UNCLASSIFIED

UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D. C. 20523

ROCAP

PROJECT PAPER

EXPORT PROMOTION FUND
"BLADEX"

Loan Number: 596-T-012
Project Number: 596-0109

UNCLASSIFIED

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: A (A = Add, C = Change, D = Delete) — Amendment Number: ____ — DOCUMENT CODE: 3

2. COUNTRY/ENTITY: ROCAP

3. PROJECT NUMBER: 596-0109

4. BUREAU/OFFICE: Latin America and the Caribbean — 05

5. PROJECT TITLE (maximum 40 characters): Export Promotion Fund

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM DD YY 09 30 84

7. ESTIMATED DATE OF OBLIGATION (Under "B:" below, enter 1, 2, 3, or 4)

A. Initial FY 82 — B. Quarter 4 — C. Final FY 83

8. COSTS ($000 OR EQUIVALENT $1 =)

A. FUNDING SOURCE	FIRST FY 82 B. FX	C. L/C	D. Total	LIFE OF PROJECT E. FX	F. L/C	G. Total
AID Appropriated Total	10,000	-	10,000	25,000	-	25,000
(Grant)	( )	(-)	(-)	(-)	(-)	(-)
(Loan)	(10,000)	(-)	(10,000)	(25,000)	(-)	(25,000)
Other U.S. 1.						
Other U.S. 2.						
Host Country						
Other Donor(s)						
TOTALS	10,000	-	10,000	25,000	-	25,000

9. SCHEDULE OF AID FUNDING ($000)

A. APPRO-PRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	C. PRIMARY TECH. CODE 2. Loan	D. OBLIGATIONS TO DATE 1. Grant	D. 2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	E. 2. Loan	F. LIFE OF PROJECT 1. Grant	F. 2. Loan
(1) FN	910		840	-	-	-	5,000	-	5,000
(2) SDA	910		840	-	-	-	5,000	-	20,000
(3)									
(4)									
TOTALS				-	-	-	10,000	-	25,000

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each): 510 | 831

11. SECONDARY PURPOSE CODE: 730

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)

A. Code

B. Amount

13. PROJECT PURPOSE (maximum 480 characters)

To increase non-traditional exports to markets outside of Central America.

14. SCHEDULED EVALUATIONS: Interim MM YY 09 83 | MM YY | Final MM YY 10 84

15. SOURCE/ORIGIN OF GOODS AND SERVICES: [ ] 000 [X] 941 [ ] Local [ ] Other (Specify)

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a ____ page PP Amendment.)

17. APPROVED BY — Signature: — Title: Director, ROCAP — Date Signed: MM DD YY 08 25 82

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION: MM DD YY

AID 1330-4 (8-79)

UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON D.C. 20523

PROJECT AUTHORIZATION

Name of Borrower:	Banco Latinoamericano de Exportaciones ("BLADEX")
Name of Project:	Export Promotion Fund
Number of Project:	596-0109
Number of Loan:	596-T-018

1. Pursuant to Sections 103 and 106 and Chapter 4 of Part II of the Foreign Assistance Act of 1961, as amended ("FAA"), I hereby authorize the Export Promotion Fund project for Banco Latinoamericano de Exportaciones ("Borrower") involving planned obligations of not to exceed Twenty Five Million United States Dollars ($25,000,000) in loan funds ("Loan") over a two (2) year period from the date of authorization, subject to the availability of funds in accordance with the AID OYB/allotment process, and subject to such Congressional Notification as may be required, to help in financing foreign exchange and local currency costs for the project.

2. The project ("Project") consists of providing financial resources to BLADEX for extending short to medium-term credit to export industries in Central American countries participating in the Caribbean Basin Initiative ("CBI").

3. The Project Agreement, which may be negotiated and executed by the officer to whom such authority is delegated in accordance with AID regulations and Delegations of Authority, shall be subject to the following essential terms and covenants and major conditions, together with such other terms and conditions as AID may deem appropriate.

a. Interest Rate and Terms of Repayment

The Borrower shall repay the Loan to AID in U.S. Dollars within fifteen (15) years from the date of first disbursement of the Loan, including a grace period of not to exceed five (5) years. The Borrower shall pay to AID in U.S. Dollars interest from the date of first disbursement of the Loan (i) at the rate of six percent (6%) per annum during the first five (5) years, and (ii) at a rate equivalent to LIBOR commencing as of the expiration date of the grace period, except as AID may agree in writing, provided that such interest rate shall not be less than six percent (6%) per annum, on the outstanding disbursed balance of the Loan and on any due and unpaid interest accrued thereon.

b. Source and Origin of Goods and Services

Goods and services, except for ocean shipping, financed by AID under the Loan shall have their source and origin in the countries of Central America or in countries included in AID Geographic Code 941, except as AID may otherwise agree in writing. Ocean shipping financed by AID under the Loan shall be financed only on flag vessels of the countries of Central America or countries included in AID Geographic Code 941, except as AID may otherwise agree in writing.

c. Condition Precedent to Obligation of Funds Not Previously Justified to the Congress

No more than Ten Million United States Dollars ($10,000,000) in funds authorized under Section 106 of the FAA and Five Million United States Dollars ($5,000,000) in funds authorized under Section 103 of the FAA shall be obligated for the Project until the required Congressional Notification has been made and the necessary waiting period has expired.

d. Condition Precedent to Disbursement

Prior to any disbursement, or the issuance of any commitment documents under the Project Agreement, the Borrower shall, except as AID may otherwise agree in writing, furnish, in form and substance satisfactory to AID, a certification that there have been no significant changes in the Borrower's financial condition as reflected in the Borrower's most recent certified audit statement.

e. Covenants

The Borrower shall covenant that, unless AID otherwise agrees in writing, it will:

(1) establish a revolving fund from reflows generated from subloans utilizing Loan proceeds, which revolving fund shall be used for the purposes of the Project, including coverage of administrative costs, establishment of an adequate reserve for losses and provision for payment of principal and interest under the Loan;

(2) provide, during the disbursement period of the Loan, additive co-financing for the Project equal to twice the amount of the Loan, such additive co-financing to consist of additional credit for the Project (exclusive of the Loan or funds derived from the Loan) exceeding the average credit balance extended for the same purpose by the Borrower in calendar year 1981;

(3) maintain, during the term of the Loan, an average amount of such co-financing during any six month period at a level not less than twice the outstanding principal of the Loan during such six month period.

(4) provide, prior to using project funds for medium-term lending, in form and substance satisfactory to AID, a description of the type of medium-term lending proposed and the criteria established to appraise the subloan investments.

Frank B. Kimball
for M. Peter McPherson
Administrator

Sept 27, 1982
Date

Clearances:
AA/PPC:JRBolton:[illegible] date [illegible]
GC:CLvOrman:[illegible] date [illegible]
AA/LAC:OJReich:[illegible] date [illegible]

GC/LAC:bVeirs:9/21/82:x23272

EXPORT PROMOTION FUND

Page

I. SUMMARY AND RECOMMENDATIONS

A. Recommendations

The Project Committee recommends the Export Promotion Fund Project for AID approval.

Loan $25.0 million

(Loan terms: 15 years, 5 year grace period with 6% interest during the grace period and an interest rate that would fuctuate with the 6 month LIBOR rate for the remainder of the loan

Total new AID obligation $25.0 million

B. Summary Project Description

1. The Borrower

The borrower will be the Banco Latinoamericano de Exportaciones (BLADEX). BLADEX was incorporated in Panama in 1978 with the primary objective of promoting Latin American exports of non-traditional goods. Its shareholders include Latin American central and state banks, Latin American public and private commercial banks, private international commercial banks and the International Finance Corporation. As of April, 1982, there were a total of 232 shareholder banks. BLADEX provides pre-export and export financing to its clients in the form of short-term advances and banker's acceptances. A limited part of its portfolio is comprised of medium-term loans.

2. Goal and Purpose

The goal of the project is to reduce the balance of payments deficits in Central America. The purpose of the project is to increase non-traditional exports to markets outside of Central America.

3. Project Description

Since the creation of the Central American Common Market (CACM) in 1960, the industrial sector has had a major role in the economic development of the region. In particular, as production and trade expanded in response to the opportunities of the larger market opened by the CACM, employment and income also increased. The ability of the industrial sector to continue in this role, however, has been seriously hampered by the current economic crisis and internal structural problems of the CACM.

Over the past three years, all the Central American countries have suffered deteriorating balance of payments positions and now have large deficits, international reserves are either negative or almost zero, fiscal deficits have been climbing and GDP growth has halted. These indicators reflect the serious contraction of economic activity which the region has experienced as a consequence of an adverse shift in the terms of trade and of the insecurity arising from the violence and terrorism which have characterized the social unrest and political instability in the area. In the absence of adequately functioning regional mechanisms there has been an increasing tendency for the countries to deal with balance of payments problems by imposing trade restrictions, which serve instead to aggravate the problem.

Within the CACM, the strategy of focusing on import substitution industries protected by a high tariff is now generally recognized as outdated and in need of reform. Most experts agree that, for industry to continue to fill its role as a principal growth vehicle, a strategy is needed which stresses production of non-traditional goods for export to markets outside of Central America.

The project will provide short-term financing to meet the needs of the private extra-regional export sector. The primary use of loan funds will be to finance the importation of raw materials, intermediate goods and spare parts required for producing export commodities. In addition, the funds will be used to provide exporters with credit to bridge the gap between the time of shipment and payment by the purchaser. When financed as part of one package, these activities may require short-term credits for up to 360 days; on an individual basis, however, financing usually will not exceed 180 days. By the end of the second year, the project contemplates the use of funds from reflows to finance medium-term loans for capital or plant improvements by the export sector.

BLADEX will channel loan funds to the target industries through its eligible shareholder banks using a well established mechanism based on normal international trade procedures. To be eligible to receive loan funds, the commodity in question must be for export outside the region and collections must be made in hard currency. This latter feature will result in the creation of a revolving fund which BLADEX will maintain as a continual source of financing for the export sector. The fund will be further capitalized by the spread between the AID loan and the commercial rates at which BLADEX will lend to its clients.

A final source of funding to be used in achieving project objectives will be co-financing provided by foreign commercial banks. Traditional foreign sources of credit have disappeared in the wake of the political and economic difficulties in the region, and an important objective of the project is to demonstrate that viable, bankable export opportunities can be exploited even under such circumstances. BLADEX will encourage the participation of foreign commercial banks in the project, generating co-financing at a ratio of 2:1 of the AID loan.

C. Summary Financial Plan

The project will provide $75.0 million in short-term financing over the two year implementation period:

Source	Amount
AID	$25.0 million
Co-financing	$50.0 million
Total	$75.0 million

All project resources will be provided in foreign exchange to meet the import needs of the private export sector.

The cash flow projections done as part of the Financial Analysis show that the revolving fund to be established by the project could grow to as much as $69 million by the time the principal and interest on the AID loan are fully repaid in 15 years.

D. Summary Findings

The Project Committee has reviewed all aspects of the proposed Export Promotion Fund Project and finds that it is technically, financially, socially and economically feasible for completion within a two-year period. Further, the Committee has found that BLADEX is institutionally capable of administering the Project. E. Project Committee

ROCAP

Julian Heriot - Assistant Program Economist
Clark Joel - Regional Economic Advisor
Kevin Kelly - Project Development Officer
Thomas Totino - Controller

AID/W

Peter Bittn

E. Project Committee

ROCAP

Julian Heriot - Assistant Program Economist
Clark Joel - Regional Economic Advisor
Kevin Kelly - Project Development Officer
Thomas Totino - Controller

AID/W

Peter Bittner - LAC Private Sector Officer

BLADEX

R. Scott Hesmehn - Senior Vice President
Jaime Medina - Credit Officer
Armando Nunez - Assistant Vice President
Carlos Yap - Manager

II DESCRIPTION OF THE PROJECT

A. Background

1. The Macro-Economic Situation

The Central American economy has been badly shaken as a result of various internal and external political and economic factors which have been at play for the past three years. The world-wide economic recession, the contraction of demand for traditional Central American exports, the increased price of imports (particularly petroleum), high interest rates and accumulated foreign indebtedness are some of the principal factors which have drained international reserves, reduced fiscal revenues and constrained bank credit. These contractionary forces, along with high levels of violence and political instability, have generated reinforcing movements such as the decline of private investment, capital flight and drying up of external credit.

These elements have brought the region to a point of serious crisis which is characterized by a no growth and, in some cases, a negative growth situation. The extent of the crisis and the implications for successfully confronting it are demonstrated by the following key indicators.

a. The Balance of Payments

Since 1979, the Central American countries have experienced a significant deterioration in both their current account and overall balance of payments position. Between 1979 and 1981, the region's consolidated current account deficit increased from \$744 million to \$1.93 billion (160%). Another 9% increase in the deficit (to \$2.1 billion) is projected for 1982. Over the same period, the region's combined balance of payments deficit increased from \$320 million to \$744 million (133%) and, whereas ROCAP has projected an increase to \$778 million in 1982, the Central American Monetary Council estimates that the combined balance of payments deficit may reach as high as \$1.0 billion.

Table 1 summarizes the current account and overall balance of payments deficit situation (in millions of current U.S. dollars):

TABLE 1

	Deficit (-) or Surplus (+) on Current Account				Overall Balance of Payments Deficit			
	1979	1980	1981 1/	1982 1/	1979	1980	1981 1/	1982 1/
Guatemala	-206	- 163	- 601	- 583	- 15	- 250	-423	-305
El Salvador	132	- 86	- 227	- 344	-108	- 196	- 59	-237
Honduras	-192	- 321	- 299	- 354	- 17	- 61	- 97	- 76
Nicaragua	124	- 387	- 293	- 293	- 80	- 172	- 10	- 10
Costa Rica	-602	- 661	- 511	- 526	-100	- 456	-155	-150
	-744	-1618	-1931	-2100 2/	-320	-1135	-744	-778 2/

1/ Projected.
2/ No 1982 data for Nicaragua are available. In totalling, Nicaragua's deficit for 1982 was assumed to be the same as in 1981.

Although dismal, these figures significantly understate the severity of the crisis. A much more serious balance of payments gap was avoided only through the imposition of tight foreign exchange controls which led to sharp declines in the levels of real imports throughout the region. For example, in Guatemala and Honduras imports fell by 7% between 1979 and 1981 while, over the same period, the decline was 25% in El Salvador and 27% in Costa Rica. To a large extent, therefore, these actions resulted in the contraction of income and employment which are adjustments to the balance of payments disequilibrium not reflected in the deficit statements.

The principal factors which have contributed to this unfavorable balance of payments situation include:

-- The impact of violence, destruction and fear on capital flows, exports and tourism. The tourism industry (a major source of foreign exchange) is functioning at 25 to 40% of capacity, while capital flight during 1979-81 is estimated to be at least $1.5 billion.

-- The severe deterioration in the region's terms of trade. Between 1979 and 1981, the price of oil almost doubled, while the cost of other essential imports also jumped significantly. At the same time, the price of the region's traditional exports not only did not keep pace but actually fell precipitously. For example, coffee prices declined by about 30%, cotton 10% to 12%, while sugar stayed roughly at the 1979 level.

-- Contraction of both regional and extraregional markets. The Central American Common Market (CACM) has contracted substantially as a result of current account deficits, capital flight and the sharp reduction in private investment (in 1981, intraregional trade declined by about 15%, in current prices). The contraction of the extraregional market has affected prices for traditional exports as well as the demand for manufactured goods.

-- A nearly complete cut-off of foreign sources of credit in response to the violence and debt servicing defaults by Nicaragua and Costa Rica. The region has been particularly hurt by the cancellation of foreign lines of credit to finance purchases of raw materials and intermediate goods. This, in turn, has resulted in a lower level of manufactured exports and a drop in foreign exchange earnings.

The continued presence of these factors makes the outlook grim for short-term improvements in the situation. The only bright spots on the horizon are increased production and exports of petroleum for Guatemala, and the possibility that the Caribbean Basin Initiative will provide badly needed balance of payments support and facilitate the sale of manufactured exports in the U.S. market.

b. Net International Reserves

As the region's balance of payments deficit has increased, international reserves have declined sharply. Table 2 shows that between the end of 1979 and the end of 1981 net international reserves have dropped from a positive $858 million to a negative $576 million. Over this period, each country in the region has seen its reserves fall drastically, with El Salvador, Nicaragua and Costa Rica now having substantial negative net reserve balances while those of Guatemala and Honduras are fast approaching zero.

Table 2

	Net Int'l. Reserves ($Millions)		
	12/31/79	12/31/80	Latest Date
Guatemala	691.6	413.1	70.0 1/ (2/28/82)
El Salvador	126.3	69.9	-128.5 2/ (12/31/81)
Honduras	116.2	55.2	31.9 (8/31/81)
Nicaragua	-192.6	-362.8	(-363.0) 3/
Costa Rica	117.0	- 95.3	-186.3 (12/31/81)
TOTAL	858.5	- 59.7	-575.9 3/

1/ As calculated by the Central Bank of Guatemala. Net international reserves were only $60 million according to the IMF formula.
2/ Projected.
3/ No data for Nicaragua are available. Net international reserves were assumed to be the same as at the end of 1980.

c. Fiscal Deficits

Fiscal deficits have increased substantially over the past three years. Between 1979 and 1981, the combined deficits of the five Central American governments grew from $640 million to almost $1.5 billion. Approximately the same level is projected for 1982. These deficits have compelled the banking system to devote practically all of the permissible bank credit expansion to the public sector, thereby significantly compressing credit resources available to meet the working capital requirements of the private sector.

Factors contributing to the rapid growth of the region's fiscal deficits include:

-- increased expenditures for employment generation in response to social unrest and political pressures;

-- substantial increases in current expenditures related to the need to staff completed capital projects;

-- increases in living costs which have led public employees to demand and obtain substantial increases in wages and fringe benefits in Costa Rica, Honduras and El Salvador;

-- stepped-up security expenditures in all countries of the region, with the exception of Costa Rica; and

-- reduced tax collections, including collections of income tax, import duties on non-essentials and on coffee exports (the coffee tax is graduated so that the rate declines with the price of coffee; moreover, Guatemala has lowered its coffee tax rate schedule).

Table 3 summarizes the region's fiscal deficits:

Table 3

	Central Govt's Overall Budget Deficit (-) ($Million)			
	1979	1980	1981	1982*
Guatemala	-148	- 368	- 698	- 453
El Salvador	- 24	- 199	- 191	- 297
Honduras	- 74	- 193	- 196	- 352
Nicaragua	-125	- 189	- 275 1/	N/A
Costa Rica	-269	- 328	- 105 2/	- 109 3/
	-640	-1277	-1465	-1411 4/

* Projected

1/ Converted at the official rate of C10 to $1.
2/ Converted into dollars at C20 to $1 (for 1981).
3/ Converted into dollars at the current free market rate of C40 to $1 (for 1982).
4/ Nicaragua's 1982 deficit is projected at $200 million, although no data for Nicaragua are available at this time.

d. GDP Growth

After increasing at an annual average rate of 5.5% over the period 1960-1978, the combined effect of the economic crisis has been to halt GDP growth. Table 4 shows the decline in the real GDP growth rates since 1979. In 1981, the real GDP growth in El Salvador continued to slide, Honduras and Costa Rica experienced negative growth for the first time, while Guatemala's growth rate slowed from a traditional 6-7% to only 1%.

TABLE 4

	Real GDP Growth Rate (%)		
	1979	1980	1981*
Guatemala	4.5	3.5	1
El Salvador	- 1.5	- 9.6	-9.5
Honduras	6.7	2.4	0 to -2.0
Nicaragua	-24.0	10.7	5 to 7
Costa Rica	4.9	1.2	-3.6

* Projected

e. Plight of the Private Sector

The private sector has traditionally played a dominant role in the Central American economy, accounting for 80% to 90% of the total value of goods and services produced. Since 1979, however, there has been a sharp decline in private investment activity. According to available data, between 1979 and 1980 real private investment declined by 24% in Guatemala, 39% in El Salvador, 45% in Nicaragua, and 2% in Honduras. In 1981 additional decreases are expected to be about as large as those of 1980, while no recovery is expected in 1982.

The following are the major factors explaining the low state of the private investment climate:

-- The risks arising from the unstable political situation and the spread of terrorist activity;

-- acute shortages of working capital arising in large part because of cancellation of foreign lines of credit from both commercial banks and suppliers, as well as the acute foreign exchange shortage resulting from the balance of payments deficits. At the same time, the domestic banking system finds itself unable to replace the foreign lines of credit as it must accommodate the public sector's substantial deficits;

-- contraction of the market, both in Central America and abroad. In the case of the latter, the depressed prices of coffee, cotton and sugar is a major contributing factor; and

-- in some countries, a lack of definition with respect to government intentions has also discouraged private investment activity. This is particularly true in El Salvador and Nicaragua where the scope of activity left to the private sector is either unknown or has been unduly restricted. In Costa Rica and Honduras, there has also been growing concern with respect to the increasingly dominant role assumed by the government in the economy.

2. <u>The Role of Intra- and Extra-Regional Trade in the Economic Growth of Central America</u>

The establishment of the Central American Common Market (CACM) in 1960 provided an important stimulus to the region's development by creating a region-wide market, promoting economies of scale and encouraging investment by foreign firms interested in taking advantage of the broader market protected from outside competition by the Common External Tariff.

Between 1960 and 1968, total intraregional trade grew at an average annual compound rate of 29%, while value added by the manufacturing sector increased at an annual rate of 8.7% in real terms and private investment spending increased by 7.6%. In absolute terms, intraregional trade increased from only $32.7 million in 1960 to $1,160 million in 1980.

The close interrelationship between intraregional trade and the growth of the manufacturing sector is further demonstrated by the fact that approximately 87% of total intraregional trade consists of manufactured goods. This represents 63% of Central America's total exports of manufactured products.

Although the CACM has made a significant contribution to the region's development, certain structural weaknesses have become increasingly evident. These include the promotion of industries with high import coefficients which are not well suited to compete in world markets, the encouragement given by the tariff structure to assembly-type operations, and the promotion of import-substitution activities in preference to those oriented toward the world market. After two decades of development based, in part, on the protection provided by the tariff structure, the region now confronts a situation in which most of the easy possibilities for substitution industries have been exhausted and many industries dependent on the tariff structure are inefficient and costly to support.

Another consequence of the region's rapid industrialization has been the increased dependence of the manufacturing sector on the importation of raw materials and intermediate goods. The latter category alone almost quintupled between 1970 and 1980. As a proportion of total GDP, total imports increased from 17% in 1960 to 26% in 1980. Despite this increasingly important role, however, the manufacturing sector has been particularly affected by the balance of payments crisis because the lack of foreign exchange has limited the ability to finance needed imports thereby creating a constraint to production and the export expansion which can help reduce balance of payments pressures.

Based on recent experience and a clearer understanding of the inherent weaknesses of the CACM, there now is a general consensus that Central America must develop a growth strategy oriented increasingly toward exports of non-traditional goods to external markets if the manufacturing sector is to fulfill its role in the long-term economic development of the region. Such a strategy is important because increased emphasis on the export of non-traditional goods can help reduce the impact on the economy of external shocks emanating from fluctuations in world commodity prices for the region's traditional exports, encourage renewed foreign investment, and contribute significantly to Central America's balance of payments difficulties.

The Caribbean Basin Initiative (CBI) to establish a free-trade zone for Caribbean Basin products, therefore, is a timely measure and represents a major long-range opportunity for Central America to overcome its development problems and set the stage for its sustained growth as part of the world economy. A successful export drive during the twelve-year duty-free period of the CBI would assist the region in implementing a strategy of decreased dependence on the exports of traditional commodities as well as helping to turn the industrial sector from its narrow reliance on the CACM toward the world market. Such restructuring, however, can only be achieved over the long-term.

The most urgent and immediate need is to provide emergency foreign exchange credit to finance the importation of raw materials and intermediate goods, with priority to be given to the extraregional export manufacturing sector. As will be shown in the economic analysis, the current backlog of unsatisfied demand for this latter purpose alone is estimated at $220 to $250 million, while the total annual demand for raw materials and intermediate goods (also for the extra-regional export manufacturing sector alone) originating in eligible free-world countries is estimated at nearly $200 million.

3. Project Objective and Rationale

The objective and rationale of the proposed project are deeply rooted in the close relationship between the non-traditional export sector and the economic development of the region. The lack of credit and the subsequent inability to finance production and trade has had a severe and negative effect on the CACM. For example, in El Salvador more than 100 plants have been forced to close and in Guatemala unemployment is growing at an alarming rate. If this situation continues, it can only intensify existing political problems and create conditions which will make it even more difficult to design effective, longer-term assistance programs to stimulate extraregional exports and encourage foreign private investment.

The project, therefore, is seen as a means for helping to bridge the gap between the situation created by the current crisis and the time when the economic and political scene has stabilized and a return to commercial operations involving private investment and external sources of credit is achieved. By providing resources to revitalize and, ultimately to expand the exportation of non-traditional commodities, the project will help reduce the possibility of the various countries adopting development approaches which emphasize narrow national concerns and priorities to the exclusion of broader regional objectives. The availability of project resources will also help reduce the continued dependence on traditional exports and high vulnerability to external market forces that these approaches entail.

Finally, the project recognizes that the ability of the manufacturing sector to take advantage of trade liberalization and investment incentives offered by the United States as part of the CBI, or to have extraregional exports of non-traditional goods become the key impetus to renewed growth, becomes academic unless the private industrial sector can survive the current crisis. The ROCAP-financed private sector study highlighted this concern and identified the desperate need for credit and foreign exchange as critical to their efforts in this regard. The proposed project, therefore, is also designed to address this requirement by providing credit and foreign exchange to meet the present crisis and, at the same time, establish an export fund which can help meet the longer range demands for export financing so that the region can take maximum advantage of the special trade preference under the CBI.

4. Relationship to the CDSS and Regional Priorities

In its most recent CDSS, the Mission discussed the magnitude of the current economic crisis and its implications both for intraregional trade and the formulation of a new development strategy based on extra-regional exports of non-traditional commodities. The problem created by the crisis has been consistently recognized by the governments of the Central American countries as one which should not be affected by political differences. In response, periodic meetings of the Ministers of Economy and Central Bank Presidents have examined the alternatives and have repeatedly emphasized that the balance of payments and intraregional trade problems are the top priorities which must be addressed.

Within this context, the CDSS concluded that the need for fast disbursing balance of payments assistance to provide the private manufacturing and agriculture sectors with foreign exchange required to import essential raw materials, intermediate goods and spare parts must be a priority for U.S. assistance to the region in the short-term. The proposed project responds directly to this conclusion and supports the efforts of the Central American countries to begin evolving a new growth strategy.

The project is also consistent with the broader, longer-term objectives of the CBI. By financing exports which earn foreign exchange, the project will create a revolving fund which will finance exports well into the future, thereby providing resources to assist the private industrial sector to take maximum advantage of the trade opportunities the CBI is expected to offer.

5. AID and Other Donor Assistance

The proposed project represents the principal effort planned by ROCAP to provide assistance in addressing the current economic crisis. A smaller, but equally important ROCAP activity, which complements the credit orientation of this project is a grant to the World Trade Institute (WTI). That project is designed to assist the Central American private industrial sector to identify the opportunities available in the U.S. market and the local products and industries capable of taking advantage of those opportunities. As appropriate products are identified, funds from this loan will be available for pre and post-export financing.

Through the bilateral missions, AID is planning a major effort to assist the region in addressing the balance of payments crisis. The primary source of this assistance will be ESF funds, particularly the $216 million of the proposed $350 million supplemental FY 1982 ESF request which is planned for Central America. These funds will be used for purposes similar to those of this project, but will not necessarily have the narrow focus on the export manufacturing sector. And, although the ESF funds will make a significant contribution toward financing the existing deficits, a large gap remains to be filled. While not intended to fill the gap, this project will complement the other assistance being provided, and the revolving fund it creates will multiply its impact for many years.

International donor assistance to the manufacturing sector comes primarily from the IBRD and IDB, both of which are planning industrial credit projects to most countries in the region. Information available at this time indicates a spending level of up to $170 million is being considered for six projects (see Annex I for detail). However, these projects are designed to finance medium and long-term investment, and are not intended to address the short-term needs created by the current economic situation. Nonetheless, this position is being reconsidered in the case of an industrial development loan the IDB is planning in Costa Rica, and other projects also may be modified to be more responsive to the crisis.

B. Detailed Project Description

1. Goal and Purpose

The goal of the project is to reduce the balance of payments deficits in Central America by stimulating extra-regional exports through the provision of foreign exchange to import raw materials, intermediate goods and spare parts. A revolving fund will be created and will be continuously replenished because all repayments will be made in hard currency, thereby providing a long-term source of foreign exchange for the private non-traditional export sector. Over time, this fund is projected to grow and, as the value of exports increases, it will help to reduce the balance of payments pressures.

The purpose of the project, therefore, is to increase non-traditional exports to markets outside of Central America. As production increases in response to expanding exports, employment opportunities will increase generating a significant income effect.

2. Beneficiaries

In general terms, the private sector will be the beneficiary of the project. Within the private sector, project benefits will accrue to three groups. Direct beneficiaries include the manufacturing sector and other non-traditional producers who export to hard currency areas. With the foreign exchange provided by the project, they will have the means to continue producing, exporting and generating income. A second group of direct beneficiaries are the individuals employed by the export industries. By helping to maintain production levels, the project will also have a positive impact on employment by curtailing the regional decline in the demand for labor. The economic analysis in Section III.B.2, below, includes a detailed examination of the employment effect of the project.

Indirectly, the project has the potential to benefit the entire export sector. By reducing the balance of payments deficits and, therefore, part of the pressure on scarce national reserves of foreign exchange, it will be possible to use those resources to finance intraregional trade. Moreover, as production and extraregional exports increase, the value added by the manufacturing sector will generate foreign exchange additional to the amounts required to finance imported inputs. These additional foreign exchange earnings can ease the current constraints on intraregional trade financing. The availability of resources to finance intraregional trade would help to eliminate one of the principal constraints to stabilizing the CACM which, as discussed above, is absolutely essential to the long-term viability of the industrial sector in Central America. The extent to which indirect benefits are realized will, in part, depend on the impact of the project in addressing the current crisis. In this regard, the long-term nature of the project, made possible by the revolving fund it will create, significantly improves its potential for providing these indirect benefits.

3. Project Features

a. The Borrower

The Banco Latinoamericano de Exportaciones (BLADEX) will be the borrower under the proposed loan. BLADEX is a Latin American bank which is headquartered in Panama (see Section III.D, Institutional Analysis for details). It was selected as the Borrower for two reasons: first, the principal objective of BLADEX -- to promote Latin American exports, primarily of non-traditional products -- coincides with the underlying objective of the project; and, second, in a brief time span, BLADEX has established an effective mechanism for delivering short-term capital to clients in the private export sector who constitute the target group of this project.

b. What the Project will Finance

In light of the current economic crisis and shortage of foreign exchange, the primary focus of the loan will be to finance the foreign exchange component of working capital required by firms in the Central American extraregional non-traditional export sector to import needed raw materials, semi-finished or intermediate goods, and spare parts. This financing will be provided in the form of short-term advances, bankers acceptances, and/or usance letters of credit, in each case for up to 180 days.

Although the Economic Analysis (see Section III.B) shows that demand for these essential imports by the export manufacturing sector, the major component of non-traditional exports, exceeds the available supply of foreign exchange for that purpose, loan funds will also be used to provide short-term credits (up to 180 days) for post-export financing to bridge the gap between time of shipment and payment by the foreign buyer. Normally, this type of financing provides the producer with credit based on a percentage of the FOB value of the exported good (typically [illegible]) until payment is received from the buyer. Initially, loan funds for this purpose will be limited; however, because this financing can often permit an exporter to offer incentives to a buyer and, therefore, can help non-traditional exports from the region gain a needed foothold in a new market, availability of loan funds for this purpose will contribute significantly to the objectives of the project.

A final use of project funds will be to finance medium-term loans (up to five years) for capital improvements planned by export industries. During the first two years of the project, loan funds will not be used for this purpose since satisfying the demand for short-term requirements is of top priority. As the revolving fund generated by the interest rate spread begins to grow, however, these funds will be used for medium-term loans. When project funds are used for this purpose, BLADEX will apply its usual conditions and terms, including the length of the loan and the interest rate to be charged. BLADEX already makes medium-term loans and is currently following a policy of maintaining a ratio of $2 in short-term credits for every $1 in medium-term credits which it extends. The BLADEX policy controlling this ratio which is in effect at the time project funds are used for medium-term loans will be followed. BLADEX will submit medium term lending plan to AID before making such loans.

c. <u>Eligibility Criteria</u>

Lending criteria have been kept as simple as possible in order to maintain maximum flexibility and assure that project funds are disbursed as quickly as possible. Four basic criteria will apply in all cases involving pre-export financing.

1) The commercial bank requesting project funds must be a Class A or B shareholder in BLADEX;

2) The funds must be used to import raw materials, intermediate goods or spare parts needed to produce export commodities (working capital for local currency requirements will not be financed with project funds);

3) The final borrower must be an exporter of manufactured goods or non-traditional agricultural commodities with an emphasis on small and medium sized, labor intensive enterprises with significant backward linkages. The only export products which will be excluded are traditional primary export products such as sugar, cotton, coffee, bananas, beef, etc.; and

4) The commodity produced must be for export to hard currency areas.

When project funds are used to provide export financing, only criteria (1), (3) and (4) will apply.

In cases where there is a question as to the eligibility of a manufacturer, BLADEX will be the final judge based on an analysis of the firm and the commodity being produced.

A final criterion to be applied relates to the size of loans made to the final borrowers. To assure as widespread coverage as possible for project funds, a maximum of $1.0 million will be established for any single loan to a final borrower; it is expected, however, that the majority of the loans to final borrowers will be considerably smaller.

BLADEX clients which are designated for participation in the Caribbean Basin Initiative (CBI) will be eligible to participate in the project. Also, rather than allocating funds on a country-by-country basis, project resources will be made available on a first come, first served basis. However, to ensure that no one country obtains an undue share of loan funds, a maximum of one-third of the AID contribution to any one country will be imposed during the first year of the project. Afterwards, no annual limits will be imposed.

d. The Lending Mechanism

1) How it Functions

The project will utilize the lending mechanism already established within BLADEX to finance non-traditional Latin American exports, and it will not depart significantly from normally accepted correspondent banking procedures used in international trade.

In the case of pre-export financing, the BLADEX loan mechanism can be referred to as "compensating finance". Through this procedure a Central American manufacturer imports raw materials necessary to fulfill an export order and payment is made directly by BLADEX to the supplier. When the export order is ready for shipment, the procedure is reversed; BLADEX receives payment directly from the customer, deducts the amount which it loaned for the raw material imports and then forwards the balance to the manufacturer (this assumes a situation in which BLADEX wishes to excercise full control over loan and export payment proceeds; however, the Bank determines the extent to which it will excercise such control on a case by case basis). It is compensating finance because the manufacturer, in effect, uses the hard currency earnings from the exports to cancel the obligation incurred by the imports.

Although details may vary from case to case, the essential features of each transaction will be the same. Usually, the principals will be: (1) BLADEX, (2) an eligible commercial bank, "the domestic bank", (3) a Central American manufacturer and exporter, "the manufacturer", (4) a foreign supplier of imports referred to as, "the supplier", (5) the foreign buyer of the Central American manufactured goods referred to as, "the customer", and (6) a foreign bank servicing the needs of the supplier and the customer.

The following is a step by step summary of a typical transaction:

- The manufacturer requests a domestic bank to open a letter of credit in favor of the supplier. The letter of credit would be confirmed by the foreign bank. The foreign bank will have a previously negotiated understanding with BLADEX under which BLADEX will pay the foreign bank under the terms of the letter of credit.

- The raw materials and/or intermediate goods are shipped to the manufacturer against the letter of credit and BLADEX makes payment to the foreign bank, simultaneously creating a loan to the domestic bank.

- After the goods are produced by the manufacturer and are ready for shipment to the customer, the line of credit could be extended into the post-shipment phase, if necessary.

- Before shipment, the foreign customer opens a letter of credit through a foreign bank confirmed by the domestic bank in favor of the manufacturer. When shipping documents are presented, the foreign bank will be instructed to collect payment from the customer and forward the payment to BLADEX. The use of a letter of credit would be determined by the manufacturer, and the manufacturer and customer would acknowledge that BLADEX should receive the payment.

- BLADEX, upon receipt of the funds, will deduct the amount due BLADEX, and forward the net amount to the respective central bank which, in turn would forward the local currency equivalent to the domestic bank, which would then credit the manufacturer.
- The manufacturer will be paid in local currency, with the foreign exchange equivalent accruing to the respective central bank.

2) Relationship of the Lending Mechanism to Foreign Exchange Control Systems

Under the above-described mechanism, financing for raw material imports and hard currency collections will take place outside the foreign exchange control systems of the Central American countries (i.e., BLADEX will be repaid before the net foreign exchange proceeds are remitted to the exporter's central bank). This is a common transaction in international finance and does not normally contravene the foreign exchange regulations of most countries. However, with the onset of financial difficulties, several Central American countries have modified their foreign exchange regulations which, under a strict interpretation, could now force prompt repatriation of all foreign exchange earnings and preclude BLADEX from collecting loan repayments directly from the foreign buyer prior to forwarding the balance to the respective central bank.

To determine what effect these new regulations might have on the proposed project, ROCAP and BLADEX visited each of the five CACM countries and raised this issue with officials at the central banks. In Honduras and Nicaragua, BLADEX already employs "compensating financing" in dealing with its clients and, therefore, the same mechanism being utilized by this project will not present a problem. In Costa Rica and Guatemala, senior central bank officials indicated that the procedures of this mechanism can be utilized in their countries. Due to unforseen circumstances, senior level officials were unavailable in El Salvador to discuss this issue.

Subsequent to the visits to each central bank, the ROCAP Mission Director met with the president of each central bank on July 10, 1982, at a meeting of the Central American Monetary Council in Guatemala. The proposed loan mechanism was explained in detail and the question raised as to whether it would be possible to utilize the mechanism given the respective foreign exchange regulations of each country. The answer in each case was that it would .

e. The Revolving Fund

A major feature of the project is that it will create a revolving fund from which loans will be made long after the project terminates. Three factors will contribute to the development of the fund:

1) All loans must be repaid in hard currency, thus avoiding the non-convertibility problem associated with the Central American currencies;

2) In accordance with BLADEX policy not to subsidize credits, all loans will be made at current market rates (i.e., the cost of funds to BLADEX plus a spread to cover risk, overhead, etc.), thereby assuring that decapitalization of the initial AID loan does not occur. For Central America, the rate applied by BLADEX at this time is LIBOR plus a spread of 2%; and

3) The spread between the interest on the AID loan and the market rates charged to BLADEX clients will be channeled into the revolving fund, thereby serving as a principal source for its continued capitalization. BLADEX will not earn a profit from its participation in the project; rather, after setting aside funds for possible losses and administrative costs, the remainder of the income generated by the interest spread will go to the revolving fund. The Financial Analysis in Section III.C calculates the expected growth of the revolving fund.

f. Co-Financing Arrangements

As previously noted, the lack of credit from traditional foreign sources has been a major factor contributing to the recent declines in manufacturing production in Central America. While the reasons causing the foreign commercial banks to reduce their exposure in the region are understandable, it is also clear that support from those sources must return if the private non-traditional export sector is to fill its role in the long-term development of Central America.

In order to draw sources of credit back into the region, an important function of the project is for BLADEX to demonstrate that there are viable, bankable export opportunities which can be exploited even under the existing conditions in the region. As part of this effort, BLADEX will generate co-financing at a ratio of 2:1 of the AID loan, but will do so cautiously and in such a way that participation of foreign commercial banks will be continually encouraged.

A number of potential methods for achieving the required co-financing exist and will be employed by BLADEX. These include, but are not limited to: usance letters of credit, allocation of additional assets to Central America, and the receipt of additional funding from other banks.

Since these methods involve the continual movement and rollover of funds, BLADEX's exposure in the region will likewise be in a constant state of flux. For example, as short-term credits mature, BLADEX's exposure will fall but then rise as new credits are extended. The immediate result is that BLADEX's compliance with the 2:1 co-financing requirement will not be a static concept that can be accurately measured at a pre-determined point in time. Rather, to give BLADEX the flexibility to utilize these methods in a prudent fashion in meeting the co-financing objective, the flow of additional resources generated will be examined over a six-month cycle. During this period, the amount of co-financing will, at times, exceed the 2:1 requirement and, at others, fall short. On average, however, the flow of resources will satisfy the requirement. A program will be developed for the BLADEX accounting system that will permit the tracking and measuring of this flow.

4. End of Project Status

The proposed project is designed to respond to the immediate needs of the non-traditional export sector created, at least in part, by the current economic crisis in Central America. Demand for the financing the project will provide is high and, as the mechanism already exists for moving funds, disbursement is expected to be rapid. For this reason only a two year life of project is planned.

The principal output of the project will be the establishment of a revolving fund which will be capitalized by the loan and replenished through the hard currency repayments. Since most of the lending from the fund will be for short-term purposes, reflows will begin within six months after the first loan is made. By the time the five year grace period on the AID loan ends in 1987, the fund is projected to grow from the $25 million initial capitalization to as much as $ 50 million. When the AID loan is fully repaid, the fund is projected to have a balance of $ 69 million.

An important feature of the project is the requirement for co-financing at a ratio of 2:1 to the AID loan. As a result of the experience from providing co-financing private commercial banks are expected to reassess their current positions regarding lending in the region and gradually begin to increase their exposure.

The project will also have a significant impact on employment in Central America. It is estimated that 22,000 jobs, representing 4% of the industrial labor force, will result from the increased production made possible with loan funds.

Finally, with the funds provided by the project, the financial support will exist for the region to begin moving away from an import substitution development strategy toward one based more on the exportation of non-traditional commodities. One sign of this change taking place will be non-traditional exports accounting for a growing percentage of total exports from the region.

III. Project Analyses

A. Accumulated Unsatisfied Demand

As part of the intensive review, the Mission has undertaken two types of demand analyses: an estimation of the current unsatisfied demand for foreign exchange to finance needed imports for export production, and an estimation of the 1982 import requirements of the manufacturing sector. The economic analysis, below, covers the latter analysis, while this section examines the former.

During their visits to the various central banks to discuss the lending mechanism of the project and its relationship to foreign exchange control regulations, ROCAP and BLADEX personnel also discussed the question of unsatisfied demand for foreign exchange to finance imports with central bank and local commercial bank officials.

Although no hard data were available on this specific question, information was available on the total backlog of foreign exchange requests at the respective central banks. While these data included requests for foreign exchange for a variety of imports, and not just those needed by the export sector, banking officials used their experience with various types of import demand to arrive at the following estimates of current unsatisfied demand for raw material imports for manufacturing firms exporting outside of the CACM:

Costa Rica	$50 million
Nicaragua	$60 million
Honduras	$15 million
El Salvador	$50 million
Guatemala	$60 million
Total	$235 million

The figure for Honduras is significantly below the other countries because the import component of their extraregional export sector is low. The majority of Honduras' exports outside the CACM are wood products such as furniture and pre-cut lumber. For this reason, it is expected that while the Honduran demand for pre-export financing will be limited, the demand for post export financing will be much greater than that in the other countries.

B. Economic Analysis

This section consists of three parts: an estimation of the foreign exchange required by the private manufacturing sector--the dominant component of non-traditional exports--to import essential raw materials and intermediate goods, with special attention given to determining the magnitude of the requirement of the manufacturing sector that exports goods to outside the CACM; an analysis of the possible impact of the proposed project on net exports, GDP and employment; and an attempt to show that, according to available information, the increase in the region's exports of manufactured goods made possible by this project can be sold in extraregional markets, assuming that Central American manufacturing production remains price-competitive and that the private sector will pursue a successful drive to export non-traditional goods to new markets.

1. The Resource Gap

In the discussion of the macro-economic situation in Section II.A.1, above, the existence of a substantial balance of payments deficit for the region, equal to almost $800 million in 1982, was documented. While no projections have been made beyond that year, a significant improvement cannot be expected unless either the prices of coffee and cotton recover significantly from their present lows, or the state of violence is reduced to the point where foreign lines of credit can be reestablished and entrepreneurs decide that modernization and plant expansion can be undertaken without undue risk.

Table 5 develops estimates on the total 1982 import requirement of raw materials and intermediate goods of the Central American manufacturing sector, the value of this total expected to be imported from eligible supplier countries (AID Geographic Code 941), and also narrows this latter figure to identify the value of these imports required for the production of manufactured goods destined for export -- i.e., the demand which project resources will attempt to satisfy. The projections are based on 1978 data, the last year for which complete figures are available, using central bank projections and other factors to allow for price changes to arrive at 1982 figures. (The methodology used to arrive at these projections is outlined in detail in the footnotes of Table 5).

The analysis shows that, in 1982, the region's export manufacturing sector will require imports of raw materials and intermediate goods valued at $204 million to

TABLE 5

ESTIMATE OF TOTAL CENTRAL AMERICAN IMPORT REQUIREMENT FOR RAW MATERIALS AND INTERMEDIATE GOODS FOR THE MANUFACTURING SECTOR IN 1982 (In Millions of US dollars)

	(1)	(2)	(3)	(4)	(5)	(6)
	Total CA Imports of Raw Materials and Intermediate Goods		Raw Materials Intermediate Goods Imported from Eligible Suppliers		Estimated Value of Raw Material Imports Required for Extraregional Exports of Manufactured Goods in 1982	
	In 1978[1/]	Projected for 1982	In 1978[1/]	Projected[2/] for 1982	For All Extraregional Exports of Manufactured Goods	For Extraregional Exports of Manufactured Goods Using Raw Materials Originating in Eligible Countries
TOTAL CA	1681.9	2316.5	1260.0	1737.4	204.0	153.0
Guatemala	454.4	568.4[3/]	315.0	426.3[6/]	54.0 [7/]	40.4 [8/]
El Salvador	376.3	520.0[4/]	283.0	390.0[6/]	49.4 [7/]	37.1 [8/]
Honduras	237.4	328.0[4/]	190.0	246.0[6/]	15.0 [9/]	11.3 [10/]
Nicaragua	238.7	330.0[4/]	186.0	247.5[6/]	31.4 [7/]	23.6 [8/]
Costa Rica	375.1	570.1[5/]	286.0	427.6[6/]	54.2 [7/]	40.6 [8/]

1/Data for 1978 from SIECA (unpublished IBM printouts CUODE CODE 5). SIECA data shows that in 1978, about 75% of raw material and intermediate products imports destined for the CA industrial sector came from elegible suppliers (i.e. Code 941 countries).

2/75% of the amount in Column 2.

3/Unpublished projection by Bank of Guatemala.

4/1978 data were projected to increase in accordance with the following rates of increase suggested by the Consejo Monetario Centroamericano to adjust for inflation: 1979 1.06; 1980 1.16; 1981 1.06; 1982 1.06

5/The value of raw material imports for industry and mining was projected at $570.1 million for 1980 by the Central Bank of Costa Rica ("Principales Estadísticas sobre las Transacciones de Costa Rica con el Extranjero, 1955-80, Table IV-1, P. 31). No further increase was allowed for 1982 as this import projection is already on the high side.

6/Calculated at 75% of figures in Col. (2).

7/Calculated at of the figures in Column 2. The ratio of total extraregional exports of CA manufactured goods to the total gross value of CA manufacturing production in 1978 was 9.5%. Source: SIECA, Series Estadísticas Seleccionadas ... 1980 pp. 91-6 and Compendio Estadístico 1981, p. 275, 353.

8/Calculated at 9.5% of the figures in Column 4. See footnote 7 for explanation of the 9.5% assumption.

9/A survey revealed that the imported component of extraregional manufactured exports in Honduras was significantly less than that for all manufacturing, i.e., less than 9.5% of Column 2. Our figure of $15 million is based on conversations with Central Bank and commercial bank officials in Honduras.

10/See footnote 8. We have taken 75% of $15 m. in Column 5.

meet its production needs (Column 5 of Table 5). Of this amount, $153 million will originate in eligible supplier countries and, therefore, will be eligible for financing under the project. As shown in Table 6, below, this demand will increase to $258.4 million by 1986.

2. Impact of the Project

a. On Meeting the Need for Imported Inputs for the Export Manufacturing Sector

With the level of demand estimated through 1986, the analysis calculates the amount of foreign exchange that will become available for lending each year over the same period as a result of the proposed project. The total amount of raw materials and intermediate goods that can be purchased with these credits is also estimated. Columns 1, 2 and 3 in Table 6 show the cumulative amounts that will become available to Central America through BLADEX as a result of this project, assuming that (a) $10 million will be disbursed by AID in the latter part of 1982, and another $15 million in the early part of CY 1983; (b) that co-financing will be provided in a 2:1 ratio to the AID loan; (c) that this whole amount will be additive (i.e., over and above the financing that would otherwise have been available to the region); and (d) that BLADEX funds will have an average annual turnover of two.

The total amount of raw materials and intermediate goods that can be purchased by Central American exporters with these credits is shown in Column 4. These purchases are significantly larger than the cumulative AID disbursements and commercial bank loans shown in Column 3 because loans made to exporters will have maturities shorter than one year, typically three to six months. (This analysis assumes that the average length of a loan will be six months, though in practice it will be shorter). Since the first $10 million will be disbursed in the latter part of 1982, a turnover was not assumed for that year. However, in 1983, the $10 million disbursed to BLADEX in 1982 plus the $20 million in co-financing will be turned over twice, while the second $15 million AID tranche disbursed to BLADEX in early 1983 along with the $30 million co-financing, will be used only once in that year. This will permit imports valued at $105 million. Beginning in 1984, the whole $75 million of BLADEX's funds derived from this project will turn over twice a year, and will provide some $150 million for the purchase of raw materials and intermediate goods for the region's export manufacturing sector.

TABLE 6

FINANCING PROVIDED BY PROPOSED PROJECT IN
RELATION TO PROJECTED REQUIREMENT
(in millions of dollars)

	(1) Amount Privided by AID 1/ (Cumulative)	(2) Co-Financing (Cumulative) 2/	(3) Total Financing, Cumulative (1) + (2)	(4) Total Amount of Raw Materials and Intermediate Goods that can be Purchased under Project 3/	(5) Total Amount of Raw Materials and Intermediate Goods to be Purchased in Eligible Countries to Meet Requirement of Extraregional Export Manufacturing Sector 4/	(6) Col. (5) as % of (6)
1982	10.0	20.0	30.0	30.0	153.0	19.6
1983	25.0	50.0	75.0	105.0	174.4	60.2
1984	25.0	50.0	75.0	150.0	198.8	75.5
1985	25.5	50.0	75.5	151.0	226.7	66.6
1986	26.8	50.0	76.8	153.6	258.4	59.4

1/ Assuming that AID will disburse $10.0 million to BLADEX in the Fall of 1982 and another $15.0 million in early 1983. The figures in Col. (1) were derived from the Financial Analysis in Section III.C, and take into account the difference between the interest rate earned by BLADEX (assumed to be 12% a year) and the 6% paid to AID, as well as allowance made to BLADEX for administrative expenses and the build-up of a reserve fund for bad debts.

2/ Assuming a 2:1 co-financing ratio by foreign commercial banks. No additional allowance for bad debts is required as the one made in Col. (1) is sufficient to cover BLADEX and commerical banks exposure and the AID contribution.

3/ Assuming the following loan turnover rates:

CY 1982	$30.0 million		once
CY 1983	For CY 1982	$30.0 million disbursement	twice
	For CY 1983	$45.0 million disbursement	once
	For CY 1984	and years following, the turnover for the amount in Col. (3) is assumed to be twice a year.	

4/ Figures for 1982 from Table 5 (Col. 6). This estimated requirement was then projected to increase at 14% annually to allow for inflation and increase in world demand for manufactured goods.

Project funding covers only a portion of the import needs of the export sector. The analysis in Table 6 also relates import capacity under BALDEX financing to the estimated import requirements for extra-regional manufactured exports. As shown in column 6 of Table 6, the portion of the region's total requirements for raw materials and intermediate goods to be imported from eligible countries that will be met by BLADEX funds will rise from about 20 percent in 1982 to 76 percent in 1984 and then decline to about 60 percent in 1986. To the extent that project funds are used for post-production export financing, or, in later years, for medium term loans for capital equipment, the proportion of estimated import requirements that can be financed by the project will be reduced.

This project is expected to complement bilateral programs of balance of payments assistance to the eligible countries. By providing financing for a substantial portion of the estimated import requirements of the export sector, the participating countries will have greater flexibility in allocating their export receipts and assistance from other donors to other critical balance of payments needs in accordance with each country's perceived priorities. It is reasonable to assume that, to the extent that financing the import requirements of the export sector is high on a country's priority list, financing for such needs as cannot be met with funds from this project will be provided from foreign exchange available to the country. Moreover, each country whose exporters receive financing under the project will benefit from the increased foreign exchange earnings generated by the net value added in the export sector. Thus, this project, in conjunction with bilateral balance of payments assistance, will significantly relax a major constraint on extra-regional exports, and contribute to easing balance of payments problems.

b. <u>On Net Exports</u>

Table 7 calculates the potential increase in exports that could be generated with the imports purchased with the credits provided under this project. A recent SIECA analysis has shown that approximately one dollar of imports of intermediate goods is required to produce four dollars in manufacturing production (gross value). To arrive at a more conservative economic impact estimate, a 1 to 3 ratio has been assumed, i.e., that $1 in raw materials and intermediate goods imported will generate $3 worth of manufactured goods. On the basis of this assumption, and allowing for lags between providing credit funds and the resulting increase in exports, the potential increase in gross exports is estimated to grow from zero in 1982, to $462 million in 1987.

These data refer to gross exports. To calculate net export earnings, the value of raw materials and

TABLE 7

POTENTIAL AMOUNT OF EXPORTS GENERATED BY PROJECT
(In millions of dollars)

	(1) Amount of Raw Materials and Intermediate Goods Purchased Under Project1/	(2) Potential Increase in Gross Exports2/ (Col. (1) x 3)	(3) Potential Increase in Net Exports3/ (.667% of Col. 2)
1982	30	--	--
1983	105	90	60
1984	150	315	210
1985	151	450	300
1986	154	453	302
1987	156	462	308

1/Figures in Column 1 are from Table 6, Col. 4.

2/It was assumed that the first $10 million AID disbursement effected in the latter part of 1982, along with the matching $20 million commercial bank contribution, would not result in any increase in exports until 1983. In that year, it would generate $90 million in gross exports. A multiplier effect (gross value of manufacturing products to raw material imports) of 3 to 1 is actually conservative since SIECA has determined that imported intermediate goods constitute, on the aggregate, only 23% of the gross value of manufacturing production (SIECA, Evolución de la Economía Centroamericana 1978-80, June 1981, Table 43), which implies a multiplier of 4.35 (one over .23). In 1984, it was assumed that about $150 million in raw materials and intermediate goods will be purchased on the basis of the $75 million in the revolving fund (composed of $25 million from AID and $50 million from the commercial banks) turning over twice a year. Assuming a time lag between loans and exports, the full impact of this loan on exports would not be felt until the following year.

3/Gross exports less imports of raw materials and intermediate goods.

intermediate goods that must be imported has been subtracted, with the result that additional net exports are expected to rise from $60 million in 1983 to over $300 million in 1987. Thus, even if less optimistic assumptions than those justified by the SIECA study are made, the project can be expected to generate a substantial increase in net exports.

The above analysis is predicated on the assumption that the shortage of financing for imports of intermediate goods represents the major obstacle to the expansion of Central American exports. Conversations with private sector and central bank representatives in the various countries confirm the fact that the shortage of import financing is currently perceived as the main obstacle to the fuller utilization of existing manufacturing capacity and, therefore, to the export of manufactured products. This is not to say, however, that other obstacles do not exist. Impediments cited by various individuals include unstable exchange rates (in the case of Costa Rica), the absence of suitable banking services to exporters (know-how in areas of markets and finance, collection of bills, timely opening letters of credit, etc.), high shipping rates and inadequate transportation. Obviously, these must also be addressed.

c. Impact on GDP

The impact of the proposed project on GDP will be significantly greater than its impact on net exports since the earnings of workers, suppliers, entrepreneurs, etc. generated in the process of producing the net exports will be spent on other goods and services, generating additional income. Two alternative approaches have been used to estimate the size of the income multiplier for Central America: (1) relating changes in autonomous expenditures (public and private investment, government consumption and net exports) to changes in GDP over the ten-year period 1970-1980; and (2) estimating the marginal propensity to import and save over this ten-year period (the income multiplier being the reciprocal of the sum of these marginal propensities). These two approaches yielded an income multiplier in the range of 1.9 to 2.3.

Using a multiplier of 2.0 for purposes of the present calculation, following disbursement of the full $25 million of the AID loan and the $50 million in co-financing, and allowing for time lags, the projected increase in net exports of $300 million (see Table 7, Column 3) will yield an estimated increase in GDP of $600 million annually beginning in

1985. In 1980, Central America's total GDP is estimated at \$21.1 billion in current dollars. The estimated annual increase in GDP in the target year, therefore, would be about 2.8% of the 1980 GDP:

$$\left(\frac{\$600 \text{ million}}{\$21{,}105 \text{ million}} = 2.8\%^{*} \right).$$

This significant income effect resulting from the AID loan is due to the various "multipliers" assumed in the analysis: (a) the 2 to 1 co-financing feature of the project; (b) the 2 to 1 impact on intermediate goods imports resulting from the fact that the average bank loan turns over twice annually on the average; (c) the assumption (based on the SIECA study) that foreign exchange provided to finance imports of intermediate goods will generate at least a three-fold increase in gross exports; and (d) an income multiplier effect of 2.0.

d. Impact on Employment

The employment picture in the CACM is blurred by the lack of reliable data, and is further complicated by the fact that the labor force in manufacturing is composed of formal and informal subsectors. The formal sector offers employment in modern factories of five or more workers and produces relatively high technology, high income goods. This sector contains about one-third of the total manufacturing labor force but produces 75% of value added by the manufacturing sector.1/ The informal sector is composed of self-employed artisans and factories of less than five workers

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* The ratio would, of course, be smaller if GDP increases in real terms between 1980 and 1985. No allowance need be made for inflation, however, since none was made in projecting exports (i.e., the analysis in real terms).

1/ The ratios are for manufacturing in Guatemala and it is assumed that they apply to C.A. See CNPE, El Sector Industrial de Guatemala 1976-80, Cuadros 11, 13, 16, 17.

producing low technology goods for low income markets. It is estimated that, in 1981, employment in the formal manufacturing sector was about 202,000 and about 404,000 in the informal for a total of approximately 606,000 in all manufacturing. This latter figure constitutes about 9% of the economically active population in the CACM.

The impact of an increase in extraregional manufactured exports on employment could be divided into three states or effects. The direct effect increases employment in the factories directly affected by the increase in demand. The indirect effect increases employment in the factories supplying inputs to the directly affected industries and could spill over into agriculture in the case of food processing, leather and wood products and into the service sector for such inputs as banking, insurance, transportation and the like. The third effect is an income effect that, through the multiplier, increases employment in all sectors of the economy as a result of the increase in incomes in manufacturing, the directly affected sector.

In Table 8 various possible employment effects of an increase in manufactured exports have been calculated including two possible scenarios for the direct and indirect labor effects on employment in manufacturing stemming from such an increase. The first scenario examines the employment effects in manufacturing in broadly defined terms, i.e., in both formal and informal sectors. The first step was to calculate productivity in the manufacturing industry by dividing total employment in industry into total value added by this sector in 1981. The resulting figure ($6,825) was then used to calculate the direct and indirect effect on the projected increase in gross manufactured exports.

In the second scenario, the employment effects were limited to the modern manufacturing sector alone by calculating productivity per employee in that sector and using the same ratio as that from above. By calculating value added in modern manufacturing and dividing this by the estimated employment in that sector, a productivity figure ($15,359) is obtained. Dividing this figure into the projected increase in exports yields the direct and indirect employment effect in the modern manufacturing sector.

Both methodologies make the questionable assumption of constant labor productivity through time, when in actuality, it will vary considerably from year to year as demand changes causing employers to be reluctant to hire or lay

TABLE 8

EMPLOYMENT IMPACT

	(1) Potential Increase in Net Exports (Millions)1/	(2) Net Increase Over Prior Year (Millions)2/	(3) Direct and Indirect Employment Effects (No. of Workers)3/	(4) Direct and Indirect Employment Effects (No. of Workers)4/	(5) Total Employment Effects (No. of Workers)5/	(6) Total Employment Effects (No. of Workers)6/
1983	90	90	4,879	2,168	9,758	4,336
1984	315	225	12,198	5,420	24,396	10,840
1985	450	135	7,319	3,252	14,6[illegible]	6,504
1986	453	3	163	72	326	144
1987	462	9	488	217	976	434
Cumulative Increase (1987 over 1982)		462	25,047	11,129	50,094	22,258

1/From Table 7, Column 2.
2/The increase in gross exports that occurs from any one year to the next.
3/Derived by multiplying the data in Column (2) by .37 (percentage of value added in value of final output) and dividing this product by $6,825. This latter figure is derived by dividing total value added in CA manufacturing in 1981 ($4,134 million) by total manufacturing employment (605,700).
4/Derived as in Column (4) except that a figure of $15,359 is used instead of $6,825. This new figure is VA per employee in modern manufacturing derived first by multiplying total valued added in manufacturing by .75, the estimated percentage in modern manufacturing, and dividing the product by employment in modern manufacturing (201,900).
5/Column (3) x 2.
6/Column (4) x 2.

off workers until they are convinced that the change is permanent. However, the assumption of a stable, or at least predictable, labor productivity is essential to the estimate of the employment impact of any investment project.

Columns (5) and (6) of Table 8 add the income effect to the direct and indirect effect.1/ If it is assumed that the employment multiplier is of roughly the same magnitude as the income multiplier (estimated at 2.0), the income effect would double the direct and indirect employment effects. Column (5) shows the total employment effect for manufacturing broadly defined and Column (6) is the total effect in manufacturing narrowly defined to include only the formal subsector.

With these two methods, the employment impact of the project can be estimated between 22,000 and 50,000 jobs, approximately 4% to 9% of the manufacturing labor force in 1981. There are two reasons for pointing to the low side of the range (22,000) as the most realistic estimate of the total employment effects of the project. First, inasmuch as the projected increase in exports amounts to only 4.5% of manufacturing output in 1981, a 4% increase in employment seems more reasonable than 9 percent. Second, the lower estimate -- i.e., the total additional employment generated in the modern manufacturing sector alone -- probably represents the maximum employment impact of the project since very little informal manufacturing is directed at the extraregional export market.

e. Conclusion

The preceding analysis suggests that the proposed project is likely to have a very substantial impact on net exports, GDP and employment. In part, this is due to the 2 to 1 co-financing on which the AID loan is conditioned; in part, to the fact that the shortage of foreign exchange is generally viewed as a major bottleneck to the expansion of the region's industrial exports; and in part, to the revolving

1/ The income effect must be added since the direct and indirect effects measure only the impact on manufacturing and on other industries providing inputs for the manufacturing sector. They do not include the secondary income effects resulting from the spending of the income received by the factors of production employed in manufacturing.

nature of the proposed fund, which will enable the region to purchase an amount of intermediate goods and generate an amount of exports equal to a substantial multiple of the initial resources provided for the fund.

This project addresses one major constraint to expanding extra-regional trade. The actual effects will depend on adeqaute external assistance and domestic will to address other constraints.

Finally, the economic impact figures projected in this analysis should be regarded as theoretical upper limits. To the extent that other bottlenecks are not addressed and act to hold down the growth of exports over 1983-87, the actual economic impact will be below the limits indicated here. Even so, the analysis suggests that the impact on exports, income and employment is likely to be very substantial.

3. Extraregional Market for Central American Manufactured Products

This section analyzes available data in order to make a judgment with respect to the ability of the extraregional market for manufactured products to absorb the increase in exports that this project is expected to generate.

The historical trend in Central American exports of non-traditional products,* consisting mostly of manufactured goods, over the period 1970-80, is presented in Table 9. Over this period, the region's total exports of manufactured goods increased at an average annual rate of 16.8%, far in excess of the annual rate of inflation. The most rapid rate of expansion was experienced by Costa Rica (annual rate of 22%) followed by Guatemala (18%) and Honduras (16%). Nicaragua's weak performance (average rate of 7.4%) is due to the sharp decline experienced after 1978, which is attributable to the civil war and a set of policies discouraging private sector activity. During the pre-revolution period 1970-78, Nicaragua's exports of non-traditional products increased at an annual rate of 15%.

*To all countries, including Central America.

TABLE 9

EXPORTS OF NON-TRADITIONAL PRODUCTS*
(MOSTLY MANUFACTURING), 1970-80
(In millions of dollars)

	(1) Total CA Manufactured Products	(2) Col. (1) as % of Aggregate CA Exports %	(3) GUA.	(4) EL SALV.	(5) HOND.	(6) NIC.	(7) C.R.
1970	351.4	32.0	117.7	88.2	32.2	60.3	58.9
1973	517.8	31.1	164.6	134.6	33.3	84.9	100.4
1975	729.9	31.8	207.4	174.8	58.9	126.0	163.0
1977	1066.2	25.9	292.8	249.4	72.3	176.5	275.4
1978	1170.0	29.1	335.2	273.0	95.8	184.3	281.4
1979	1243.9	28.0	381.0	311.2	115.8	122.3	313.6
1980	1660.7	35.9	629.0	327.7	147.4	123.5	433.1
Average Annual Growth Rate%							
1970-89	16.8%		18.2%	14.0%	16.4%	7.4%	22.1%

*Products other than the following "basic products": fresh meat, shellfish, bananas, refined sugar, coffee (unhulled), cacao, tobacco, wood, raw cotton, non-ferrous metals, silver and platinum, plants, flowers and seeds. Comprises all exports of non-traditional products, including those destined to Central America.

Source: SIECA, Estadísticas Macroeconómicas de Centroamerica 1970-80, July 1981, Tables 19-24.

While detailed data showing the composition of exports of manufactured goods for the region as a whole are lacking, Table 10 shows the distribution of manufacturing exports for Costa Rica in 1980. Exports of manufactured goods are widely distributed over a number of categories. The most important by far is foodstuffs and beverages ($177 million) followed by chemical products ($97 million), metal manufactures, machinery and equipment ($82 million), and textiles, apparel and leather goods ($74 million).

These product categories should continue to sell well in the U.S. and other extra-regional markets, assuming that the region follows sound monetary-fiscal and exchange rate policies to assure the competitiveness of Central American products abroad; makes efforts to resolve transport, quality and design problems to continue the rapid penetration of foreign markets that have characterized Central American export performance during the 70s (Table 10); and that there is some reduction in the current level of violence and uncertainty. The Guatemala Export Promotion Agency (GUATEXPRO) was asked to project exports of non-traditional products to markets outside the non-CACM on two alternative assumptions: (a) that the principal obstacles (the shortage of raw material import financing and some other impediments[1/]) are removed; and (b) that these obstacles remain. GUATEXPRO projected increases in non-traditional exports of 17.8% for 1982 and 21% for 1983 on the assumption that these obstacles are removed; and increases of only 4.8% in 1982 and 1.8% in 1983 if they are not. Another factor to consider is the projection of OECD imports from the LDCs of products in the category labelled "chemicals, manufactures and machinery." These are projected to increase from $90.0 million to $322.8 million over 1981-1990, indicating an average annual compound growth rate of 15.2%.[2/]

1/Including inadequate fumigation, cooling facilities and packing sheds at the airport for agricultural products, and improvements in port facilities on both coasts.

2/OECD projection provided by AID/W in STATE 141354.

TABLE 10

EXPORTS OF MANUFACTURING PRODUCTS BY COSTA RICA
(In millions of dollars)

	1980 1/		
	Rest of the World	Central America	Total
Manufacturing Industries, Total	257.246	260.659	517.905
Foodstuffs, beverages and tobbaco	151.591	25.610	177.201
Textiles, clothing and leather industry	18.311	55.666	73.977
Wood industry, wood products, including furniture	6.545	6.896	13.441
Paper products; output of printing establishments and publishing houses	3.485	16.005	19.490
Manufacture of chemical substances and chemical products derived from petroleum, coal, rubber and plastics	34.768	62.029	96.797
Manufacture of non-metallic minerals with the exception of those derived from petroleum and coal	1.400	7.569	8.969
Basic metal industries	1.739	4.078	5.817
Manufacture of metal products, machinery and equipment	29.047	52.883	81.930
Other manufacturing industries	10.360	29.923	40.283

1/ Preliminary

C. Financial Analysis

1. Project Resources

The AID loan to BLADEX will be $25.0 million, of which $10.0 million is planned for obligation in late FY 1982 and the balance in early FY 1983. The loan will be for 15 years, including a 5 year grace period. During the grace period the interest rate will be 6%. Following the grace period, the interest rate will increase to LIBOR but will be subject to renegotiation based on an assessment of the risk factor for lending in Central America at that time. BLADEX counterpart for the project will consist of the co-financing generated through the mechanisms discussed in Section II.B.3.c., above.

All of the loan funds will be used for foreign exchange requirements; any local currency needs will be supplied from the co-financing or from the borrowers' own resources.

2. Cash Flow Analysis

A cash flow analysis was performed to estimate the growth of the revolving fund generated as a result of the AID loan. Although the loan funds will be obligated over two fiscal years, the analysis is based on a calendar year and assumes that all AID funds will be available between September 1982 and September, 1983. In addition, the analysis assumes that:

a) The AID loan will be for 15 years at 6% during the 5 year grace period, with the interest rate going to LIBOR at the end of the grace period;

b) All funds will be for short-term loans (medium-term loans planned under the project are excluded from this analysis because the amounts and terms of those loans cannot be defined at this time);

c) Co-financing will be provided at a ratio of 2:1 to the outstanding balance of the AID loan principal throughout the 15 year life of the project;

d) Co-financing will be received through short-term loans which average one year and require that principal be repaid on quarterly basis;

e) 1% of the portfolio will be needed to pay for administrative costs;

f) Bad debt expenses will be 1% of the total portfolio; and

g) BLADEX will lend at current market rates which are defined as LIBOR plus a spread of 2%.

Using these assumptions, several projections were run and are summarized in Table 11 (see Annex H for the details). The only variable which is changed in these projections is the market interest rate--that is, the interest paid on co-financing recived--since the remaining variables have been fixed in accordance with proposed terms of the loan.

The portfolio represents the amount which will remain in the fund after all principal and interest on the loans have been repaid. The most conservative projection assumes that the lowest interest rate at which BLADEX will borrow is 9.% (i.e., LIBOR) and will lend at 11% (i.e., including a 2% spread for risk, overhead, etc.). This results in a portfolio of $ 36.0 million in year 15. Less conservative assumptions with higher interest rates result in correspondingly higher balances in the portfolio.

The fund will be able to grow during the first five years because the spread between the interest on the AID loan and the rate at wehich BLADEX will lend will be used to capitalize the fund. The co-financing will contribute little to the capitalization since it is assumed that the co-financing principal will be continually repaid. (The one quarter lag in the repaymemt will, however, make a small contribution.) It should also be noted that, since the initiation of repayments on the AID loan principal will correspond to the increase in the interest rate on the AID loan to LIBOR, the fund will actually experience several years of decapitalization since the spread on the AID funds (the previous source of additional capital) will be eliminated while new principal payments will reduce the existing capital base. Any decapitalization will, however, depend on how much the fund has grown during the five year grace period. For example, at the lowest interest rate, the decapitalization occurs until all principal and interest have been repaid because the fund did not achieve a size large enough to prevent the continued draw down on the capital base. At the higher rates, however, decapitalization is a relatively short-term effect because the size of the fund is sufficient to compensate for draw downs on the capital base.

TABLE 11

SUMMARY
CASH FLOW PROJECTIONS UNDER DIFFERENT ASSUMPTIONS
($ 000)

ASSUMPTIONS:	A	B	C	D
AID LOAN	25,000	25,000	25,000	25,000
CO-FINANCING	50,000	50,000	50,000	50,000
INT. RATE CHARGED - %	11	12	13	14
INT. PAID TO AID - %(5 yrs.)	6	6	6	6
INT. PAID TO CO-FIN - %	9	10	11	12
BAD DEBT EXPENSES	1	1	1	1
ADMIN. EXPENSE %	1	1	1	1
AID LOAN - YRS	15	15	15	15
CO-FINANCING LOANS - YRS	1	1	1	1
GRACE PERIOD - YRS	5	5	5	5
INT. PAID TO AID - %(10 yrs.)	9	10	11	12
RESULTS:				
PORTFOLIO AT END OF 5 YRS	44,620	46,280	47,984	49,733
PORTFOLIO AT END OF 10 YRS	39,430	44,011	48,999	54,415
PORTFOLIO AT END OF 15 YRS	35,930	45,411	56,291	68,791
PORTFOLIO AT END OF 20 YRS.	54,220	72,022	93,775	120,187

3. Financial Status of BLADEX

a. The Accounting System

The BLADEX accounting system has been computerized from the inception of the bank. A trial balance is run daily at the close of operations. Three desk model mini-computers are owned by the Bank and used for cash flow and other projections. Individual information on all member banks, including balance sheets, income statements and financial ratios is automated for instant recall. This information is updated monthly by the credit officers. Additionally, country profiles are kept in the automated data bank so that country risk analyses can be done. These risk analyses are based on 12 indicators, including balance of payments situation, amount of gold reserves, exports as percentage of GNP, exports as a per cent of net foreign debt, and gross revenues as compared to debt service. BLADEX completes almost all of its financial transactions electronically, an operation that is facilitated by on-line ticker tape communications to major world money markets.

The following analysis is based upon BLADEX's audited financial statements for the period ended December 31, 1981, and unaudited statements as of March 31, 1982. The CY 1981 information was reviewed and certified without exception by Touch Ross & Co. (Comparative financial statements for 1978 through 1981 are in Annex H .)

As in most banks, virtually all of BLADEX's income is derived from interest earned. BLADEX divides interest earning assets into three categories: interest earning deposits, short term loans and medium term loans. Furthermore, every effort is made to maintain a 40% 40% 20% balance in these three categories. The 40% representing interest earning deposits is kept in short-term deposits with large commercial banks earning prevailing interbank rates. This is a low risk activity for BLADEX. The second 40% represents short-term loans outstanding on which the average turnover has been 120 days. This is used for export financing where it generates foreign exchange at LIBOR plus a margin. Because foreign exchange is both the basis for its loans and repayments to the bank, any loss due to currency fluctuation is minimized. Finally, the remaining 20% is in medium-term loans which currently average 4.6 years.

In 1981 BLADEX maintained a reserve for possible losses equal to 0.625% of loans outstanding which, in the management's judgment, is sufficient to cover such eventualities. Through 1981, only one loss had been suffered (amounting to $200,000) while this account had a balance of $2.5 million. The Mission feels that this is conservative because they are lending to shareholder banks and not directly to the final borrower. In the proposed loan BLADEX will establish a reserve for possible losses equal to 10% of the AID portfolio outstanding in Central America. This will give them an added cushion to allow lending to a higher risk region.

b. Financial Performance

BLADEX obtains money from two main sources: (1) deposits placed with BLADEX by central and commercial banks and international organizations; and (2) from borrowed funds. Deposits placed with the bank totalled $424 million in 1981, which indicates a strong acceptance of BLADEX by the world banking community. Borrowed funds for the same year were $146 million. These are borrowed based on the LIBOR rate. Interest paid to depositors is also based on LIBOR.

Although the bank's earnings per share has risen from $47.75 to $153.17 since operations began, this has not been distributed. Rather, shareholders have voted that they be kept as retained earnings. In fact, from inception the bank has funnelled all its earnings into operating funds, thereby increasing its portfolio and contributing significantly to its rapid growth. During the April, 1982, shareholders meeting, a stock dividend was declared for the first time. This stock dividend insured that retained earnings would be maintained as a part of the Bank's tangible net worth.

In slightly more than two-and-one-half years BLADEX reached the billion dollar plateau in amount of exports fi- nanced and required only nine additional months to reach the two billion dollar mark. During 1981, BLADEX extended $606 million in advances and other short term loans (representing 68% of total loans made), $97 million was for medium-term loans (11%) and $188 million was for acceptances (21%). Disbursements for single loans during the year ranged in size from $1,282 to $18 million.

For banks, leverage is used as a measure to indicate how much of their total assets is covered by capital. In the case of BLADEX, this ratio is currently a conservative 14:1. With more experience and a proven track record, it is planned to increase the ratio to 20:1. Due to the composition of the BLADEX portfolio, i.e., 40% is in virtually risk free deposits and 40% is in relatively problem free short-term export financing, a leverage ratio of 30:1 would be acceptable. However, leverage is not solely an internal policy, but is subject to market pressures. A well accepted rule of thumb, therefore, is the 20:1 ratio BLADEX plans to achieve. Notwithstanding, the nature of BLADEX's asset mix should make it possible to realize a 25:1 ratio without encountering much market resistance. Up to that point, BLADEX will be on the conservative side and should not face any difficulties in obtaining deposits. The fact that BLADEX surpassed its five-year projections (prepared before operations began in 1978) by obtaining more than $420 million in deposits in three years of operation is an indication of the banking community's confidence in BLADEX's management.

4. Conclusion

In a period of less than four years, BLADEX has developed into an important regional bank which, within the limits it has set for itself, is very effective in meeting the needs of its clients. Although it has experienced a rather phenomenal growth, the above analysis demonstrates that BLADEX is, in fact, pursuing a fairly conservative course in its initial years.

BLADEX has been able to grow rapidly yet in a controlled fashion because (1) a high demand exists for its funds while exposing the Bank to little risk, (2) the short-term nature of most of its loans results in quick turnover and re-investment of its resources, and (3) shareholder banks have expressed continued confidence in the Bank.

Based on this analysis, the Mission has concluded that no financial constraints exist which would affect BLADEX's ability to implement this project.

D. Institutional Analysis

This section examines all aspects of the development of BLADEX with the exception of its financial growth which is reviewed immediately above.

1. Background

BLADEX began to take shape in 1977 with the development of it Articles of Incorporation and By-Laws which guide the Bank's operations. The original charter was signed on September 18, 1977 in Cartagena, Colombia by 24 individuals representing 25 banks from 19 countries in Latin America. The principal objective of BLADEX is to promote Latin American exports, particularly non-traditional goods and services, by providing pre- and post-export financing in the form of short-term advances, banker's acceptances and medium-term loans.

BLADEX was formally incorporated in Panama in 1978 withn authorized share capital of $99.0 million (representing 99,000 shares). By late 1978, an initial capital inscription of approximately $25.0 million had been paid, which permitted the Bank to commence operations in January, 1979. A total of 193 banks participated in this initial inscription. The central banks or their designees from 20 Latin American and Caribbean countries each contributed $200,000 for $4.0 million in equity, 172 private commercial banks from Latin America, the United States, Europe, Asia and the Middle East contributed approximately $18.5 million, and the International Finance Corporation (IFC) contributed $2.5 million to become the largest individual shareholder. In 1981, the authorized share capital was increased to $110.0 million and, as of April 30, 1982, the number of shareholder banks had increased to 232 raising paid in capital to a total of approximately $34.0 million. (See Table 12).

Income in the Bank's first year of operation was $1.5 million, with assets of $192.6 million. By the end of 1981, the net annual income had grown to $5.2 million and assets to $691.1 million.

2. Shareholders

When the Bank was created, three classes of shareholders were established: Class A, comprised of central banks and state-owned banks designated to be in this class; Class B, consisting of public and private banks or financial institutions with a majority of their capital from Latin America; and Class C, comprised of international commercial banks. At the 1981 shareholders meeting, a Class D shareholder was established for international organizations. Currently, the IFC is the only shareholder in this class (previously, it was a Class B shareholder).

TABLE 12
BANCO LATINOAMERICANO DE EXPORTACIONES
(BLADEX)
As of March 31, 1982

	No. of Shareholders				Amount ($ '000)				Total Amount	Percentage Ownership of Total
	A	B	C	D	A	B	C	D		
Argentina	1	54	1	-	1,172	1,055	700	-	2,927	8.62
Bolivia	1	5	-	-	670	326	-	-	996	2.93
Brasil	1	15	-	-	1,172	491	-	-	1,663	4.90
Chile	1	11	-	-	1,172	498	-	-	1,670	4.92
Colombia	1	5	-	-	538	551	-	-	1,089	3.21
Costa Rica	1	1	-	-	291	10	-	-	301	0.89
Ecuador	1	6	-	-	1,172	686	-	-	1,858	5.47
El Salvador	1	4	-	-	509	88	-	-	597	1.76
Guatemala	1	8	-	-	509	100	-	-	609	1.79
Haití	1	1	-	-	291	100	-	-	391	1.15
Honduras	1	11	-	-	291	368	-	-	659	1.94
Jamaica	1	4	-	-	291	100	-	-	391	1.15
México	1	8	-	-	509	138	-	-	647	1.91
Nicaragua	1	1	-	-	291	8	-	-	299	0.88
Panamá	1	18	-	-	525	581	-	-	1,106	3.26
Paraguay	1	2	-	-	1,172	175	-	-	1,347	3.96
Perú	1	13	-	-	1,172	1,930	-	-	3,102	9.13
Rep. Dominicana	1	4	-	-	350	291	-	-	641	1.89
Uruguay	1	4	-	-	509	569	-	-	1,078	3.17
Venezuela	1	10	-	-	670	860	-	-	1,530	4.51
Canada	-	-	2	-	-	-	800	-	800	2.36
Germany	-	-	1	-	-	-	400	-	400	1.18
India	-	-	1	-	-	-	200	-	200	0.59
Italy	-	-	1	-	-	-	200	-	200	0.59
Japan	-	-	4	-	-	-	1,600	-	1,600	4.71
Korea	-	-	1	-	-	-	400	-	400	1.18
Nederlands	-	-	1	-	-	-	400	-	400	1.18
Spain	-	-	4	-	-	-	1,150	-	1,150	3.39
Switzerland	-	-	2	-	-	-	600	-	600	1.77
United Kingdom	-	-	1	-	-	-	400	-	400	1.18
United States	-	-	6	-	-	-	2,000	-	2,000	5.89
ARLABANK	-	-	1	-	-	-	400	-	400	1.18
IFC	-	-	-	1	-	-	-	2,500	2,500	7.36
Total	20	185	26	1	13,276	8,925	9,250	2,500	33,951	100.00

The shareholders meet annually and are responsible for electing the Board of Directors. The Board has ten members (three each from classes A, B and C, and one from Class D) with each member being elected to a two-year term by the shareholders of their respective class. The Board meets quarterly with BLADEX management and provides guidance on a wide range of policy issues. An important function of the Board is to elect the Executive Vice President of BLADEX who is the legal representative of the Bank as well as the Chief Executive Officer in charge of day to day operations.

Annex G, contains the Articles of Incorporation and By-Laws of BLADEX and details the specific responsibilities of the shareholders, the Board of Directors and the Executive Vice President.

3. Structure, Management and Staff
Figure 1, shows how BLADEX is currently organized.

Under the Executive Vice-President are three functional departments: Assets, Liabilities and Administrative. Each Department is headed by a Senior Vice-President. The Assets Department is responsible for managing credits to clients, for syndications and for medium-term loans. The Liabilities Department handles deposits, floating rate notes, Lines of Credit and acceptance financing. The Administrative Department performs computing, personnel and accounting functions.

In order to manage the rapid growth of the Bank, its staff has almost tripled since operations began in 1979 (from 33 to 87 as of April, 1982). Future growth on the size of the staff commensurate with the growth of the Bank is planned.

Approximately half of the staff (43) have a university-level degree, and slightly more than half (45) are women. BLADEX places a high priority on training its personnel at all levels of responsibility. This priority is demonstrated by the relatively low level of turnover experienced thus far. Also, 60% of the professional staff is 30 years old or younger.

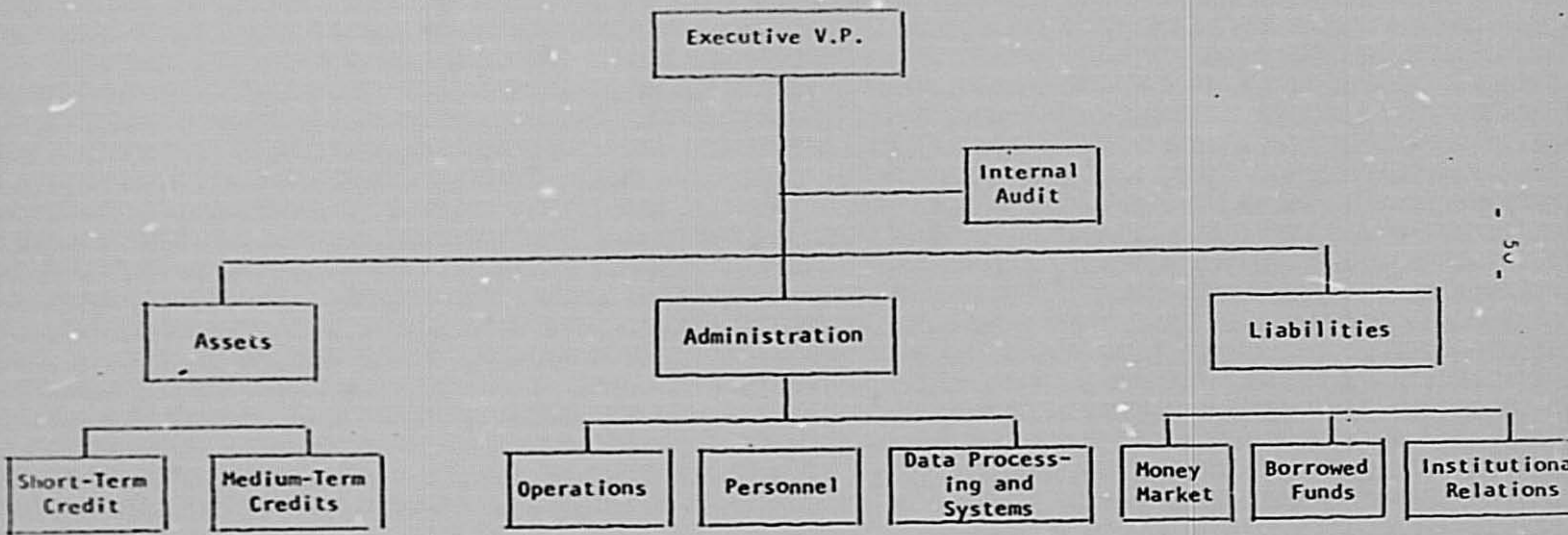
Annex G, provides additional detail on the composition of the BLADEX staff and how it is divided among the functional departments.

4. Lending Regulations and Procedures

As a relatively new institution, BLADEX has been able to design its operations around the capabilities of advanced

FIGURE 1

BLADEX ORGANIZATION CHART



automated data systems. The Bank has recently installed an IBM System 38 which maintains all of its records, including up to date listings on its portfolio balance, in easily and readily available automated form. The staff includes a senior computer expert as well as programmers who manage the system and assist other staff members with specific requests.

In accordance with its statutes, BLADEX may lend only to its shareholder banks in Classes A and B. Further, before lending to any bank, the respective country must have a Class A shareholder. This regulation limits the banks which may borrow from BLADEX to those that are Latin American.

In its lending operations, a primary concern is the promotion of exports from the region and, during 1981, approximately 73% of the goods financed by BLADEX were destined for non-Latin American markets. The primary market was North America (40%), with Europe (26%) and Africa and Asia (7%) accounting for the rest. For transactions financed in Central America, the same percentage of goods exported outside the region also holds true.

As noted above, the Assets Department manages the granting of credits to client banks. Nine officers from the Department constantly travel to these banks to review loan applications and to update the detailed analysis BLADEX maintains on their financial status. Using this information, the credit officers are able to recommend appropriate action to the Senior Vice President for Assets.

5. Conclusions

Although it has been in operation for just three and a half years, BLADEX is performing well. Its rapid financial growth has been managed effectively and has been matched by an appropriate increase in the Bank's staff.

The professional staff is young but very well qualified, and the emphasis placed on training has been rewarded by a dedicated staff which has responded to the challenge created by the growth of the bank. The availability and use of an advanced automated data system has also greatly facilitated the work of the Bank.

In summary, after reviewing all available information, the Mission concurs with the finding of the IFC in its most recent Supervision Report of BLADEX: It ..."is sound, well managed and moving in the right direction in terms of achieving its broad objectives." (p. 4, Annual Supervision Report of the BLADEX Portfolio Review Committee, April 30, 1982).

E. Social Analysis

A traditional social analysis examines the design of the proposed project with respect to the social and cultural characteristics of the target group to determine whether these present any constraints which would affect implementation and achievement of project objectives. For this project, however, a traditional analysis has not been undertaken for two reasons: first, the project deals most directly with commercial banks and the industrial sector through well established procedures and, second, the proposed design does not include any new features which would affect the relationship between the industrial sector and labor force which depends on it. Instead, this discussion briefly reviews the general social environment in which the project is set and the benefits which will accrue to the industrial labor force.

With the development of the industrial sector spurred by the CACM, the demand for labor (primarily unskilled) contributed to the steady stream of migrants looking for work in the urban centers. In addition, as the disruption of daily life in rural areas caused by the unstable political situation has intensified over the past few years, the perception that work could be found convinced many people to leave the rural areas in search of a better life. What they have found, however, is that employment opportunities, even for unskilled labor, have become scarce and, in many cases, are disappearing altogether as plant owners decide to scale back or cease operations in response to the contracting market, the shortage of credit for working capital and the general uncertainty about the future.

The growing level of unemployment is a major cause of concern throughout the region. In this period of political instability, high levels of unemployment can create a fertile ground for extremist groups to exploit in recruiting participants for their activities. If unattended, this situation will serve to deepen the strife which characterizes much of the region.

The proposed project, therefore, is particularly well suited to respond to this situation because by providing resources that the private industrial sector needs for production purposes, it will also have a significant employment impact. As estimated in the economic analysis, at least 22,000 jobs, representing approximately 4% of the existing labor force, could be affected by the project. Section III.B.2.d, above, contains a detailed discussion on this impact, including the income benefits which are expected as a result of the increased employment.

Based on the importance and magnitude of the employment and income benefits that will accrue to the industrial labor force and the fact that no new features are introduced, the Project Committee has concluded that the proposed project is socially sound.

IV. IMPLEMENTATION ARRANGEMENTS

A. Project Management

1. Role of BLADEX

a. Management Procedures

BLADEX, through the Senior Vice-President of the Liabilities Division, will have overall responsibility for project implementation and for keeping ROCAP advised on all matters related to the loan. The Senior Vice-President for Liabilities will also inform the BLADEX Executive Committee (consisting of the Executive Vice-President and the other two Senior Vice-Presidents) on the progress of the loan.

The Executive Vice-President of BLADEX will be responsible for advising the Board of Directors on the status of the project. The Board of Directors, however, will not have any direct role in project management since all necessary authority, including approval of any loan request, has already been delegated to the Executive Vice-President.

No major variation from the current analysis BLADEX conducts as part of its normal operations will be required. Existing staff is sufficient to meet all demands which may arise in implementing the project.

b. Project Implementation

Credit officers in the Assets Division will be responsible for reviewing all loan requests. They will examine the criteria established for this loan along with the normal factors BLADEX reviews when a loan application is received (e.g., country risk analysis, composition of the shareholder bank's portfolio, and the implications of the added liability on the bank's financial position). Based on their analysis, the credit officers will recommend either approval or rejection to the Senior Vice President of the Assets Division who will then advise the Executive Committee on the appropriate course of action to follow.

At the outset of the project, BLADEX will advise ROCAP of its estimated requirements for a 60 day period and that amount will be advanced and deposited in an account in a major U.S. bank identified by BLADEX. As funds are disbursed from the account, BLADEX will advise ROCAP and request that the account be replenished.

When a loan request is approved, BLADEX will notify the shareholder bank of the decision and initiate the preparation of appropriate loan documentation. At the same time, BLADEX will arrange for the transfer of funds needed to finance the approved activity. Most of these steps will occur almost simultaneously because the communication between banks is handled electronically.

Following disbursement of funds, it will be the shareholder banks' responsibility to provide BLADEX with all the documentation to show that project funds have been utilized in accordance with agreed upon terms. BLADEX will not have any direct relationship with the final borrowers. A similar procedure is currently applied for all of BLADEX's lending activities with its client banks.

As part of the normally scheduled visits to the client banks, the credit officers will review project status with appropriate bank officials and, in this way, will identify any problems which may arise and call them to the attention of the Executive Committee.

2. Role of ROCAP

ROCAP's Program and Project Development Office will have overall management responsibility for the project. Specifically, the project manager assigned to that office will monitor all loan activities, maintain regular communication with BLADEX on project status, assure compliance with the Loan Agreement, participate in project evaluations, and report to AID/W on a continuing basis.

An implementation committee has been established to assist the project manager on addressing and resolving any issues that may arise. Fiscal control of loan funds will be the responsibility of the ROCAP Controller.

ROCAP will not exercise prior approval rights on loans being contemplated by BLADEX. The project manager, however, will visit BLADEX offices on a regular basis and, as feasible, will visit participating banks in conjunction with visits planned by BLADEX's credit officers to assure that funds are used in accordance with the Loan Agreement.

In addition to quarterly reports on loan approvals, commitments, disbursements and the uses of AID funds, BLADEX will be required to submit an annual audited financial statement and an annual audit prepared by an independent CPA firm acceptable to ROCAP.

B. Implementation Plan

The proposed project has been designed to address the critical problem of the scarcity of foreign exchange needed for essential imports. BLADEX already has installed a mechanism which is capable of delivering resources quickly and efficiently and, therefore, the project will not lose any time in establishing a framework within which to address the present crisis. Eligibility criteria have been purposefully kept at a minimum to permit maximum flexibility. As a result, it is expected that once the Loan Agreement is signed and the Conditions Precedent satisfied (which BLADEX should do in a short period of time) loan applications will be reviewed and first disbursements made without delay.

The project includes no major activities that must be planned for a specific time in order to assure smooth implementation. Once the CPs are satisfied, the principal activity will be to monitor loan requests, approvals and disbursements. Table 15 contains the schedule of the principal project events.

Table 15
Implementation Timetable

1. Project Authorization Received	September 1982
2. Loan Agreement Signed	September 1982
3. Conditions Precedent Satisfied	October 1982
4. Initial Disbursement	October 1982
5. FY 83 Funds Obligated	December 1982
6. Review of Co-financing Levels	March 1983
7. Project Evaluation	October 1983
8. PACD	September 1984

C. Evaluation Plan

Given the demonstrated demand for resources such as those to be provided by this project and the existence of a functioning mechanism capable of delivering them to the target group, the loan is expected to be disbursed in a very short period of time. As a result, only one evaluation is planned over the life of the project.

This evaluation will focus on the objective of the project to assist in increasing non-traditional exports to areas outside of the CACM and will assess the extent to which loan funds have helped participating enterprises expand their export production. The longer term impact expected from the project, such as increased GDP and employment, are not expected to be fully evident during the life of the project; nonetheless, the evaluation will be able to gain some insight as to the initial short-term impact in these areas.

BLADEX and ROCAP staff with assistance from outside consultants will carry out the evaluation. The Logical Framework (See Annex F) will be the general basis used for measuring project progress in achieving goal and purpose targets.

D. Disbursement Procedures

ROCAP will make a dollar advance to the revolving fund, the balance of which will equal BLADEX's projected sub-lending requirements for a 60 day period. ROCAP will replenish the advance upon submission of vouchers and supporting documentation (e.g., a copy of the notification to a client bank that funds have been transferred to its account) which evidence loan disbursements.

E. Procurement Procedures

In this project, BLADEX will function as an intermediate credit institution. Procurement procedures, therefore, will be in accordance with the policies set out in Chapter 19 of Handbook 1, Supplement B. All project funds will be used to pay for the procurement of goods with dollars (foreign exchange). The source and origin of the goods procured will be in those countries included in Code 941 of the AID Geographic Code Book and the countries of Central America.

F. Conditions, Covenants, and Negotiating Status

1. Conditions Precedent to Disbursement

The project has been designed to draw upon an already existing mechanism within BLADEX for channeling funds to the target group. Project analysis has shown that this mechanism, which is essential to achieving the stated objectives, functions well and that no changes are needed to meet the requirements of the project.

Other than those Conditions Precedent which are standard prior to initial disbursement (i.e., designating official representatives and obtaining a legal opinion on the Bank's authority to enter into an agreement with AID), BLADEX will be required to attest that there has been no significant change in its financial situation since the time of its last certified audit statement.

2. Covenants

a. Funds made available under the loan shall be utilized for financing activities in those countries in Central America which are designated for participation in the Caribbean Basin Initiative.

b. Borrower will create a system for accounting for the AID funds separately, with all repayments of principal and interest (once an adequate reserve for losses is established and administrative costs are covered) to be used only for those purposes for which AID funds were originally made available.

c. Borrower will submit a quarterly status report to AID containing a breakdown of subloans, types of industries receiving assistance, commitments and disbursements, terms and conditions of financing, uses of BLADEX and AID funds, and other comments as appropriate.

d. BLADEX agrees to provide, during the disbursement period of the AID loan, co-financing for the project in an amount equal to twice the AID loan; that co-financing is defined as the outstanding balance of credit provided by it for the purpose of promoting exports from countries eligible to par tcipate in the project, minus the average for 1981 of the outstanding balance of such credits and exclusive of any credits provided from the AID loan or funds derived from the AID loan; and that BLADEX shall, during the entire term of the AID loan, maintain a level of co-financing such that the average amount of co-financing during any six month period is no less than twice the outstanding principal of the AID loan during that six month period.

e. BLADEX agrees that, prior to using project funds for medium term lending, it will submit, in form and substance satisfactory to AID, a description of the type of medium term lending proposed and the criteria established to appraise the subloan investment.

3. Negotiating Status

The proposed project has been developed in close coordination with BLADEX, whose staff has made significant contributions to the content of the project paper. No problems are foreseen in the negotiation of a loan agreement. ROCAP expects to sign the loan agreement shortly after receiving the project authorization.