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

ASSISTANT
ADMINISTRATOR

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EXECUTIVE SECRETARIAT
ACTION MEMORANDUM FOR THE ADMINISTRATOR

THRU : AA/PPC, Richard Derhan *R. Derhan*
FROM : AA/LAC, Victor M. Rivera *V. Rivera*
SUBJECT: PAAD Amendment: El Salvador Private Sector Support I
Program No. 519-0257

Action: Your approval is requested to authorize an increase in grant funding to the subject Program of \$65 million from the Section 531 Economic Support Fund appropriation. This tranche will bring the Life of Project funding for the Program to a new total of \$405 million.

Discussion: This Program was initially authorized on November 25, 1980, with a \$20 million ESF cash transfer to the Government of El Salvador (GOES). The original Grant Agreement and subsequent Amendments totalling \$320 million have provided essential balance of payments support to El Salvador. All Agreements have required that the GOES make available an equivalent amount of foreign exchange for the importation from the United States of raw materials and intermediate goods needed by the manufacturing, industrial, and business sectors.

Under the first Agreement, the GOES was required to provide the local currency equivalent of \$20 million in credit to the agrarian reform sector, and to establish a working capital credit fund for industry, also in an amount equivalent to \$20 million. The local currencies resulting from the \$120 million in increments obligated in FY 1982 and FY 1983 were programmed under an arrangement which passed them to the GOES for allocation to the private and public sectors of the economy. As part of this same arrangement, the Mission and the GOES established a series of budgetary and monetary targets for CY 1982 and CY 1983 in areas of priority interest to A.I.D. These included agrarian reform, employment generation, restoration of vital public services, humanitarian assistance and credit to the private sector. In FY 1984, local currency generations were again programmed for specific uses. In that year, the local currency equivalent of \$100 million was used to directly finance specific line items in the GOES budget in the areas of agrarian reform, employment generation, restoration of public services, humanitarian assistance and policy development.

In general, the ESF conditionality strategy in El Salvador in recent years has been to push for policy or program adjustments from the GOES aimed at supporting the social and economic

reforms promulgated in 1980, stabilizing the economy, and providing short-term assistance to victims of the civil conflict in that country.

The Mission is now requesting authorization to obligate \$55 million from the FY 1984 Supplemental appropriation to provide continued balance of payments support under the subject program.

In support of the request, the Mission has presented a transition strategy for FY 1985 which covers the use of both the FY 1984 Supplemental and FY 1985 funds. The strategy calls for a change in the focus of the Mission's program from one on stabilization and relief to one on longer term recovery, resettlement, reorientation of basic services, and political development. The basic assumptions behind the transition strategy are that the war will wind down and that the Duarte Administration will seek to expand basic social services.

The principal components of the ESF program strategy are as follows:

Economic Stabilization and Recovery. Stabilization has almost been achieved, with the downward trend in the Gross Domestic Product (GDP) arrested in 1983 and 2.0 percent real growth expected in 1984. Per capita GDP is expected to stabilize in 1985 or perhaps show growth, but this will require a GDP growth rate of at least 3.0 percent. The most important stabilization tasks will be to reduce the public sector fiscal deficit and to reduce the country's dependence on extraordinary levels of external balance of payments support.

Stabilization activities will include continued provision of foreign exchange to finance essential imports, and local currency to help finance the restoration of public services damaged by civil conflict, emergency job programs, and credit to the agricultural, industrial, and reform sectors, and the small business subsector. Building on these stabilization activities, the Mission will also help the GOES focus greater effort on longer term economic recovery. Special attention will be given to helping the GOES establish a recovery program which has the appropriate policies to stimulate the private sector while minimizing inflation; restores investment and production levels to pre-1979 levels; initiates an intensive, export-oriented agribusiness and assembly industry development effort; and expands small business activities.

Humanitarian Assistance. Programs which provide jobs and health care activities for the roughly 500,000 persons displaced by the war will continue.

New programs are being developed to resettle the displaced as the violence subsides, and upgrade marginal communities in which many displaced and other squatters have settled. With the local currency equivalent of the resources provided under the cash transfer, the Government of El Salvador will finance these efforts. In addition, the Mission is programming P.L. 48C Title II commodities and FY 84 supplemental Development Assistance funds to support its humanitarian assistance objectives.

Social Development. Local currencies will be used to complement other Mission-supported recovery and development activities in agriculture, health, education and family planning.

In the LAC Bureau's review of the Mission's revised ESF strategy and proposed use of the \$55 million of FY 1984 Supplemental funds, it was agreed that the FY 1984 Supplemental funds would be authorized in response to steps already agreed to by the GOES, namely that the GOES would: move 40% of total import and export transactions to the parallel market by March 31, 1985; unify the exchange rate by the end of December 1985; establish a high-level policy analysis group to study and propose solutions to the major economic issues that arise during the Government's development of a comprehensive economic program; and invite the IMF to come to El Salvador to initiate discussions on a standby agreement. A.I.D. would disburse the initial \$55 million in roughly equal tranches in December and March against this prior agreement rather than use conditions precedent as leverage. The Mission argues, and we agree, that this is a much more realistic and appropriate approach to the policy dialogue in El Salvador. The Mission through its support for the establishment of two policy development units within the GOES, one for dealing with macro-issues and the other to address questions on the agrarian reform, will work collaboratively with the GOES to achieve the necessary policy reforms.

Finally, the Mission has stated its plans to establish an ESF local currency trust fund which would be used to finance a portion of the costs associated with the operation of the Mission. The initial amount to be negotiated with the GOES will be the local currency equivalent of \$1.28 million.

The LAC Bureau concurs with the general approach laid out by the Mission, as it applies to FY 1984 Supplemental funds. We have asked the Mission to prepare a separate PAAD on the use of FY 1985 money. The PAAD will include a more detailed analysis

of the fiscal situation for 1985 and a specific strategy for dealing with the expected deficit. It will also specify procedures for use of the ESF Special Account called for under the FY 1985 Continuing Resolution. The FY 1985 PAAD will not be submitted until March or April, at which time we can assess progress in expanding the parallel market and establishment of policies needed to support economic recovery.

The Mission has indicated that the levels of imports from the United States at present are such that the current request for balance of payments assistance exceeds the values of those imports. This would require a broadening in the base for attribution or financing from the special ESF account, beginning with FY 1985 funds. The Mission has therefore proposed that the source and origin of eligible goods be expanded to include CBI-designated Central American Common Market countries (this would exclude Nicaragua), which should permit full usage of the ESF funds. We concur with the Mission's proposal and suggest that Panama be included with the CACM countries for eligibility purposes.

Recommendation: That you sign the attached PAAD Amendment authorizing an additional \$65 million in ESF grant funds for the Private Sector Support I Program and expanding the eligible source and origin countries for dollar use attribution to include the Central American Common Market countries, with the exception of Nicaragua, and Panama.

Attachment Tab A PAAD Amendment - \$65 million ESF

Clearances:

PPC/PDPR: EHullander *ESTH*

GC : HFry *HFry*

LAC/DR: LKlassen:MSDugan:(02770):12/07/84:ext.28126

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CLASSIFICATION:

AID-112-1	AGENCY FOR INTERNATIONAL DEVELOPMENT PROGRAM ASSISTANCE APPROVAL DOCUMENT	1. PAAD NO. 519-0267 519-K-607 2. COUNTRY El Salvador 3. CATEGORY Cash Transfer 4. DATE November 28, 1984 5. DVB CHANGE NO. 6. DVB INCREASE
7. TO: A/AID, M. Peter McPherson		TO BE TAKEN FROM: Economic Support Fund (ESF)
8. FROM: AA/LAC, Victor Rivera		
9. APPROVAL REQUESTED FOR COMMITMENT OF: \$ 65,000,000		10. APPROPRIATION - 72-114/51037 BPC:LES 485-35519-KG-31 (470-65-519-00-50-51)
11. TYPE FUNDING <input type="checkbox"/> LOAN <input checked="" type="checkbox"/> GRANT	12. LOCAL CURRENCY ARRANGEMENT <input type="checkbox"/> INFORMAL <input type="checkbox"/> FORMAL <input type="checkbox"/> NONE	13. ESTIMATED DELIVERY PERIOD FY 1985
14. TRANSACTION ELIGIBILITY DATE		
15. COMMODITIES FINANCED		

16. PERMITTED SOURCE U.S. only: Limited F.W.: \$65,000,000 Free World: Cash: \$65,000,000	17. ESTIMATED SOURCE U.S.: \$65,000,000 Industrialized Countries: Local: Other: CACM including Panama, excluding Nicaragua.
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18. SUMMARY DESCRIPTION

The purpose of this program is to assist the Government of El Salvador (GOES) to: (A) Stabilize and reactivate the economy; (B) Provide relief and resettlement to displaced individuals and squatters surrounding the major urban centers; (C) Rehabilitate and reorient basic social services; and (D) Build the basic institutions fundamental to the democratic process underway in El Salvador. The strategy is in transition from a focus on stabilization, relief, and agrarian reform to longer term recovery, resettlement, reorientation of basic services, and political development. The most important stabilization tasks will be the reduction of the public sector fiscal deficit and reduction of the dependence of the balance of payments on extraordinary levels of external compensatory financing. Upon the obligation of \$65 million, the GOES will agree to provide \$65 million in foreign exchange for the importation of raw materials, intermediate goods, spare parts, agricultural inputs, and capital goods from the United States and the Central American Common Market countries, excluding Nicaragua, and including Panama. The GOES will agree to provide \$65 million local currency equivalent for private sector credit, counterpart for USAID projects, and other priority public sector programs complementary to the USAID program in El Salvador. The local currency equivalent of \$1.28 million will be used to establish an ESF trust fund, which will finance a portion of the costs of operating the program from the USAID Mission in El Salvador.

19. CLEARANCES LAC/CEN: Paskin <i>[Signature]</i> 11/30/84 ARA/ECF: RBeckham <i>[Signature]</i> 12/4/84 FM: CChristensen <i>[Signature]</i> 12/10/84 GC/LAC: RMeindan <i>[Signature]</i> 11-30-84 GC: HFry <i>[Signature]</i> 11/6/84 AA/PPC: RDerham <i>[Signature]</i> LAC/DP: JOlson <i>[Signature]</i> LAC/DR: DJohnson <i>[Signature]</i>	20. ACTION <input checked="" type="checkbox"/> APPROVED <input type="checkbox"/> DISAPPROVED <i>[Signature]</i> 14 DEC 1984 AUTHORIZED SIGNATURE DATE
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CLASSIFICATION
11/30/84