

DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT
ALLIANCE FOR PROGRESS
WASHINGTON, D. C. 20523

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LA-CAEC/A-72/36

Meeting of the
CAPITAL ASSISTANCE EXECUTIVE COMMITTEE

Monday, May 15, 1972 - 2:30 P. M.
Room 2248 N.S.

ROCAP - CABEI: Tourism Infrastructure - IRR

LA-CAEC/P-72/49

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LA-CAEC/P-72/49
Project Activity
No. 596-22-995-045

MEMORANDUM FOR THE L. A. CAPITAL ASSISTANCE EXECUTIVE COMMITTEE

FROM: ROCAP/Guatemala

SUBJECT: IRR - CABEI: Tourism Infrastructure

I. The Borrower

The Borrower is the Central American Bank for Economic Integration (CABEI), a multinational public development banking institution. Membership in CABEI is the same as that of the Central American Common Market: The Governments of Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua.

II. Amount of Proposed Loan: \$15.0 Million

Terms: 40 years including a ten-year grace period on amortization of principal - with interest at 2% during the grace period and 3% during the 30-year repayment period. CABEI will relend the AID funds to the Central American Governments at reasonable terms (to be established during the intensive review) commensurate with their ability to repay and the economic return of the financed project.

III. Borrower Contribution: \$5.0 Million

CABEI proposes to contribute a minimum of \$5.0 million, \$2.5 million from the five CACM Governments (\$500,000 each) which will be added to the Bank's capital, and \$2.5 million in cash from CABEI's own resources.

IV. Purposes

The purposes of the proposed AID loan are (i) to stimulate tourism in Central America by providing CABEI with loanable funds for financing on a regional basis priority public infrastructure projects necessary to encourage private investments in tourism industries which have high foreign exchange earnings potential; (ii) to insure the continued regional involvement of a dynamic and responsive regional development bank, CABEI, which has emerged as the leading financial institution in the region, and one of the strongest single cohesive forces in the Central American Common Market today; (iii) to strengthen

the Central American Integration movement. One of the U.S. Government's basic policies in Central America is to foster the economic integration of the five countries comprising the Central American Common Market, and to increase the economic stability of the region by reducing the dependence of these countries on a limited number of traditional export industries.

V. Project

The proposed \$15 million loan to CABEI would enable the Bank to act as the driving force for undertaking the coordination and financing of a major program of tourism development - involving both public and private sectors - throughout the Central American Common Market (CACM).

The AID funds would provide supplemental financing to the Central American Fund for Economic Integration ("the Fund" - see Section VIII). The Fund will continue to use the AID loan and CABEI's cash contribution along with funds contributed by the five countries of the Central American Common Market to finance up to 100% of the costs of engineering and construction of infrastructure projects such as small landing fields and improved harbor facilities (e.g. channel dredging, piers, landings, etc. - modest in size) water and sewer systems, access roads, bridges, transportation facilities and recreational areas. The focus of the project would be on tourism development in areas outside the principal cities of each CACM country where many of the most promising tourism attractions are located.

CABEI already has a number of excellent well-studied projects (see Attachment A) that could be financed quickly under the proposed loan, if approved, and could develop within a reasonable time additional projects in areas which have a high potential for tourism development.

The AID loan would set aside about \$1.5 million for financing feasibility studies (including final plans and specifications) and master plans for preserving the culture (ecology control, zoning, etc.) in developing specific areas. It would also include about \$500,000 for training tourism (hotel) personnel and for undertaking on a regional basis through SITCA and National Tourism Institutes, etc. promotional programs that may be required.

CABEI also intends to make prompt use of a portion of its \$4 million Feasibility Studies Loan from the IDB (approval expected soon) in developing projects which would be ready for financing just as soon as the funds under the AID loan become available. The IDB loan would be most helpful to CABEI in that it would provide CABEI with the lead time it needs in developing a reservoir of fully studied priority projects.

The proposed loan is closely tied to CAREI's \$30 million AID loan No. 596-L-010 signed in September 1970. Within this loan, \$5 million is presently available to the private sector for financing tourism projects, mostly hotels and motels in the outlying areas (the balance is available for export diversification). \$2.5 million is already committed, and CAREI is reviewing loan requests for an additional \$5 million, which will probably require an increase of the tourism allocation in the AID loan from \$5.0 to \$7.5 million. (During the intensive review a listing of these projects showing the timing of CAREI's sub-loan commitments and disbursements will be developed to substantiate this activity.) Under this program the private developers provide their own (but limited) infrastructure facilities such as water and sewer systems, etc. There is generally no involvement of CACM governments in providing infrastructure facilities because for the most part these projects are relatively small.

As noted above, CAREI's experience to date reveals a strong demand for financing private tourism projects. The Bank estimates that its private sub-loan activity alone will aggregate close to \$42 million over the course of the next five years. Many of these loan applications, however, will not go forward until there is a timely input of public investment into tourism infrastructure. With this investment, the prospects for generating and financing private investments by CAREI and other banks in the region at an increasing rate are excellent.

The tourism component of the \$30 million AID loan is relatively small and limited. Yet, it has demonstrated clearly the interest of the private sector in investing in tourism activities in Central America, and if this investment potential is to be realized, it must be supplemented by an equitable investment from the public sector; hence the purpose of the proposed AID loan.

CAREI will coordinate all tourism promotional and financial activities with the regional tourism organization - Secretariat for Central American Tourism Integration (SITCA), the National Tourism Institutes, and the Government Planning Offices in each CACM country. Such coordination, including the financing of specific projects, will conform to a previously agreed-upon plan of action endorsed by these entities, which are composed of participants from both public and private sectors. Since 1967 ROCAP has provided SITCA with technical assistance funds for conducting its promotional activities in Central America and the U.S.

Three recent studies describe in detail the benefits to be derived from an aggressive, regional tourism promotion and development program in Central America.^{1/} Many of the recommendations contained in these studies are now being implemented, and others could be implemented as a result of the proposed loan.

VI. Estimated Costs and Financial Plan

The cost of the entire project would total close to \$20 million. This includes an overall Central American contribution of \$5.0 million, \$2.5 million from CABEI cash and rollover funds, and a \$2.5 million contribution to the Fund's capital from the five CACM Governments (\$500,000 per country), and the proposed \$15.0 million loan.

As in the past the Fund would finance the total engineering and construction costs of eligible infrastructure projects. AID's funds would cover all foreign exchange costs and part of the local currency costs of these projects. CABEI estimates that about 50% of the AID loan funds would be for direct foreign exchange procurement in Area Code 941 countries, and 50% for local procurement in the CACM.

The terms of the AID loan, CABEI's relending terms and local currency needs will be thoroughly reviewed during the intensive review and supported, as appropriate, by cash a flow analysis. The Bank's current terms on most of its infrastructure sub-loans are: interest - 5-1/4%; repayment - up to 20 years; grace period - up to 5 years.

For this program, CABEI's Board may consider softer relending terms, perhaps interest rates ranging from 4% to 5%, and up to 30

^{1/} The studies are:

A Marketing Analysis prepared by Compton Advertising, Inc., spelling out the tourism potential in Central America;

A five-year Tourism Development Plan, prepared by SITCA's Secretary General, proposing institutional changes and establishes loan priorities;

A long-range Promotional and Financial Plan prepared by the Spanish firm Tecniberia, focussing on developing major tourism centers, and specific projects within these centers, throughout the region in areas with the best tourism potential. The first draft of this study is now being reviewed by CABEI, SITCA and the National Tourism Institutes in each CACM country.

years for repayment. This would be attractive to the Member Governments with respect to their own balance of payments problems, and would facilitate the ability of the Governments to service their debts, particularly their foreign exchange obligations. (All CAHEI sub-loans are denominated in dollars). Further, it would encourage the Governments to give the program their fullest support, which is needed, and which in turn could be used to advantage in strengthening the economic integration movement by facilitating the increased flow of tourism in the region; for example, enacting standard tourism legislation, eliminating immigration and customs barriers and fees, introducing a Central American tourist card, streamlining inspection procedures, etc. During the intensive review recommendations will be developed and incorporated in the Loan Paper for developing a unified Central American approach to attracting tourists to the region and encouraging the countries to cooperate with SITCA in developing "tour packages" involving visits to sites in several or all C. A. countries. For this reason AID's most concessional terms would be desirable. Also, the spread between AID's rate of interest to CAHEI and CAHEI's rate of interest to the Governments (sub-borrowers) remains in the Fund and serves to cover operating costs (including costs of the Bank's engineering staff and various managerial and administrative services), and to add to the capital of the Fund. In view of the difficulty the Governments have in making regular and sizeable capital contributions to the Fund, the importance of capitalizing a part of the interest spread cannot be overemphasized.

A cash flow analysis to be undertaken during the intensive review will strongly justify the need for the AID funding and will show that CAHEI's resources (cash and rollover) are completely inadequate to finance the tourism projects proposed under this program as well as other priority infrastructure projects.

VII. Economic, Social and Political Aspects

A. Economic

Tourism, like any industry, has its linkages with other economic sectors. In addition to its important role purchaser of domestic labor, food commodities and artisary products, tourism as an industry has important linkages with the public sector as a user of electricity, water, roads, transportation and other infrastructure services. Input-output models developed recently by the World Bank for several developing economies suggest that the tourism industry purchases from 25% to 40% of its "goods and services" from the public sector.

The tourism industry is largely in the hands of small private entrepreneurs. Unlike manufacturing or commercial sectors, the tourism industry is located in marginal or often primitive areas which appeal to growing numbers of vacationing foreign and domestic urban dwellers. Unfortunately public infrastructure services located in areas of high tourism appeal are also "primitive"; most public investments to date have been responsive to the needs of the manufacturing and commerce sectors which are concentrated in urban areas. Financial assistance through the proposed AID loan will stimulate public sector response to financing infrastructure development essential to sustaining the momentum of Central America's emerging tourism industry.

B. Social and Political

This program would provide a timely and needed stimulus to the CACM and the integration movement. Successful economic integration, by making resources, goods and services more mobile, will result in an accelerated rate of increase in Central American per capita gross domestic product, greater net exports and a greater variety of output; in general it will shorten the road to political integration. The orientation toward the outlying areas will stimulate a flow of funds to these neglected areas, and the financing of "labor intensive" industries, such as tourism, will contribute to a more diversified economic structure in the region. The program will have the effect of increasing income and employment in sectors and areas where few expansive forces have heretofore been felt.

An added benefit is that tourist facilities - hotels, restaurants, resorts, recreational areas - all will be attractive to the countries' own citizens, and aid the economy by helping keep local money in circulation and giving nationals a place to vacation within their own countries.

VIII. Background

The proposed loan would represent ROCAP's fourth infrastructure loan to CAHEI and like the others would be administered by the Bank's Central American Fund for Economic Integration ("the Fund"), established in March of 1963 by the Presidents of the Central American Republics and the President of the United States "for the purpose of fulfilling additional investment needs of the public sector which tend to promote and strengthen the economic integration and balanced development of Central America". According to the statute establishing the Fund, the Bank administers the Fund under a trustee arrangement with the five governments of the CACM countries, and handles the operations of the Fund under separate guidelines than its normal development lending activities (industry and housing).

The existing three ROCAP loans (Nos. 006, 007 and 008) to the Fund total \$85 million. About \$82 million finances highway projects (1,130 Kms. of the Central American Highway Network), and \$3 million finances an airport and inland water canal. Those loans are fully committed and as of March 31, 1972, \$48.4 million were disbursed (57%). About \$20 million were disbursed during the past twelve months alone. Attachment B contains further information about the ROCAP loans.

Over the past ten years (fiscal years 1961 to 1971) CAMEI has approved from various resources (mostly AID and IDB) 101 infrastructure loans aggregating \$155.5 million, as shown below:

	<u>No.</u>	<u>Amount</u>	<u>%</u>
- highways	53	120.0M ^{1/}	77.0
- telecommunications	6	15.4M	10.0
- electric power	10	7.2M	4.5
- ports	7	4.6M	3.0
- airports	3	2.3M)	1.5
- canals	1	1.3M) ^{2/}	1.0
- others ^{3/}	<u>21</u>	<u>4.7M</u>	<u>3.0</u>
Totals	101	155.5M	100.0

^{1/} AID Funds: \$82 Million

^{2/} AID Funds: \$ 3 Million

^{3/} railroads, silos

Of the above total \$75.3 million has been disbursed, \$35.5 million (47%) of which was disbursed during the latest fiscal year, 1970/71. The bulk (90%) of the balance is estimated to be disbursed by June 30, 1974. Estimates of the final disbursement dates on the AID funds (\$85 million) are shown in Attachment B.

IX. Alternative Source of Financing

AID/W is hereby requested to investigate the availability of alternative sources of financing on reasonable terms from EXIM, IDB and IBRD to confirm AID's position as a lender of last resort.

X. Performance of Intensive Review

The Intensive Review will be performed by ROCAP. The drafting of the Capital Assistance Paper will begin upon approval of the IRR, with presentation to AID/W scheduled no later than the first week of June, 1972.

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List of Potential ProjectsCosta RicaBahía Culebra

- Airport	\$ 950,000*
- Access Road	1,100,000*
- Water System	185,000*
- Electric Power	56,500*
- Telephone & Telegraph	10,000*
- Sewage Treatment	228,000
- Urbanization (initial)	200,000
- Road Improvement	<u>500,000*</u>

Total Costa Rica:\$3,229,500El Salvador1. Gulf of Fonseca

- Access Road	\$ 100,000*
- Water Supply	152,000*
- Electric Power	72,000*
- Telephone & Telegraph	10,000*
- Sewage Treatment	229,000
- Urbanization (initial)	800,000
- Airport	<u>1,400,000</u>

\$2,763,000

2. Cerro Verde

- Road Improvement	\$ 100,000 *
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3. San Marcelino

- Access Road	\$ 450,000 *
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4. Tazumal

- Access Road	<u>\$ 100,000 *</u>
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Total El Salvador:\$3,413,000

Guatemala

1. Iztapa (Pacific Coast)

- Access Road	\$ 100,000*	
- Improving Existing Airport	300,000*	
- Water, telephone and power	<u>150,000*</u>	
		\$ 550,000

2. Iztapa or Amatique
(Atlantic Coast)

- Sewage Installation	\$ 300,000	
- Urbanization, initial	<u>1,000,000</u>	
		\$1,300,000

3. Tikal Development

- Paving of Airport	\$ 100,000*	
- Water Supply	160,000*	
- Electric Power	100,000*	
- Park Development (initial)	<u>1,000,000</u>	
		<u>\$1,360,000</u>

Total Guatemala: \$3,210,000

Honduras

1. Tela

- Access Road	\$ 450,000*	
- Bridge	100,000	
- Water System	520,000*	
- Electric Power	40,000*	
- Telephone	10,000*	
- Urbanization (initial)	500,000	
- Sewage Treatment	<u>216,000</u>	
		\$1,836,000

2. Bay Islands

- Road Extension	\$ 600,000*	
- Airport Improvement	<u>350,000*</u>	
		\$ 950,000

3. Copan

- Airport	\$ 500,000	
- Access Road	<u>500,000*</u>	
		<u>\$1,000,000</u>

Total Honduras: \$3,786,000

Nicaragua

1. Masachapa

- Access Road \$ 930,000*

2. San Juan del Sur

- Access Road \$ 100,000*
 - Water System 150,000*
 - Electric Power 10,000*
 - Telephone & Telegraph 100,000*
 - Sewage Treatment 267,000
 - Urbanization (initial) 1,000,000
 \$1,627,000

3. Corn Island

- Airport \$ 200,000*
 - Road Extension 30,000*
 - Water System 100,000*
 \$ 330,000

4. Rio San Juan & Granada
 Island, Lake Nicaragua

- Docking & navigation
 facilities \$ 167,000

Total Nicaragua: \$3,054,000

SUMMARY

	<u>Total Projects</u>	<u>on * Projects, which work could start without extensive additional study</u>
Costa Rica	\$ 3,229,500	\$2,301,500
El Salvador	3,413,000	984,000
Guatemala	3,210,000	910,000
Honduras	3,786,000	2,470,000
Nicaragua	<u>3,054,000</u>	<u>1,620,000</u>
	<u>\$16,692,500</u>	<u>\$6,285,500</u>

SUMMARYROCAP INTEGRATION FUND LOANS

(Millions US\$)

As of March 31, 1971

<u>AID Loan No.</u>	<u>006</u>	<u>007</u>	<u>008</u>	<u>Totals</u>	<u>%</u>
Amount	35.0	20.0	30.0	85.0	100
Committed	35.0	20.0	30.0	85.0	100
Not Committed	--	--	--	--	--
Under Construction	35.0	20.0	21.0	76.0	89.4
Not Under Construction	--	--	9.0	9.0	10.6
Disbursements	33.5	10.7	4.2	48.4	57.0
Undisbursed Balance	1.5	9.3	25.8	36.6	43.0
Estimate date fully disbursed June 30	'73	'74 ^{1/}	'75 ^{2/}		

1/ 96% disbursed by June 30, 19732/ 90% disbursed by June 30, 1974