PD-18
July 30, 1991

USAID

POLICY DETERMINATION

The Administrator

Local Currency

1.0 Summary

1.1 Important modifications in the Agency's policy governing the generation, programming, and accountability requirements associated with host country-owned local currency are described in this policy determination, which was transmitted as State 202944 (June 20, 1991). This new policy supersedes existing Agency policy. [1/]

1.2 The new policy is different from existing Agency policy in three respects: (a) the new policy clarifies the circumstances under which local currency is generated and must be deposited into a separate account; (b) it explicitly permits missions to jointly program local currency to help fund a government's deficit or reduce its debt; and (c) it adopts new accountability standards for managing local currency as explained in separate operational guidance issued by FM. [2/] The policy (in contrast to the accountability standards) applies only to host country-owned local currency resulting from assistance provided under the Foreign Assistance Act (FAA); however, important provisions associated with PL 480 and Section 416(b) local currency are included as implementation guidance.

1.3 The key elements of the new policy are summarized in the attached "Local Currency Decision Tree." The decision tree depicts a logical sequence for considering: (a) options for generating and/or depositing local currency; (b) options for programming local currency that has been generated; and (c) accountability requirements linked to each programming option.

2.0 Background

1. Policy Determination No. 5 on "Programming PL 480 Local Currency Generations" (February 1983), and 87 State 327494 entitled "Supplemental Guidance on Programming Local Currency" (October 1987).

2. State 204855 entitled "Supplemental Guidance on Programming and Managing Host Country-owned Local Currency (June 21, 1991).

2.1 Policy Determination No. 5 (PD-5) on “Programming PL 480 Local Currency Generations" has been the Agency's basic policy statement governing the use of host country-owned local currency since February 1983. The policy was extended in 1984 to cover commodity import programs (CIPs) and cash transfers. It was supplemented in 1987 (87 State 327494) to incorporate USAID monitoring, special account, and trust fund requirements.

2.2 This policy guidance supersedes both PD-5 of 1983 and the supplemental guidance of 1987. It focuses on both the generation and the programming of host country-owned local currency. Separate operational guidance (State 204855) focuses on accountability requirements and management concerns. Questions concerning the new local currency policy should be addressed to AA/PPC. Questions concerning the new accountability standards should be addressed to FM.

2.3 The policy covers host country-owned local currency generated by, or otherwise made available for joint programming as a result of: (a) Development Assistance (DA); (b) the Development Fund for Africa (DFA); (c) the Economic Support Fund (ESF); and (d) the Special Assistance Initiative (SAI).

2.4 Local currency not covered under this guidance includes: (a) U.S.-owned local currency; (b) local currency purchased with USAID appropriated dollars for disbursement under project assistance; and (c) local currency generated under PL 480 and Section 416(b) agreements. However, important provisions associated with PL 480 and Section 416(b) local currency are attached as implementation guidance.

2.5 The policy covers, as a separate item in Section 7.0, local currency which is held in trust by USAID and used largely, but not exclusively, to help meet mission operating expense requirements. The guidance on programming local currency (5.0) and managing local currency (6.0) is not applicable to local currency trust funds.

2.6 The new policy is effective on July 1, 1991. It applies to all local currency generated from obligations made on or after that date. However, some missions may be unable to comply with the policy on July 1, because they are in the midst of negotiating new agreements with the recipient country. Under these circumstances, geographic bureau assistant administrators (AAs) may waive the effective date of the new policy for FY 1991 obligations, as long as such waivers are not prohibited by statute. Copies of such waivers shall be provided to AA/PPC. Waivers for FY 1992 (and subsequent) obligations will not be permitted.

3.0 Policy

3.1 The new policy, like PD-5, recognizes that USAID participation in programming FAA-generated local currency is not an end in itself but rather a tool for moving toward the more important goal of an overall host country budget that represents a sound development-oriented allocation of budgetary resources set within a market-oriented macroeconomic policy framework. It also recognizes that negotiation of the external assistance agreement often constitutes the best opportunity for the U.S. to achieve its development assistance objectives, including the allocation of host country budgetary resources. As a result, joint programming of local currency should normally not be undertaken as a separate exercise additional to negotiating the agreement.

3.2 USAID policy recognizes that local currency generations are not additional resources and should not be viewed and managed as such. USAID also recognizes that the recipient government assumes primary responsibility for allocating its own budgetary resources. At the same time, Agency policy encourages the integration of local currency with external resources (primarily ESF, DA, and DFA resources, and PL 480 food aid) to help achieve specific program and policy objectives and to enhance the developmental impact of the external resources.

3.3 USAID missions must make an initial judgment and reach agreement with the host government on: (a) whether or not the anticipated uses of the dollars disbursed under a cash transfer program or the commodities financed under a CIP will result in the generation of local currency for deposit into a separate account, as described in paragraph 4.0; (b) if not generated, whether or not local currency will still be required to be set aside and deposited into a separate account; (c) if deposited, what constitutes eligible, and ineligible, uses of the local currency; and (d) who will bear what monitoring and oversight responsibilities.

3.4 Local currency that is deposited into a separate account must be programmed consistent with Section 575(a) of the Foreign Operations, Export `Financing, and Related Programs Appropriations Act, 1991 (the “1991 Appropriations Act"), which sets forth eligible uses of local currency. Missions should continue to refrain from jointly programming local currency for activities expressly prohibited by legislation governing appropriated funds. In addition, the agreement between USAID and the host country government should prohibit the use of local currency generations for police training pursuant to Section 660 of the FAA, as well as the use of jointly programmed local currency for military or paramilitary purposes.

4.0 Generating Local Currency

4.1 Local currency is generated under commodity import, cash transfer, and non-project sector assistance programs in one of two ways:

(a) First, when the use of FAA dollar disbursements, as specified in the bilateral assistance agreement, results in the receipt of local currency by the recipient government. Examples of such transactions may include dollars used for private sector imports under a commodity import program (CIP) or a cash transfer program. In addition, public sector imports would generate local currency if the recipient government sold the imported commodities to the private sector or to a quasi-private entity, such as a self-financing parastatal body.

(b) Second, in the absence of a local currency flow as described in (a) above, when USAID requires a deposit or set aside of local currency by the recipient government as a condition or term of the assistance agreement; (this should be distinguished from the statutory 25 percent contribution requirement of Section 110 of the FAA, which is not subject to the separate account requirement.)

4.2 If generated, the local currency must be deposited into a separate account for joint programming. USAID and the host-government may specify in the agreement when during the life of the agreement local currency deposits shall be made and the amounts of local currency to be deposited. Such agreed upon amounts must accurately reflect projected local currency generations under the agreement (State 204855, para. 3.0).

4.3 Local currency need not be generated or deposited into a separate account in all other cases; that is, cases not covered under 4.1(a) and 4.1(b) above. This may occur when dollars are used to service external public sector debt or when commodities are imported by, and for the use of, the recipient government. Likewise, an intra-governmental transfer of the commodities would not generate local currency.

4.4 Missions can always require that the recipient government set aside an agreed upon amount of local currency as a condition of the assistance agreement -- regardless of the actual uses of the dollars. However, before missions exercise this option, they should ensure that budgetary resources are available for such a set aside; if they are not, the recipient government would need to: (a) reduce expenditures for activities that have been included in the budget; (b) increase revenues from taxation or borrowing; and/or (c) print money.

4.5 USAID's Office of the General Counsel (GC) has reviewed the legal issues associated with the generation of local currency; the key points of GC's conclusions are summarized in Annex A.

5.0 Programming Local Currency

5.1 When local currency is generated, it must be programmed to support economic development objectives as defined in current legislation [Section 575(a) of the 1991 Appropriations Act (FAA)]. Within this context, missions have four basic options. They may program local currency to support one or more of these four options, even though the local currency was generated from a single assistance source. The four options for programming host country-owned local currency are:

(a) investing in developmentally sound projects;

(b) supporting particular sectors of the government's budget;

(c) funding the government's deficit or reducing the government's domestic debt; and

(d) funding USAID administrative costs.

5.2 Each programming option is associated with certain accountability requirements. These requirements are described in the operational guidelines (State 204855) as indicated below:

Accountability Guidelines Programming Options	Section	Terminology
(a) projects	6.3.C. 6.4	specific sector support extra-budgetary support
(b) sectors	6.3.B.	general sector support
(c) deficit/debt	6.3.A.	deficit/debt
(d) admin. costs	8.0	OE trust funds

5.3 Jointly programmed local currency may be used to help meet the host country's contribution to USAID-funded projects, including the mandatory 25 percent contribution required under Section 110 of the FAA. Local currency may also be used to support activities funded by other OECD and multilateral donors and private voluntary organizations (PVOs). The host government and USAID should assure themselves that projects supported by local currency meet acceptable technical, financial, administrative, and accounting standards. Projects that are funded and monitored by other donors or undertaken by strong, highly respected host government or private sector institutions would generally meet such standards.

5.4 USAID may also jointly program local currency to help meet the budgetary requirements of particular sectors or ministries of the recipient government, say, the Ministry of Agriculture. In this case, the mission must generally satisfy itself that the quality of overall sectoral activities and the technical and administrative capability of the implementing entity or entities to carry out the program are satisfactory.

5.5 Local currency may also be used to help fund the government's deficit, the effect of which is to reduce public sector borrowing from what it otherwise would be, thereby making those funds available for private sector borrowing. Similarly, local currency may be used to reduce the domestic debt owed by the government to the banking system or to another government (or parastatal) entity. Programming local currency to help fund the public sector deficit or reduce the public sector domestic debt (which is equivalent to supporting the government's overall budget) is normally appropriate only in countries implementing an IMP-sponsored stabilization program and/or a World Bank-sponsored Public Investment Program, under which the domestic money supply and credit ceilings (for both public and private sector borrowing) are firmly established. Jointly programming local currency in this way must first be approved by the Assistant Administrator (AA) of the relevant geographic bureau. This option for programming local currency would not, of course, be applicable in a country where the government was not running a deficit or had no domestic debt.

5.6 In general, jointly programmed local currency should be disbursed as quickly as is consistent with sound programming and prevailing economic conditions in the recipient country. On occasion, however, disbursement delays occur unavoidably. Therefore, USAID policy favors that local currency be place into an interest-bearing account in a deposit-taking institution, with any interest earned programmed as if it were principal, so long as such accounts are permitted under host country law and regulation and do not undermine internationally supported stabilization agreements and sound monetary policy.

5.7 Sterilization, or de-monetization, is not permitted under the new policy. However, missions may choose to program local currency so it disburses relatively slowly by establishing, for example, an endowment, the earnings of which would be designated to support development programs of NGOs or other appropriate organizations, or a development-oriented guaranty fund.

6.0 Managing Local Currency

6.1 USAID participation in programming and accounting for host country-owned local currency has changed substantially over the past 30-35 years. Prior to 1972 Agency policy and practice generally encouraged USAID involvement in programming and monitoring host country-owned local currency. In 1972 the policy was changed; USAID was not to participate in local currency programming. In 1976 it became obligatory for missions to consider the merits of participation in local currency programming. Beginning in 1983 USAID policy required more active participation in local currency programming. By 1987 greater USAID involvement had led to greater USAID accountability.

6.2 In recent years, the Agency has increasingly been criticized by the Inspector General (IG), the General Accounting Office (GAO) and key Congressional subcommittees for the way in which host country-owned local currency is managed. The management problem appears to be most serious when local currency is jointly programmed as budget or sectoral support rather than as support for discrete projects where the impact of the funding is easier to document. The problem is most visible in countries where a relatively large proportion of U.S. economic assistance is in the form of program (as distinct from project) assistance. In countries where we continue our active participation, we need to handle the accountability concerns of the IG and the GAO more effectively.

6.3 Missions that generate local currency and/or require local currency set asides are required to establish separate accounts, jointly program the local currency with the host government, monitor the implementation of local currency-financed activities, provide regular reports, and permit audits to be conducted. State 204855 clarifies these accountability requirements.

6.4 This new local currency policy with staff of key Congressional committees as well as the Office of the Inspector General (IG). Although neither the Congress nor the IG has of the policy outlined above, both are supportive of the overall thrust of the policy.

7.0 <u>Trust Funds</u>

7.1 USAID has authority to establish trust accounts for host country-owned local currency. If USAID manages or administers local currency owned by the host government for any reason, this can be done only pursuant to a trust fund agreement. The trust fund agreement entered into between USAID and the host government defines the uses to which trust funds may be put, and no other uses are permissible. Finally, the uses specified in the trust fund agreement must be consistent with specific statutory requirements, which may be applicable to FAA-generated local currency.

7.2 Trust funds are primarily used by USAID to help meet the administrative costs of its overseas missions. In addition, they have proven to be a useful tool when used, for example, like Project Development and Support (PD&S) funds to facilitate project design and implementation.

7.3 Trust funds utilized to finance discrete new projects or activities are generally not favored, but it is recognized that under exceptional circumstances their use for this purpose may be warranted. The use of trust funds to finance projects must be permissible under the terms of the trust fund agreement between the host government and USAID When trust funds are utilized to support discrete new projects or activities, missions must develop, analyze, justify and implement the activity as if it were an USAID project, including the use of a Project Paper-like authorization document. Given the significant burden on limited mission staffs associated with such trust fund projects, trust funds may be utilized for this purpose only with the approval of the highest USAID official at post. Copies of each such approval shall be forwarded to the Assistant Administrator (AA) of the relevant geographic bureau and to AA/PPC.

7.4 Local currency held in trust, whether used for administrative or program purposes, is not U.S.-owned local currency, and therefore statutory restrictions that apply to appropriated funds do not as a matter of law apply to its use unless specifically applicable to local currency programming. Since this local currency is administered by

A. I .D. as a trustee and is not jointly programmed with the host government, USAID must account for the local currency and report periodically to the host government on the uses of the trust funds (State 204855).

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Implementation Guidance for PL 480 and Section 416(b)

1. The Food, Agriculture, Conservation, and Trade Act of 1990 (the "1990 Farm Bill") and the Agriculture Act of 1949 [Section 416(b)] permit the generation and use of local currency as a statutory end in itself, and not just a by-project of the sale of the food aid. Indeed, unlike the Foreign Assistance Act (and PL 480 Title I), the statutory objectives of monetized PL 480 Title III programs, as well as emergency PL 480 Title II and Section 416(b) assistance, would not be satisfied unless the local currency proceeds were used for their intended purposes.

2. These intended purposes are defined in the legislation: (a) PL 480 Title III [Section 306(b)] identifies 13 specific economic development purposes for which local currency proceeds may be used; (b) PL 480 Title II emergency food aid programs require that the food (if it is not distributed to needy people) may be sold, as long as the local currency is then used for emergency purposes; and (c) Section 416(b) stipulates that sales proceeds may be used either for costs incidental to moving the Section 416(b) commodities or for activities that are consistent with providing food assistance to needy people. [Note that Section 203(d) of Title II applies to the generation and use of local currency by PVOs and cooperatives under non-emergency, as distinct from emergency, programs.]

3. Local currency requirements are complicated, not only when comparing FAA provisions with PL 480 provisions, but also when distinguishing among Title II, Title III, and Section 416(b) monetization programs. Key distinguishing characteristics of local currency generated from the sale of PL 480 and Section 416(b) commodities are listed below.

(a) The 1990 Farm Bill prohibits the use of local currency derived from the sale of food commodities for abortion related activities [Section 403(k)] or to finance the production for export of agricultural commodities that would compete in the world market with similar items produced in the U.S. if such competition would cause “substantial in jury” to U.S. producers.

(b) The 1990 Farm Bill requires that 10 percent of the local currency generated under Title III must be used to support indigenous non-governmental organizations (NGOs), but only if the Title III local currency is deposited into a separate account [Section 306(b)].

(c) The 1990 Farm Bill requires separate accounts for Title III programs to the extent determined appropriate by the Administrator. If local currency is generated in a food aid program, it must be deposited into a separate, interest bearing account. In the unlikely event such a deposit is prohibited by local law or regulation or would clearly be counterproductive, a waiver may be granted by the geographic bureau AA. If the requirement for a separate account is waived, USAID must still be able to verify that an equivalent amount of local currency was used for specific economic development purposes [Section 304(a)].

(d) The 1990 Farm Bill requires consultations with the IMP, World Bank, and other donors to ensure that the use of PL 480 local currency for development purposes will not have a disruptive impact on the farmers or the local economy of the recipient country [Section 403(b)].

(e) Programming local currency to support developmentally sound projects is permissible under Title III agreements; to support projects that pertain to emergencies, under Title II agreements; and to support projects that pertain to food assistance to needy people, under Section 416(b) agreements.

(f) Programming local currency to support particular sectors of the government's budget is permissible under Title III agreements and Title II emergency assistance; and to support the agriculture sector only, under Section 416(b) agreements.

(g) Programming local currency to reduce the government's debt may be permissible under Title III if this use can be justified under one of the specific economic development purposes described in Section 306(a) of PL 480; this use is not permissible under Title II or Section 416(b).

(h) Programming local currency to establish an endowment is permissible under Title II and Title III, but only if established by a NGO (and not by a host country); this use is not permissible under Section 416(b).

(i) Programming local currency to help fund USAID operating expenses is not permitted under PL 480 or Section 416(b).

ANNEX A

Generation of Local Currency

USAID's Office of the General Counsel (GC) has reviewed the legal issues associated with the generation of local currency in its memorandum of March 8, 1991, to AA/PPC, the key points of which are summarized below.

1. As used in section 575(a) of the FY 1991 Appropriations Act, the term "generation" encompasses a tangible flow of local currency to the host government rather than an internal account transaction. Generated local currency is considered owned by the host country rather than by the U.S. Government.

2. The direct and foreseeable use of FAA dollar disbursements determines whether and how much local currency will be generated for purposes of section 575(a) and its separate account deposit and use requirements.

3. Since planned dollar uses must be included in a Congressional Notification, the bilateral assistance agreement also should specify dollar uses. Where dollar uses cannot be specified (e.g., when dollar separate accounts are waived or otherwise not required, or disbursements are commingled) no generation results under section 575(a).

4. Where dollar uses can be specified, but do not result in a tangible flow of local currency to the host government, no generation results under section 575(a).

5. In the absence of a local currency generation (i.e., under the circumstances mentioned in paragraphs 3 and 4 above), the assistance agreement may require host governments to set aside local currency. Such local currency would then be considered a "generation" for purposes of section 575(a) and its separate account deposit and use requirements.

6. All local currency generations are subject to the deposit and use requirements of section 575(a) and assistance agreements may not require the deposit of amounts of local currency less than the amount generated.

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Ronald W. Roskens	Date