6
ROCAP*	15.2	8.2	2.5	5.7	—	8.2

*Regional Office of Central American & Panama, established in July 1962.

Source: AID, W-129, "Operations Report", June 30, 1963.

ANNEX C

US Exports to Latin-America (including Reexports) by Leading Countries, 1960-1963

(Millions of Dollars)

Country	1960	1961	1962	1963
Total 19 American Republics	3254	3401	3231	3118
Central American Common Market	213	207	240	266
Costa Rica	44	42	50	53
El Salvador	42	35	41	50
Guatemala	63	60	61	74
Honduras	34	37	43	44
Nicaragua	30	32	46	45
Republic of Panama	89	107	105	109
Latin American Free Trade Assn.	2310	2489	2288	2086
Argentina	350	424	380	189
Brazil	430	494	425	377
Chile	195	229	171	162
Colombia	246	245	227	240
Ecuador	55	50	45	57
Mexico	820	813	805	827
Paraguay	9	13	8	11
Peru	143	173	184	194
Uruguay	62	48	44	30
Dominican Republic	41	29	71	91
Haiti	25	26	24	21
Bolivia	25	27	32	37
Venezuela	551	516	471	507

Source: Bureau of International Commerce, OBR-64-43, "US Foreign Trade, Jan-Dec 1963, May 1964.

ANNEX D

A.I.D. FINANCING OF COMMERCIAL COMMODITY IMPORTS--

LOCAL COST FINANCING

Definition of Commodity Financing:

Commodity financing is the provision by A.I.D. of foreign exchange (whether by loan or grant) which by terms of the applicable agreement is to be identified with particular commodity import transactions to the recipient country, and includes the following:

1. Cases where the explicit A.I.D. purpose is to meet a country's foreign exchange requirements through the financing of commercial imports (commodity program assistance).

2. Cases where A.I.D. provides foreign exchange for the explicit purpose of generating local currencies to meet local project and other program requirements (dollar local cost financing), except when the local cost financing is in amounts such that the annual total of the activities so financed does not have a significant or meaningful effect on the import requirements of the country. The exception will be presumed applicable, subject to the confirmation by the responsible Regional Assistant Administrator, whenever the total amount of dollar local currency financing for a particular country does not, on an annual basis, exceed the lesser of 5% of imports or $25,000,000. The applicability of the exception in any doubtful case within these limitations and in all cases where the amount of dollar local cost financing exceeds these limitations must be affirmed by the Administrator.

3. Cases where the explicit A.I.D. purpose is to meet the foreign exchange requirements of specific projects (direct project imports).

SOURCE: AID, PD-22, July 30, 1963.

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Washington, D.C.

NEGATIVE LIST

Illustrative List of Commodities Ineligible for A.I.D. Financing Under Special Letters of Credit

ANNEX E

The items listed below are of the type normally ineligible for financing under the Special Letter of Credit procedure. This list is not complete and the absence of an item does not necessarily indicate that it is eligible for financing.

The listing is presented by the 3-digit A.I.D. commodity code number (A.I.D. Commodity Code Book).

CODE	COMMODITY
070	Confections - Gum, chewing or bubble
150	Beverages, alcholic
210	Hops, hop concentrates
215	Gum Base, chewing or bubble
370	Blood Plasma Contraceptives, oral, or cream (of any type) Dihydostreptomycin in combination with Penicillin Libido preparations (of any type)
391	Cosmetics Deodorants Hair Preparations Perfume Suntan lotions or creams
480	Chamois skins Leather, gold kid, gold leaf, or silyer laminated
541	Cloths (woven fabric) in excess of $5.00 per year FAS
542	Laces Silk yarn puer
550	Clothing, new or used
640	Stones, precious or semi-precious
698	Metals, precious solid, or liquid
720	Radio receivers, Electric, battery or transitor (in excess of $20.00 FAS each)
730	Outboard & Inboard Motors, for pleasure craft
830	Automobiles, Passenger cars including Station Wagons in excess of $2400, FAS Automobiles, convertibles Automobile accessories, separate procurements: Stainless Steel wheel rings (hubcaps) tail pipe extensions Ornaments

CODE	COMMODITY
890	Watches, wrist or pocket with jeweled cases
891	Tires, white sidewall Contraceptives, mechanical
897	Arms and Ammunition

The following ineligible items are either unclassified by A.I.D. commodity codes or fall within several codes because of their general description:

Jewelry
Rugs, fabric
Toys
Unused Machinery, equipment, apparatus or supplies

The following items of which the United States is a consistent net importer, may not be financed under a special Letter of Credit:

Fish	Silk	Nonferrous ores and concentrates	Tanning extracts
Sugar	Wool	Silver and Platinum ores and metals	Pig iron
Coffee	Jute	Crude oil	*Crude rubber
Tea	Vegetable fibers other than cotton	Fuel oils	*Nickel
Spices	Iron ore		*Tin
Malt			

*Available from stockpile

[redacted]

BIBLIOGRAPHY

There is no body of literature on the subject of this term paper. Much of the information contained in it was derived from classified Foreign Service despatches, and in the course of discussions in Washington and in the field with officials concerned with these matters. However, the following sources, most of which were cited in the text, were drawn on for basic data and information; the titles, by themselves, in most cases describe the reference document:

AID Papers, Documents, and Publications:

Policy Determination 21, "Commodity Procurement Source and Origin Policy," July 5, 1963.

Policy Determination 22, "AID Financing of Commercial Commodity Imports - Local Cost Financing," July 30, 1963.

AID Manual, Orders No. 1162.1 - 1162.5, September 30, 1963. (Describes Criteria and procedures for AID financing under special letters of credit).

"Operations Report," W-129, Data as of June 30, 1963.

"Principles of Foreign Economic Assistance," (Summary statement of the principles which guide U.S. economic assistance programs).

"Proposed Mutual Defense and Development Programs FY 1965," April 1964.

"U.S. Assistance to Latin America - Obligations and Loan Authorizations, FY 1949 - FY 1963."

"Latin America - Trends in Production and Trade," Statistics and Reports Division.

OTHER:

"Report to the Inter-American Economic and Social Council" on the Alliance for Progress," 1963. (Report prepared by the U.S. Government to set forth U.S. participation in the Alianza, the responsibilities and functions assumed by the U.S. and its

[redacted]

commitments under the Charter of Punta del Este, and the extent to which the U.S. has met these commitments.)

U.S. General Accounting Office, "Audit of U.S. Aid to Chile for Earthquake Reconstruction and Rehabilitation."

1. See AID Policy Determination 21, "Commodity Procurement Source and Origin Policy,"July 5, 1963.

2. AID, "Operations Report,"June 30, 1963. "the transfer of non-project resources, most commonly in the form of commodities under either loan or grant, under circumstances where the totality of the resources made available, rather than their particular use, constitute the primary U.S. concern."

3. See Annex D for definition of three types or cases of commodity financing. Cases 1 and 2 cover the program assistance type loans under discussion.

4. These are described in AID Manual Orders No. 1162.1 - 1162.5, September 30, 1963.

5. Because of timing, importers generally have no way of knowing in advance whether AID financing will cover any specific transaction. However, since there is a negative list of commodities (a relatively limited one - see Annex E) they can be aware well ahead of time that certain items will not, in any case, be authorized for AID financing.

6. Importers handling American goods claim that even though the Chilean Central Bank certificate is required for imports from all sources, it is discriminatory in that U.S. suppliers tend to be more conscientious and correct in furnishing information on commissions than their foreign competitors.

7. The U.S. General Accounting Office in their recent "Audit of U.S. Aid to Chile for Earthquake Reconstruction and Rehabilitation" noted as follows on page 30:

> "It would seem reasonable to expect that the disbursement of some $86 million in earthquake assistance to Chile during 1961-62 ($66 million of which was tied to U.S. procurement) would result in an increase in Chilean imports from the U.S. over and above the normal amount. However, as shown above, the opposite took place in that Chilean imports from the U.S. declined in these two years both in dollar value and in relation to total imports despite the fact that total imports into Chile were higher in both 1961 and 1962 than in previous years. Thus, it is apparent that the inclusion of requirement in the $100 million loan agreement that the dollars be used to finance imports from the U.S. was not effective in increasing such imports but merely freed Chile's own foreign exchange for other purposes."

[redacted]

[redacted]

8. As of the time of this writing, AID's "Operations Report" (W-129) for the period ending June 30, 1963, which was the latest available, accounts separately by commodity group for only $13 million of the December 1962 $60 million program loan to Colombia and no data is shown for the January 1963 $35 million Chilean loan.

9. This margin, again, can only be estimated. The most generous estimate is based on the assumption that any additional foreign exchange made available through the aid program would be expended according to the established pattern of trade (in the absence of discrimination against imports from the United States). That is, if, as in Colombia, about half of all imports are of American-made goods, then roughly 50 percent of aid-financed imports, even without any aid tying, would be from the United States.

10. In the case of Chile, however, even this margin has apparently been eliminated by the following special circumstances. The Chilean authorities, by virtue of a law passed in 1955, permit the American mining companies which produce Chile's principal source of foreign exchange to retain on deposit outside that country the receipts of their export sales. The companies in return undertook to repatriate a sufficient amount of dollars to cover income and other local taxes as well as their local operating expenses. These expenses include those involved in the import of machinery, equipment, and supplies required for mine operations. The Chilean Government has insisted that such imports be counted in attributing shipments from the U.S. to AID-financing. The U.S. balked at this request, but then yielded rather than jeopardize the special exchange control status of the mining companies. Since the amount of such imports is believed to be as great or greater than the value of our program assistance loan to Chile, the trade effect of such tied aid is negligible, if not negative. This is especially so since the U.S. equipment and supplies imported probably were purchased for direct delivery to the operational sites in Chile by the central purchasing divisions of the mining companies. This kind of aid tying, therefore, also precluded the corallary benefits for that portion of the Chilean distribution system handling American imports (as described in the Preface above) which could improve the longer run prospects for U.S. trade with that country.

11. This is well illustrated by what goes on in Chile with not only the importer but the banks and Chilean authorities taking every advantage to delay payment, masking behind the red tape the real reason for the delay - lack of credit and foreign exchange. The regime is calculated to extend as long as possible the moment of truth, the time when payment must be made to the supplier, as can be seen from the following scenario:

    a) The Chilean importer registers his import transaction with the Central Bank before shipment, through the intermediary of a commercial bank, and lodges the applicable advance import deposit of from 5 percent to 10,000 percent in special dollar-denominated government securities for a wide range of commodities as well.

    b) The importer then has to wait 120 days after the date of the bill of lading, that is nearly 4 months after shipment has been made, before he can present all of the required documentation (including the Supplier's Certificate required for nearly all shipments, whether AID-financed or not) before he can buy from his commercial bank the dollars needed to settle his account with his American supplier. Until recently, the importer did not even have the option of buying futures to cover this transaction.

    c) The U.S. bank which opened the SLC makes payment upon presentation of documentation.

12. Under pressure from the U.S. Government, spearheaded by Embassy Bogota, the Government of Colombia has undertaken to eliminate these discriminatory arrangements. A complete description of these agreements and how they operate is contained in Embassy Bogota's A-119, September 6, 1963; and, A-576, April 21, 1964.

13. An attempt, however, has been made to close this loophole in negotiations with Colombia on program assistance loan for fiscal 1964-65. Under this proposed agreement we would lend $10 million directly to the Bank of the Republic, which administers the PIF, to be made available only for projects, or that part of any project, which involves imports - and such imports would have to be procured from the United States.

14. The controversy over the requirement of the importer to furnish information on the Supplier's Certificate regarding his commissions has been cited as a case where trade promotion could be carried on only at the expense of economic development. But is this so? It is true that the data supplied on importer's

14. CONTINUED:

commissions could be used to increase the tax yield and to plug exchange loopholes. Both these steps would therefore make more financial resources (i.e., tax revenue and foreign exchange) available, ideally for development purposes. However, in practice, it turns out that only importers dealing with the U.S. would be liable to this type of audit since other foreign suppliers are generally not as forthcoming as American exporters (who come under U.S. law by signing the certificate). Therefore, the requirement becomes a discriminatory one, and a loophole exists for any importer wishing to shift sources of supply. This tends to vitiate the advantages to the recipient country of this check and limit their revenue return from it; at the same time it disrupts established channels of trade.

15. These include a list of prohibited imports, import surcharges, advance import deposit requirements, and a compulsory deferment of import payments for a period of 120 days after date of shipment of merchandise from foreign ports. All imports must also be registered with the Central Bank before shipment. Colombia also requires prior registration for all imports as well as prior import deposits and a compulsory payment deferment of from 45-90 days.

There is talk of instituting some more direct system of import control in Chile in the near future. Such a system with its attendant problems for all U.S. exporters to that market would not be a desirable development, but, if introduced, could be made to serve as a vehicle for assuring additionality in imports (the problem of additionality is discussed further on in this chapter). The Chileans do not, so far have an import budget, but rather use differential exchange rates to influence the composition of imports.

16. It has been reported that an Embassy New Delhi proposal, for example, to tie U.S. aid to India to a share of the market for imports into that country (not unlike a plan suggested in the next chapter) was considered to be contrary to our commercial policy objectives. Some preferential and discriminatory element is inherent in any such proposal. However, the degree of preference and discrimination varies with differing circumstances, and can be held to a minimum by periodic review of the resulting trade patterns.

17. As noted, the dominant position of the U.S. in the Colombian market means that, in the normal course of events, i.e., barring discrimination, there will be some additionality whether aid is tied or not. Aid permits a greater volume of total imports than would otherwise take place. American

FOOTNOTES

17. CONTINUED:

exporters should therefore, under the most favorable circumstances, capture the U.S. market share of the additional imports made possible through aid; that market share being a function of how competitive American products prove to be. Therefore, in countries like Colombia, some opponents of the present tied aid system argue, where the U.S. market share has been 50 percent or more, our policy should seek the elimination not only of discrimination but also of any formal aid tying. This would, they hold, yield the maximum trade benefits on the most economic and least objectionable basis. So it might, in those cases where the U.S. supplied close to 80 percent of the import market, and, where there was no discrimination in any form against U.S. exports. Otherwise, even in the case of Colombia, where the U.S. market share is lagging, the additional trade, (an estimated $30 million, at least), mainly imports of capital goods, which have their own multiplier effect, is worth aiming for.

18. Contained in paragraph 604 (b) of the Foreign Assistant Act of 1961, as amended.

19. It is interesting to note, in this connection, that in what constitutes a variation on the forward procurement theme, consideration has been given under the latest program loan to Colombia to making aid-financing available for the import of certain commodities from the U.S. against which discriminatory quantitative restriction have for some time been applied. (The nature of these discriminatory controls has been described earlier, in Chapter III). This proposal to tie aid-financing to imports from the U.S. at the registration point has been opposed by some officials concerned with this problem who, after appraising the proposal, concluded that the balance of advantage was against this system. They were particularly concerned that tying aid, designating certain amounts of AID funds for the importation of specific groups of commodities included in the positive list of the AID Commodity Code, might, on net, decrease rather than increase total U.S. exports. This might happen because the increase in some tied categories might be more than offset by counter discrimination on other items. U.S. aid, as high as $100 million, after all, could only finance 1/3 of total American exports to Colombia, for example, leaving leeway for the Colombian authorities to pay Peter by robbing Paul. By the same token, some U.S. exporters would be discriminated against. Since their exports would not be covered they would not be protected against discrimination by the Colombian import licensing authorities and would therefore be receiving less fair treatment from AID than the U.S. exporters thus covered. Moreover, they hold that such a regime would weaken the U.S. negotiating position by insisting on discriminatory negotiating position. The U.S.

FOOTNOTES

19. CONTINUED:

treatment for certain of its exports through the tying of aid in this manner would encourage Colombia to maintain its present system of bilateral deals and other discriminatory devices instead of making a real effort to move to a multilateral, non-discriminatory, trading system. Thus, this proposal merely forecloses the possibility that we wouldn't get any trade in some items.

20. Ironically, in the context of the present problem, the "additionality" obtained was not considered necessary or desirable in view of the overwhelmingly favorable U.S. balance of payments in the immediate postwar period. In fact, "offshore procurement" mainly of raw materials and bulk foodstuffs was encouraged by the U.S. in those days, so that a fairly large portion of the aid funds were spent in financing the import of goods into Western Europe which were supplied from outside the U.S.

21. This could be a mixed blessing, however, since the current regime permits the Colombian and Chilean authorities to choose from the whole range of imports from the U.S. in order to select items which meet the 50-50 shipping and marine insurance requirements. If they are to be limited to only those specifically aid-financed shipments, that might put them in the position, a politically-difficult one, of having to advise, i.e., to direct, an importer involved to use U.S. bottoms, or to place marine insurance covering the shipment in the U.S. Colombian officials, for example, claim that not only would they be reluctant to do so, but would not have authority to take such action under any existing Colombian law. If they were to ask their legislature for such authority they might force the issue in favor of the proposals, which have been pending before the Colombian Congress for some time, for a more discriminatory and restrictive shipping policy.

22. Arguments made against the institution of forward procurement in Colombia and Chile hold that the speeding up of payment to the U.S. exporter would be made at expense of cutting down the period normally granted for supplier credits in those markets. Such supplier credits, it is held, are sorely needed by the importers and the shortening of the credit period would therefore hamper economic development and worsen the adverse balance of payments of those countries.

FOOTNOTES

23. It is held by some that the institution of forward procurement might require a more flexible interpretation of PD 22 (which covers program assistance and other dollars made available through special letters of credit for local cost financing) than may be possible to permit continuance of the present system of disbursement and documentation.

24. The abolition of discriminatory import policies, as Embassy Bogota, which considered this proposal in connection with the fiscal 1964 program loan, has pointed out is an important condition for attaining the normal import targets. This requires the recipient government to undertake to license imports from the U.S. whenever our goods are competitive on price, quality and credit. Licensing authorities would be required, in fact, to give U.S. suppliers the benefit of the doubt in marginal cases instead favoring other suppliers; even in marginal cases the U.S. advantage is generally justified by the very liberal terms of U.S. program loans.

Embassy Bogota estimated that if this regime had been applied in 1962 it would have yielded an additional $15 million in import registrations from American sources and boosted the U.S. share of the Colombian market from 49 to 52 percent.

25. Some of those supporting this regime hold that, in Colombia for example, this is already taking place. The adjusted line of credit would not, therefore, worsen the situation and this would not offset the considerable advantages offered.

26. Alternatively, such loans could be made to importers by a special department of the Central Bank. In many cases, the heavy hand of the Central Bank is to be avoided. Moreover, the private sector should be encouraged whenever possible. However, this may avoid some of the difficulties arising from the need under this regime for the commercial banks to discriminate among their customers since some will be more eligible than others for these loans of last resort. It would also avoid the problem of allocating the loan receipts among the different banks in the commercial banking system.

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