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

EL SALVADOR

PROJECT PAPER

ECONOMIC STABILIZATION AND RECOVERY

AID/LAC/P-515

Project Number: 519-0356
Grant Number: 519-K-614

UNCLASSIFIED

CLASSIFICATION

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT (PAAD)

1. PAAD Number
519-K-614 519-0356

2. Country
EL SALVADOR

3. Category
CASH TRANSFER

4. Date
MAY 10, 1990

5. To
AA/LAC, James H. Michel

6. OYB Change Number
N/A

7. From
LAC/DR, Terrence J. Brown

8. OYB Increase
NONE
To be taken from:
ECONOMIC SUPPORT FUNDS (ESF)

9. Approval Requested for Commitment of
$97,960,000

10. Appropriation Budget Plan Code
LES090-35519 KG31;070-65-519-00-50-01

11. Type Funding
☐ Loan ☒ Grant

12. Local Currency Arrangement
☐ Informal ☒ Formal ☐ None

13. Estimated Delivery Period
FY 1990

14. Transaction Eligibility Date

15. Commodities Financed

16. Permitted Source		17. Estimated Source	
U.S. only		U.S.	
Limited F.W.		Industrialized Countries	
Free World		Local	
Cash	$97,960,000	Other	

18. Summary Description

The purpose of this program is to provide balance-of-payments assistance for economic stabilization and recovery in El Salvador during CY 1990. The program is based on the Government of El Salvador's (GOES) stabilization and adjustment program for 1990 which consists of a monetary program to reduce inflationary pressures and numerous adjustment measures in the fiscal, financial, trade and productive sectors.

Program funds will be deposited into a separate, non-commingled ESF account or accounts in the U.S. from which payments for eligible foreign exchange transactions will be made. Eligible transactions include the importation of raw materials, intermediate goods, spare parts, agricultural inputs, and capital goods from the U.S. and CACM countries for the productive private sector, as well as the importation of petroleum and its derivatives from A.I.D. Geographic Code 941 countries.

Upon disbursement of the dollars, an equivalent amount of local currency will be deposited by the GOES in a separate, non-interest bearing account in the Central Bank of El Salvador to be used for mutually agreed upon development purposes consistent with the Foreign Assistance Act, specifically Sections 103 through 106. Methods of implementation, financing and audit coverage have been provided in accordance with Payment Verification Policy Implementation Guidance.

19. Clearances		Date
LAC/DP:BSCHOUTEN	B.S.	5/11/90
GC/LAC:KHANSEN		5/10/90
ARA/ECP:DMARSHALL		5/10/90
PPC/EA:JLAPITTUS		5/10/90
M/PFM/A:RBONNAFFON		5/25/90
DAA/LAC:FSCHIECK		
SA/AA/LAC:MKEENAN-WOOD		

20. Action

☒ APPROVED ☐ DISAPPROVED

Authorized Signature: James H. Michel
Date: 5/29/90

Title: ASSISTANT ADMINISTRATOR, LAC

AID 1120-1 (5-82) CLASSIFICATION:

Approval of Methods of Financing

This PAAD complies with current Agency guidance on methods of financing and has provided for adequate audit coverage in accordance with the Payment Verification Policy Implementation Guidance.

E. Cecile Adams, Controller, LAC

V

USAID/EL SALVADOR
FY 1990 BALANCE OF PAYMENTS SUPPORT PROGRAM
PAAD

ATTACHMENTS

-1'

USAID/EL SALVADOR
1990 BALANCE OF PAYMENTS SUPPORT PROGRAM
PAAD

MARCH 1990

I. SUMMARY STATEMENT

This PAAD provides the rationale and framework for USAID/El Salvador's $98 million Balance of Payments Support Program for FY 1990. The Government of El Salvador (GOES) has made a firm commitment to continuing the stabilization and adjustment program initiated in 1989. Recent negotiations between the GOES and the Mission have resulted in an agreement on a set of adjustment and stabilization measures to be implemented during 1990. These measures will be the basis for the continuation of USG support for the GOES program.

Nascent democracy is now functioning in this small country, and a political and economic system formerly dominated by a small group of wealthy and powerful elites is taking solid steps toward becoming a more pluralistic society with broad-based participation. In 1989, for the first time since 1931, a freely elected government handed over power to another freely elected government from another political party.

In 1989, the GOES embarked upon a bold program of stabilization and adjustment. However, at the very time when the fruits of the adjustment measures taken last year were beginning to appear, conditions took a turn for the worse. In spite of a sharp increase in production from the disastrous 1988-89 harvest, the collapse of world coffee prices in June-July, 1989 robbed the GOES of the much hoped for rebound in coffee earnings. The November 1989 FMLN offensive weakened investor confidence and the political position of the Cristiani Administration. As a result of these unfavorable circumstances, as well as the prospect of $55 million less in USG balance of payments support in 1990, the GOES temporarily lost its resolve and the stabilization and reform effort faltered at the end of 1989.

It is crucial for the USG to continue to show support for the GOES in its endeavor to stabilize and adjust the Salvadoran economy. In its conversations with the GOES, the Mission has underscored the importance of consolidating the gains achieved last year and extending the reforms into 1990. The GOES is negotiating with the IMF for a standby arrangement in 1990. If the IMF program is successful, the door will be open for IBRD and IDB participation in late 1990 and 1991. USG economic assistance will be key to this process; the GOES will not be able to achieve its inflation and growth targets for 1990 without the $98 million in balance of payments (BOP) support and the approximately $35 million in PL-480 food aid programmed for FY 1990. These resources will also cushion the shock to the economy from the adjustment measures that must be continued into 1990.

II. BACKGROUND

A. Historical Overview of Economic Performance in El Salvador

From 1960 to 1978 El Salvador enjoyed a period of almost uninterrupted economic prosperity. During these two decades, real GDP increased at the average annual rate of 5.6%. Since the annual growth in population was considerably less than that of GDP, the country enjoyed real per capita GDP growth of 2.9% annually. Along with increased consumption of goods and services, some improvements were made in health, literacy, and other social indicators.

These achievements were chiefly due to a healthy world economy based on continued expansion in the industrialized countries. For a small open economy such as El Salvador, the external terms of trade--the ratio of export prices to import prices--have special importance. From 1960 to 1978, this ratio increased by 36%, meaning that the value of the country's exports was increasing relative to its imports, generating higher domestic incomes, domestic demand, investment and growth.

The development of the Central American Common Market (CACM) parallelled the improvement in the external terms of trade. When the member countries erected a common external tariff and abolished tariffs on trade among them, the demand for regionally traded manufactured goods rose sharply. Domestic and foreign investment in these new import substitution industries increased and as a result, the participation of the manufacturing sector in GDP in El Salvador grew from 14.5% in 1960 to 19% in 1978.

In 1978, the two decades of economic prosperity ground to a halt and the country entered a prolonged economic slump from which it has yet to fully recover. Real GDP fell by 22% between 1979 and 1983 and per capital GDP fell further, by 29% during the same period. The explanation for the deterioration in El Salvador's economy can be found in the domestic political conflict and the world recession that marked the beginning of the 1980s. The year 1979 marked the beginning of one of the most dramatic upheavals in the history of El Salvador. Political unrest and escalating violence during the late 1970s brought into power a reform government that was committed to reducing the power of the traditional elites and to a statist economic model. It implemented a sweeping agrarian reform and nationalized banking and coffee and sugar marketing. However, these reforms did not dampen the extremism of the left and rural insurgent groups became increasingly successful.

The economic effects of the political crisis were enormous. Between 1979 and 1983, over 500,000 persons were displaced from their homes and hundreds of thousands more migrated to other countries. Schools, health facilities and municipal centers were destroyed. Dams, power lines, water supplies, and railroads were attacked and damaged by the Farabundo Martí National Liberation Front (FMLN). Over the course of the first four years of fighting, every major bridge in the country was sabotaged. Foreign investors left and domestic businesses closed their doors. Massive capital flight took place. Between lost production and destroyed infrastructure, the cost ran to, perhaps, $2.6 billion in 1982 dollars.

The international economic environment complicated El Salvador's political difficulties. In 1981, the industrialized economies went into deep recession. The demand for El Salvador's extraregional nontraditional exports, which had grown steadily through the 1970s, fell by 30% in 1982. The international prices of the country's traditional exports, coffee, cotton and sugar, which had in large part fueled the expansion of the 1960s and 1970s, fell sharply. The increase in oil prices fueled international inflation in spite of the world recession. Consequently, the external terms of trade fell some 50% between 1979 and 1983. These conditions affected all the CACM trading partners roughly in the same proportion, so the level of regional trade fell sharply, exacerbating the downturn.

By 1981, recognizing the seriousness of the situation, the U.S. Government framed an economic assistance strategy for El Salvador that had two essential elements - balance of payments support and maintenance of essential social services. The balance of payments support program was designed to arrest the downward slide in output, employment, and incomes. The associated local currency program, as well as dollar funded activities, were directed to restore health, education, and public utilities to pre-conflict levels. In addition, substantial dollar and local currency resources were allocated to support GOES efforts to effect a more equitable distribution of wealth, primarily through redistribution of land. Finally, U.S. food aid, temporary job programs, assistance in resettling and job training enabled the GOES to substantially reduce the social shock of war displaced persons.

By 1984, El Salvador began to enjoy some relief from the economic and political crisis. With an improvement in the political and military situation, and an end to the world recession and large inflows of concessionary aid, the economy began a modest recovery, posting average annual real growth rates of about 1.5% from 1984 to 1988. However, these did not keep pace with the growth in population, in spite of emigration, and per capita GDP continued to fall.

Aside from the political conflict, a principal cause of El Salvador's failure to engineer an accelerated recovery from the economic crisis of 1979-1983 was the reluctance to change the economic policy framework to accommodate different conditions in the international and regional economic environment. The postponement of key economic adjustments, even though it seemed necessary in the troubled political landscape of El Salvador, created profound structural imbalances in the economy. Import prohibitions and restrictions to support the overvalued exchange rate complicated the trade regime and raised the effective cost of importing for the productive sectors of the economy. The inefficient parastatal monopolies in banking, coffee, and sugar caused substantial losses to the economy. An inefficient nationalized financial system was incapable of attracting adequate levels of financial savings or channeling credit to the productive investments. Finally, the country's fiscal deficit placed pressures on available financial resources.

The priorities of the late President Duarte's administration did not permit a far reaching economic adjustment program. Government attention was focused on winning the war while trying to implement political and social reforms, curb human rights abuses and establish democratic institutions. Given the nascent democracy and the precipitous decline in social services during the period 1978-1983, these were legitimate priorities at the time. It is important to remember the context and competing priorities. The GOES examined the tradeoff between economic policy reform and its social agenda, and decided that the fragile social fabric and nascent democracy were incompatible with economic reform.

The result of the tradeoff was a stagnant economy. By 1988, GDP and GDP per capita stood at 84% and 73%, respectively, of their 1978 levels. The Salvadoran labor market adjusted to a lower level of economic activity mainly through out migration and a fall in real wages. It has been estimated that since 1978, a million Salvadorans have emigrated to the U.S., Canada, and other locations to escape the political violence and adverse economic conditions. These migrants, in general, were younger and thus active members of the labor force.

Consistent and detailed wage data are not available in El Salvador, but it is known that between 1978 and 1982 nominal wages grew by about 10% annually while inflation ran at approximately 15%. This downward trend in real wages has probably continued since 1982. The slow growth in nominal wages has also been associated with a shift in the composition in output from formal to informal sector goods and services. As incomes, and hence demand for formal sector goods and services fell, there appears to have been an increase in the demand for informal sector goods and services.

Analyses of recent urban household surveys confirm this interpretation of labor market developments over the past decade. Open unemployment is not a serious problem in El Salvador; household surveys taken in 1985-1986 indicate that only 7-8% of the labor force is actively but unsuccessfully seeking work. Work, however, is often poorly paid. According to the results of the survey, median earnings among men measured 702 colones a month (then US$140); 13% of the men reported earnings of less than 479 colones (then US$96). Among women, half earned less than 479 colones (then US$96); almost a third earned less than 300 colones (then US$60). These statistics indicate that fully 35% of the employed labor force earns less than the minimum wage. It must be emphasized that these results refer only to the urban areas of the country. However, analyses of other surveys covering the rural areas suggest that wages in the rural areas are even more depressed.

B. The GOES Program of Stabilization and Adjustment.

When the new administration of President Cristiani took office in June 1989, it was determined to firmly address the causes of stagnation in the Salvadoran economy. The free market philosophy of the new government of El Salvador was a significantly different from the previous Duarte administration with respect to economic policies. In part, this can be attributed to more stable and stronger democratic institutions. More importantly, the Cristiani Administration has much greater confidence that the private sector, under more liberal market conditions, will stimulate improved conditions both on economic and social fronts, and that such improvements would be dispersed throughout the country.

Soon after receiving a solid mandate in last year's presidential election, the new GOES administration took its first steps to overcome the problems facing the Salvadoran economy. Prior to taking office in June 1989, the Cristiani administration put together a transition team which, supported by USAID financed technical assistance, outlined an ambitious but balanced economic adjustment program to put the country on a higher medium-term economic growth path. At the same time, the administration developed a program to ameliorate the impact of adjustment on those segments of the poor population, especially urban, who in the short run will be most negatively affected.

Due to the complex political situation in 1989, the Mission adopted a transitional strategy for the 1989 Balance of Payments Support Program. The Mission and the former GOES Administration negotiated a package of measures to ensure stability in the economy until the new Administration took office in June 1989. This stabilization program was presented in the PAAD (Project No. 519-0355) that proposed a $30 million authorization of the $138.5 million 1989 Program. The PAAD was approved, and $30 million was authorized and obligated in late May 1989.

Following the March 1989 presidential election, the Mission informed the Cristiani Administration that it would support its adjustment measures. This reform program was the subject of the PAAD Amendment that was approved by AID/W in July 1989 for $108.5 million of the 1989 Program and was authorized and obligated in August of 1989.

1. Constraints to Stabilization and Adjustment in 1989.

The task that confronted the economic team of the Cristiani administration was to construct a more open economy. Only in this way, they reasoned, would it be possible to revitalize the potentially dynamic sectors in the economy, thereby increasing growth and incomes. To accomplish this, they had to turn away from the former strategy that emphasized instruments of market intervention to foster import substitution industries and protect urban consumers and adopt policies that favored market liberalization. To achieve this goal, the economic team had to design a program that would overcome numerous constraints to the functioning of free markets in the Salvadoran economy.

a. Restrictive Trade Practices

The new administration inherited an exchange and trade regime that discouraged investment in export activities and efficient production of import substitutes. A fixed exchange rate regime supported by numerous nontariff barriers (NTB) to imports (e.g., quotas, import prohibitions and prior deposits for foreign exchange permits), along with ample inflows of USG grant assistance and remittances from Salvadorans living abroad, permitted the maintenance of an overvalued national currency. The overvalued colón reduced the local currency earnings of producers exporting for the foreign market; domestically, it encouraged investment in inefficient, highly import dependent industries and in goods for domestic consumption. As a result, the trade account, roughly in balance during the 1970s, experienced a growing deficit that reached the equivalent of 9% of GDP in 1988.

b. Weak Fiscal Policies

During the regime of President Duarte, the need to sustain the war effort (which in 1988 accounted for 30% of GOES total expenditures), to extend social services to the poor, and to deepen the social and productive infrastructure of the economy was hampered by poor revenue performance. This resulted as much from poor tax administration and many tax exemptions as from the lower level of economic activity. In spite of tariff adjustments, fiscal subsidies to support current and capital expenditures by the parastatals providing water, electricity, sewerage and port services rose. The problem was further compounded by an agricultural price, credit and food subsidy program, as well as inefficiencies in government agencies which marketed El Salvador's traditional export crops, especially coffee. The result of these problems was that by 1988, the deficit in the nonfinancial public sector (before primarily USG grant assistance) reached the equivalent of about 3.7% of GDP.

c. Repressive Credit and Interest Rate Policies

By 1988, the financial system in El Salvador was not capable of channeling credit efficiently to productive uses, nor was it able to generate sufficient financial savings to finance credit expansion from the system's own resources. The system was characterized by a regime of negative real interest rates, administratively directed credit, overcentralized control of banking operations, the lack of a strong supervisory and auditing body, low levels of managerial and technical skill and portfolios cluttered with nearly 40% nonperforming assets. In that state, the financial system could not adequately provide financial intermediation for the Salvadoran economy.

d. Price Distortions in the Productive Sectors

In addition to the effects of the exchange and trade regime discussed above, improved performance in manufacturing and agriculture was impeded by numerous price distortions. Although the GOES moved to clarify investor rights in 1986 under the Foreign Investment Law, the Export Promotion Law and the corresponding regulations, other serious problems remained, such as inefficient customs administration and overly bureaucratic trade controls. Furthermore, over 200 products and services in manufacturing and agriculture were subject to retail price controls. In particular, basic grains production--the primary income source for the rural small-holder population was discouraged by controls on the retail prices of rice, corn and beans. An additional problem for agriculture was taxation on the final products instead of on the factors of production thereby distorting the allocation of land and labor and decreasing the efficiency of their use. Coffee, for example, was taxed in recent years at an explicit rate of 30-35%, versus 10% in Honduras.

2. The Implementation of the GOES Program in 1989.

In July 1989, the GOES initiated its program of stabilization and adjustment. The set of measures that were chosen to address the constraints to economic growth and recovery went far beyond what had been attempted by the prior administration. The program was balanced in the sense that it included the minimum number of adjustments necessary to address the most serious imbalances in the economy, while not so extensive as to threaten El Salvador's fragile democracy. Even though much remains to be done, the adjustment measures taken by the Cristiani administration in the last six months of 1989 achieved considerable success in addressing the constraints to enhancing economic performance.

a. The Removal of Restrictive Trade Practices.

The GOES economic team planned to significantly liberalize the market for foreign trade in order to achieve equilibrium in the balance of payments and permit higher rates of economic growth. The reforms in the exchange and trade regime were designed to increase the profitability of the export sector and remove trade restrictions that are causing distortions in the economy.

On July 25, 1989, the GOES reformed the foreign exchange market. A formal two tier system was established by preserving the official market (five colones equal one dollar), and widening the former dollar accounts market to a full inter-bank market for foreign exchange. The Central Bank (BCR) initially set a maximum spread of two percent between the rates of exchange in the inter-bank and the black markets. Below this ceiling, the actual rate was to be negotiated between banks and their customers and among banks. Well over 75% of import transactions and 65% of export transactions were captured by the inter-bank market. The transactions that remained in the official market were official debt and transfers (excepting USG flows) and medicines, fertilizers, petroleum and basic grains.

Two other important measures were implemented. First, on July 25, 1989, prior deposits for letters of credit, import prohibitions and all quotas were eliminated. The BCR also moved to simplify the procedures for obtaining import and export licenses. Second, by November 1, 1989, the GOES had secured the passage of legislation to compress all import tariffs within a range of 5-50%, as stated in the program.

The effect of these reforms has been to achieve a significant shift in relative prices in favor of exports and away from nontradeable goods (e.g., services,construction and other products not imported or exported) and inefficient import substitution industries.

The most noteworthy accomplishment was the abandonment of a fixed exchange rate and the adoption of a regime that is more flexible to changing domestic and international conditions. This not only halted the growing overvaluation of the colón, but has achieved an estimated 18% devaluation of the real rate through December 1989. At year end, with only a three percent spread between the inter-bank and black market rates, the exchange market was virtually unified.

The elimination of most nontariff barriers, the elimination of export taxes on sugar and shrimp (see below), and the adjustment of import tariff rates all supported the new exchange rate regime. The Mission estimates that with the new 5-50% range of tariff rates, the average nominal tariff rate has dropped from 23% to 20%. More importantly, the average effective tariff rate (i.e., the protection given to value added in the production process) has fallen from 47% to 33%. These changes have not only exposed domestic production to the healthy effects of international competition, but have led to less dispersion of effective protection among productive activities, significantly reducing disincentives for investment in a wide range of consumer and intermediate products.

b. <u>Strengthening Public Finances.</u>

The GOES economic team planned to reduce the fiscal deficit through revenue improvement, since opportunities to reduce spending were limited. Investment expenditures were already at very low levels, while the need to finance the war and provide necessary public services limited the possibility of reductions in current expenditures.

On November 1, 1989, the National Assembly ratified a comprehensive package of tax reform:

--The stamp tax was greatly simplified. A uniform rate (5%) was levied and most exemptions were eliminated.

--The income tax for individuals and corporations was overhauled. For individuals, the top marginal rate was lowered from 60% to 50% and the number of tax brackets was reduced from 24 to 7. For corporations, the top marginal rate was lowered from 35% to 30% and the number of brackets was lowered from five to three. Furthermore, corporate income tax payments were now to be based on estimates of current rather than on previous year sales.

--The maximum rate for the wealth tax was reduced from 2.5% to 2%. The exemption for individuals was raised from 150,000 colones to 300,000 and for corporations from 300,000 to 500,000 colones.

--Several excise taxes--such as on public shows, distribution of films and matches--whose yields were low relative to the costs of administration--were eliminated.

--Export taxes on sugar and shrimp were abolished.

In an additional revenue enhancement measure, not included in the tax package, the GOES began to calculate the CIF value of imports at the parallel market rate for the purpose of collecting tariffs on January 1, 1990.

Because of the disruptive effects of the November offensive on public sector finances, it is too early to discern the quantitative impact of the 1989 revenue measures. However, Streamlining the tax rate structure and the elimination of exonerations to indirect taxes has improved the efficiency of the tax system and set the stage for improved collections in the near term.

c. Strengthening the Financial Sector.

The GOES economic team realized that strengthening the financial sector, as with the fiscal sector, would require a long run program of activities. They planned to initiate several actions beginning in mid 1989. On August 1, 1989, the BCR set the deposit rate of interest on the 180 day colón certificate of deposit (CD) rate to equal the domestic rate of inflation plus the real rate of interest on the 180 day dollar CD rate in the U.S. The spread between this rate and the passbook savings rate was set at eight points. Loan rates were also set at positive real levels. Accordingly, on that date deposit rates paid on certificates of deposit of 180, 120 and 60 days were 18%, 16% and 14.5% respectively. The rate paid on savings deposits ranges from 10% to 13% depending on terms and type of institution. Loan rates were set at 20% for one year and 22% for more than one year. Subsidized lending was reduced to three categories, including housing. In a separate measure, the BCR conducted an audit of the nine commercial banks (with the assistance of the overseas consulting division of Citibank) to determine the extent of nonperforming assets.

d. Removing Price Distortions.

The GOES economic team underscored its intention to implement a series of reforms directly affecting the productive sectors of the economy by removing price controls in order to increase the quantity of goods and services available to the Salvadoran people.

--On July 24, 1989, price controls were removed for 230 items. Only a few essential items remained under price controls--wheat flour, edible oil, gasoline, sugar, cement and public services such as electricity, water and port charges.

--The GOES, with USAID financed technical assistance, outlined a new mechanism for maintaining producer and consumer price stability for basic grains by linking the agricultural price structure world price trends. The operations of IRA, the GOES basic grains marketing board, ceased in late 1989.

--The GOES moved to improve the efficiency of the Agrarian Reform Sector by developing a set of goals and objectives to be carried out under Phase I and III of the Reform. Among these goals was the termination of titling of Phase III properties by mid 1991, continuation of the program to place displaced families on abandoned or underutilized lands, development of beneficiary rights legislation and the beginning of voluntary parcelization of Phase I properties. The GOES has also endorsed the concept of creating a mechanism to finance the voluntary transfer of land to small farmers and campesinos.

--In September-October 1989, the GOES, with USAID financed technical assistance, conducted a study of its petroleum policies. The recommendations of this study were acted upon in February 1990. As a result, petroleum operations were removed from CEL, the state-owned electricity company, and privatized.

--In October 1989, legislation permitting private competition in the marketing of coffee was passed by the National Assembly.

The elimination of price controls has removed one of the most serious constraints to investment and output in the Salvadoran economy. In the basic grains sector, prices will now be managed in a rational manner that will not discriminate against producers.

e. Ensuring Economic Stabilization.

Aware of the danger of accelerating inflation and the need to enforce stability in domestic financial markets during this period of adjustment, the GOES stated its determination to maintain a firm grip on monetary and credit programming in 1989.

As the Salvadoran economy struggled to adjust to the measures that were taken by the GOES in the second half of 1989, it was buffeted by the fall in coffee export receipts and by the November terrorist offensive. However, economic management was remarkably good in the face of these unfavorable circumstances. The GOES did a reasonably good job in containing the potentially destabilizing consequences of the deficits in the fiscal sector and in the balance of payments through management of money and credit.

--GDP growth for 1989 has been officially posted at 1%, although this is probably an optimistic estimate. In the Mission's analysis, whatever real growth the economy had generated by midyear was probably lost through the disruption of commercial and manufacturing activity during the offensive (see below, Overall Assessment, 1989). The GOES did meet its annual average inflation target of 18% in 1989, although inflationary trends were clearly on the rise by year end. Measured on a December to December basis, rather than on an average annual basis, inflation was 23.5% at the end of 1989.

--The deficit of the Central Government (before USG grant assistance) rose to 4.8% in 1989 from 3.1% in 1988. This was 185 million colones (about $27 million) higher than the GOES target. Outlays rose to meet increased wages (pushed through the National Assembly by the previous administration) and capital spending, while current revenues fell by 8% due to the decline in coffee exports and the impact of the offensive.

--Under the weight of the contraction in coffee exports and the increase in imports because of trade liberalization, the trade deficit in 1989 reached $609 million. There was some relief in the form of an improvement in the services and transfer account, but the GOES offset the deterioration in the trade account mainly through a revaluation of gold reserves and an accumulation of arrears in the payment of international obligations. Adjusting the official figures for gold and arrears, international reserves actually suffered a loss of $120 million in 1989.

--Except for a loss of monetary control at year end (see below, Overall Assessment, 1989), for 1989 as a whole, the GOES contained the crises in the external and fiscal sectors through good management of the monetary and credit aggregates. Banking system credit to the public sector rose by 1.02 billion colones (about $157 million), 57% higher than programmed. Most of this was used to finance the wage increase and a capitalization of the arrears in interest payments due to the BCR. However, the surge in credit to the public sector was partially offset by a less than programmed increase in credit to the private sector (8.7% versus 15.3%). The shortfall in credit expansion to the private sector was due, as in previous years, to the scarcity of loanable resources in the banking system and the reluctance of the BCR to compensate for this through an expansion in the rediscount facilities. Due to the restraint in overall credit expansion, money supply (M2) grew by only 6.9% versus a program target of 11.4%.

3. Overall Assessment of Economic Performance and GOES Economic Management in 1989.

In quantitative terms, the Salvadoran economy in 1989 did not see the full fruits of the adjustment and stabilization measures taken during the last half of the year. The program was implemented too late for any significant impact to occur in 1989. Any impact that would had occurred, i.e., private sector plans for increased production and investment, was surely dissipated by the November FMLN offensive.

The offensive seriously affected the level of production during the forth quarter of 1989. According to the GDP accounts, in 1989, industry grew by .8%, agriculture by .2% and construction by 3.8%. If it had not been for the disruption of production and commercial activity during the last two months of the year, these numbers would have been higher. Based on surveys taken of the private sector during January 1990, the offensive and its aftermath resulted in a 16% decline in the volume of production in industry, a 43% decline in in construction activity and a 24% fall in commercial sales. Small scale firms suffered the worse; small enterprises in manufacturing reported a 35% decline in output.

Agriculture was the only exception to this otherwise lackluster situation. While cotton production continued its downward trend falling by 17% and sugar production rose only by enough to meet the increased U.S. sugar quota, coffee and basic grains -- together representing 75% of total agricultural output -- performed relatively well. Coffee, in spite of harvesting delays due to the fighting, rebounded sharply from the disastrous 1988-89 harvest. Basic grains production fell only 2% from the record harvests of the previous year.

Aside from the impact on economic activity, the political fallout from the November offensive -- along with keen disappointment over the course of coffee prices and the cut in USG balance of payments assistance -- weakened the resolve of the authorities to continue the brisk pace of stabilization and economic reform. First, even though money management was good throughout most of the year, the BCR temporarily lost control of the money supply in November and December. As the fighting intensified, the commercial banks were hit with a liquidity crisis due to delayed loan repayments and increased preference for cash on the part of the non-bank public. To meet the liquidity needs of the banks, the BCR resorted to active use of the rediscount facility and as a result, M1, cash in the hands of the public and demand deposits, rose by 13% in December. With the increase in money, inflationary pressures intensified. Pushed by inflation, the exchange market, virtually unified in November-December, witnessed a growing spread between the inter-bank and black market rates in January. Finally, loath to adjust interest rates during and immediately after the fighting, the BCR allowed the real rates of interest on deposits and loans to deteriorate with the rising inflation.

As the GOES economic team turns to its stabilization and adjustment tasks in 1990, it faces a weak economy. In spite of the qualitative improvement in the incentives structure for investment following the adjustment measures, investment was stagnant at the end of 1989. Fixed capital formation rose only 3% in 1989, 4.1% in the private sector and .2% in the public sector, reflecting the offensive-induced slump in investment during the last quarter. Of the firms surveyed in January 1990, only 20% reported that their investment in the forth quarter of 1989 was higher than the same period in 1988; the rest reported constant or lower levels of investment.

In its conversations with the GOES economic team, the Mission has underscored the fact that there is little alternative but to confront continued distortions in the economy with a stronger program of stabilization and adjustment, thereby solidifying and extending the reforms that it began last year. For instance:

--There must be further adjustments in the trade and exchange regimes. Firm steps are needed to unify the exchange market. Import tariffs are still too high and further compression of the tariff range is necessary to expose the export sector to increased investment incentives.

--The simplification of the tax structure must be followed by reforms in the administration of tax collections and budget control. Central control over the budget process and the capability of collecting tax revenues are essential if substantial progress is to be made in reducing the public sector deficit.

--The GOES should continue to exercise a flexible interest rate policy not only to assist the stabilisation effort, but to increase loanable resources for the banking system. The privatization of the banking system should also continue.

--In the productive sectors, the GOES must now look to two important remaining areas for reform. First, the pricing policies of the utility companies should reflect complete financial self sufficiency for these enterprises. Second, the agrarian reform should proceed.to implement a land bank and the recently developed beneficiary rights legislation. It is also important that the GOES develop a strategy to deal with the large debt burden of the reform sector.

--The situation facing the economy will require a stronger stabilization effort. For three consecutive years, judicious monetary management has allowed the GOES to keep the imbalances in the external and fiscal sectors from exploding into higher inflation. In 1990, with further deterioration in the balance of payments, the challenge will be even more daunting. Curtailing credit, the instrument of choice during these years, has resulted in a 35% real contraction of credit to the private sector. This has had a corresponding deleterious effect on investment and growth in that sector. Consequently, constraining credit growth is losing its power as an instrument of monetary control and the GOES will have to look to fiscal measures and a more aggressive interest rate policy to achieve its stabilization goals.

III. PROBLEM STATEMENT FOR 1990

Achieving sustained increases in real per capita GDP in the Salvadoran economy is essential to improving the material well-being of the Salvadoran people. In spite of significant efforts on the part of the GOES during 1989 to address the problems in the Salvadoran economy, economic performance is still inadequate with respect to achieving self-sustaining growth and an equitable distribution of the benefits of growth. Furthermore, since several earlier assumptions relating to economic conditions in 1990 will not be realized, the continuation of the adjustment program this year will be more difficult than anticipated. Coffee earnings will not likely rebound significantly from the 1989 level, USG balance of payments assistance will be less, and the November 1989 terrorist offensive has had an adverse short-term effect on investment. Consequently, higher growth and lower inflation, hoped for in the second half of 1990, will probably not appear until 1991 at the earliest. Accordingly, the GOES will be forced to concentrate more strongly on the stabilization component of the program, restraining inflation to a least last year's level in order to preserve the beneficial effects of the measures taken this year and last, while also preserving social and political stability.

IV. GOALS OF USG BALANCE OF PAYMENTS ASSISTANCE

A. Long Term: 1990-1994

Increasing the quantity and quality of goods and services in the economy is the *sine qua non* for improving the welfare of the Salvadoran people over the long term. Progress towards this goal will be measured by the following macroeconomic indicators:

> Growth in real GDP, driven by improved performance in the coffee sector and the growing participation of nontraditional exports, reaching 4-5 percent annually, compared to about 1 percent today, implying 2-3 percent growth in GDP per capita.

- With a more efficient financial sector and better instruments of monetary control, the annual inflation rate will be reduced to about 10 percent.

- With revenue improvement and better control over expenditures, the deficit in the consolidated nonfinancial public sector could be reduced to below the equivalent of 2 percent of GDP without USG grant assistance, compared to an estimated 4.8 percent in 1989.

- The balance of payments will be in equilibrium at a growth rate much higher than it is today. Even with improved export performance, the trade deficit would be constant over the 1990-1994 period, equivalent to 9-10 percent of GDP; however, an improved policy regime would encourage increased inflows of private capital and added external donor assistance.

B. Short Term: 1990

The goal of the 1990 phase of the GOES Program of Stabilization and Adjustment will be to build upon progress achieved last year, while concentrating on reducing inflationary pressures in the economy in order to protect the benefits achieved last year. This goal will be measured by the following macroeconomic indicators:

Real GDP Growth	2-3%
Inflation (December to December)	12-15%
Central Government Deficit (as % of GDP)	3.6%
Increase in Net International Reserves (as % of GDP)	$40 million
Money Supply (M2) Growth	11%

V. CONSTRAINTS

A. Remaining Restrictions in the Trade and Exchange Regime.

El Salvador still lacks a single foreign exchange market. While the 1989 measures virtually unified the market, the consequences of the November offensive weakened GOES resolve to continue exchange reform. At the present time, the exchange regime contains an official reference rate for BCR purchases of coffee and official flows, a flexible inter-bank rate and a black, or illegal, rate. The fragmentation of the foreign exchange market produces confusing price signals for the exporter and the investor leading inevitably to destabilizing speculation and a misallocation of foreign exchange resources.

In spite of last year's reforms in the trade regime, a range of 5%-50% in nominal tariff rates results in considerable dispersion in effective rates of protection. Without a further reduction in the range of nominal tariffs, there will remain a disincentive to invest in profitable export activities.

B. The Absence of Effective Expenditure Control and Tax Administration.

The tax reform measures that were implemented in 1989 have set the stage for improved revenue performance in the Central Government. Inefficient tax administration and expenditure control, however, impede significant improvement in the financial position of the GOES.

C. Deficiencies within Financial Institutions.

In spite of the adoption of a higher level of interest rates and the reduction of directed lines of credit, the financial sector is still incapable of performing its intermediation role essential for the country's development. It cannot capture sufficient financial savings and channel these to productive uses in the economy. Many of the commercial banks have negative net worth, i.e., are technically bankrupt, and require a continuous infusion of credit from the BCR to refinance weak portfolios. Management and control systems within the financial institutions are weak, preventing adequate credit analysis and long-term planning. There is no viable regulatory agency in El Salvador to oversee the financial health of banking institutions.

D. Remaining Distortions in the Productive Sectors.

The pricing policy for public sector services is inefficient. Public services--electricity, water, port charges--are not priced at cost recovery levels, therefore, these rates do not permit public sector enterprises to become financially self sufficient.

Finally, as a result of poor management and an inflexible land tenure system on the agrarian reform cooperatives, a good part of El Salvador's agricultural sector is characterized by poor utilization of its scarcest factor of production, good agricultural land, and its most abundant factor of production, rural labor. Within the agrarian reform sector, especially the large Phase I agrarian reform cooperatives, an inappropriate structure, poor management, excessive debt burden, and inadequate technical assistance, have constrained investment and productivity. Unlike other cooperatives, the membership of the Phase I cooperatives is composed of persons having little more in common than the fact that they worked on the cooperative the day the state intervened.

Consequently, members often share very little in terms of long range goals and lack the managerial skills and/or experience to administer large, complex agricultural operations.

E. Inflationary Pressures in the Economy.

The availability of foreign exchange in 1990 will likely be far less than the GOES had earlier assumed. The fall in world coffee prices in June-July 1989 deprived El Salvador of the much hoped for rebound in coffee earnings. The FMLN November 1989 offensive disrupted export activity. The reduction in ESF will cut BOP support on a disbursement basis from $156 million in 1989 to $98 million in 1990. On the other hand, money growth grew sharply late in 1989, due to vigorous credit activity surrounding the harvests, and an unseasonally heavy demand for money during the FMLN offensive. Consequently, stabilization in 1990 will be far more of a problem than was anticipated. The GOES will have to apply strict measures to prevent excessive monetary pressure on available hard currency resources.

VI. THE 1990 PHASE OF THE GOES PROGRAM OF STABILIZATION AND ADJUSTMENT.

In discussions with the GOES, the Mission has been assured of the GOES commitment to continue the adjustment program in 1990.

A. Measures to Remove Restriction in the Trade and Exchange Regime.

Measure No. 1: The GOES has agreed to unify the exchange market under a floating rate. By June 15, 1990, independent exchange traders will have been legalized and controls over transactions in the capital account will have been removed. At that point, all foreign exchange transactions will be moved to a free, unified market. The BCR will continue to purchase coffee export receipts and official capital flows at a reference rate calculated weekly on the average of transactions in the free market.

Measure No. 2: By June 15, 1990, nominal tariff rates will be further reduced to a range of 5%-35%.

B. Measures to Improve Revenue Performance in the Fiscal Sector.

Measure No. 1: With the help of a USAID financed technical assistance team, the GOES will finalize a program to improve tax administration and expenditure control by September 15, 1990. In this program of activities the GOES contemplates the following:

Increase tax and customs collections by establishing a training program for tax administrators and expanding the computer information system to improve tax audits.

MATRIX OF GOES ADJUSTMENT MEASURES FOR 1990

AREA	JUNE 1/90	SEPTEMBER 15/90
EXTERNAL SECTOR	There will be a free exchange market. This free market will include the participation of commercial banks, Banco Hipotecario, Banco de Fomento Agropecuario, Federation of Credit Unions, Savings and Loans Associations, and independent exchange traders. In relation to the latter, these will become part of the free market once the legal framework and other regulations are effective. Coffee and official revenues will be purchased by the Central Bank based on the reference exchange rate. The reference exchange rate will be based on the average rate of the previous week's transactions in the free market. Import duties will be reduced to a range of 5 and 35%.	
FISCAL SECTOR		A plan of action will be prepared for fiscal administration strengthening.
FINANCIAL SECTOR	Approval of a plan of action for banking system privatization. This plan will include a new legal code for private banking and the strengthening of the regulatory agency.	
PRODUCTIVE SECTOR	A price band will be announced for the 1990-91 crop.	IRA will be phased-out and a plan of action will be prepared for the disposition of IRA's assets. The following actions will continue in the agrarian reform sector: * Issuance of 7,150 new titles and 5,000 reassigned. * Review and analyze the new Agrarian Reform Beneficiaries Rights including all affected parties, and submit the corresponding Beneficiaries Law to the Legislative Assembly.
STABILIZATION	A monetary program will be approved by the GOES. The program will contain target and ceilings for money and credit that are consistent with 12-15% inflation and 2-3% growth.	A joint GOES-USAID review of macroeconomic performance will determine the extent of compliance with GOES monetary program.

Improve financial administration by creating an integrated financial management and auditing system capable of producing reliable and timely data on all aspects of public sector financial operations to assist public officials in making decisions on future government expenditures.

Improve customs administration by reviewing and modernizing the customs law, establishing a training program in customs nomenclature and procedures, and installing a computer system linking customs to the BCR and the Ministry of Finance.

C. Measures to Improve the Efficiency of the Financial Sector.

Measure No. 1: By June 15, 1990, the GOES will finalize a plan of action for the privatization of the financial sector. The program will span several years, but in 1990 the GOES expects to revise the legal code to accommodate a private banking system and strengthen the Superintendency of Banks.

D. Measures to Remove Distortions in the Productive Sectors.

While the GOES will move decisively to address the remaining constraints in the agricultural sector, it will leave further adjustments in tariff rates for the public service enterprises until 1991.

Measure No. 1: By June 15, 1990, the GOES will announce the implementation of a price band system for basic grains, beginning with corn. Bands for rice and sorghum will follow as the system becomes operational. The objective of the price band is to stabilize basic grain prices for producers and consumers within a range determined by historical world prices and costs of importation. The price band system will correct longstanding policy distortions which have reduced the incomes of small basic grains producers while exposing them to competition in the world market place.

Measure No. 2: With the implementation of the price band for basic grains, the GOES will close IRA, the basic grains board, and present a plan of action to liquidate the assets of the organization. Both actions will take place by September 15, 1990.

Measure No. 3: By September 15, 1990, the GOES will have furthered the agrarian reform program with the following actions:

--Issue 7,150 new titles and reassign 5,000 old titles.

--Complete the revision of the new beneficiary rights legislation which will permit agrarian reform beneficiaries to opt for alternative forms of land tenure. Before passage of the legislation, the GOES will invite comments and suggestions by intended beneficiaries.

E. Measures to Stabilize the Economy.

The monetary and credit component of the GOES program reflects the hardships that the economy will suffer in the attempt to restrain inflation. For 1990, the GOES has set an inflation target of 12-15% (December to December change in the CPI) and a growth target of a 2-3% real increase in GDP. In the specific macroeconomic accounts the program targets are as follows:

--The balance of payments (less total USG grant and loan assistance) is projected to show an overall deficit of $104 million in 1990. The current account deficit will likely be about $291 million, an improvement of $90 million from 1989, due mainly to a small increase in exports and some reduction in import demand. The capital account will likely register a surplus of $187 million, an increase of $155 million over 1989, following an increase in banking capital and a Paris Club rescheduling of some $115 million in 1990 official bilateral debt service payments. USG grant and loan assistance totalling $248 million (BOP support, disbursements under the USAID project portfolio, PL 480 Title I and II) will permit the GOES to cover the balance of payments deficit of $104 million (including the import of raw materials and spare parts for the private sector), permit the GOES to pay from its other hard currency resources $103 million in external arrears and, lastly, to accumulate an additional $40 million in net international reserves. The reserve accumulation is necessary not only to allow a prudent margin for import needs, but to assure international creditors that there will be no further increase in arrears over the near term.

--The deficit of the Central Government is programmed to fall from the equivalent of 4.8% of GDP in 1989 to 3.6% in 1990. The overall deficit of the Consolidated Nonfinancial Public Sector is expected to improve from the equivalent of 6% of GDP in 1989 to 3.5% in 1990. The GOES hopes to offset a 67% increase in capital expenditures with a substantial improvement in the current savings of the Central Government and the rest of the public sector.

--Money and credit programming in 1990 will reflect attempts to control the surge in liquidity that took place at the end of 1989. Credit growth in the financial sector in 1990 will reflect a 22% growth in credit to the private sector and a 31% increase to the public sector. Much of the latter does not represent new financial system credit to the GOES, but a capitalization of arrears in Central Government debt payments to the BCR. The money supply (M2) is programmed to increase by 11%, double the rate of 1989.

F. Analysis of the GOES 1990 Program.

Mission discussions with the GOES, along with a reading of the initial drafts of the 1990 phase of the program, confirm their determination to pursue adjustment in the face of very adverse circumstances. The final shape of the program, especially its monetary component, will depend on GOES-IMF negotiations over a standby arrangement in March-April, 1990. Nonetheless, the Mission is confident that the GOES will complete the schedule of adjustment measures and succeed in controlling inflation in 1990.

Real GDP growth in 1990 will probably be lower than the 2-3% target. The sharp rebound in coffee production during the 1989-90 harvest (already a fact) and further improvement in the basic grains crop (likely, given the now favorable producer prices) will together yield GDP growth of 1.5%, even if all other sectors of the economy are stagnant. The uncertainties rest with manufacturing and construction. With a favorable exchange rate, manufacturing firms will be encouraged to export more, but it is doubtful that they have the capacity to expand production in the near term. Construction, a credit sensitive sector, may fall victim to credit tightening.

GOES projections for the external accounts will in large measure depend on the trend in coffee prices this year and on an IMF arrangement. During the first two months of 1990, world coffee prices have increased more than $20 a hundredweight since prices slumped in the wake of the suspension of the International Coffee Organization last year. If domestic producers sell at these prices, El Salvador could gain a $90 million windfall over earlier projections. In conversations with the GOES the Mission has underscored the importance of securing an IMF program as soon as possible. In addition to the resources made available under an IMF arrangement, an agreement would open the door for a Paris Club sponsored rescheduling of as much as $115 million in bilateral official debt service late in 1990.

The financial position of the Central Government may prove to be the weakest link in the GOES program. The projected turnaround in current savings will depend on the ability to hold the line on increases in public sector salaries in 1990 and on the revenue producing effects of the tax measures taken last year. Without the expected increase in savings, trimming as much as 5% of current and capital expenditures may be necessary to keep the Central Government deficit within its target.

A more vigorous adjustment in interest rates may be necessary to achieve the noninflationary money growth target. If the demand for money, i.e., the willingness of the nonbank public to hold money balances in time deposits, falls short of projections, the BCR will be forced to cut the flow of private sector credit below the program target. Such an extreme measure would put the growth target at risk, but would keep total credit growth from placing undue pressure on the international reserves of the financial system. The GOES is cognizant of this downside risk and the final draft of the 1990 program will state the firm intention by the GOES to apply all available instruments of monetary control to achieve the stabilization objectives if the demand for money, as well as the other key variables in the program, fall short of their targets.

Overall, even with a reasonable degree of success in economic management, the GOES will likely face a depressed, but stable, economy at the end of 1990. Increased private sector investment will probably follow successful adjustment in 1991 at the earliest. However, the rise in producer prices could bode well for agriculture, with incomes and employment increasing significantly. On the other hand, production and employment in manufacturing and construction, the mainstay for the low income, urban groups, may suffer from the further application of adjustment in 1990. The most important accomplishment will be the control of inflation. A lower inflation rate by year end will certainly remove the pressure on the real wages of the urban low income groups, an important consideration for the GOES as it enters the peace negotiations and the March 1990 National Assembly and municipal elections.

VII. USG SUPPORT FOR THE GOES PROGRAM.

A. Role of USG Financial Assistance.

As can be judged from the above balance of payments projections for the 1990 program, USG financial assistance will play a critical role in the continuation of the GOES stabilization and adjustment effort. Total USG assistance (loan and grant) amounts to two and a half times the projected deficit in the balance of payments for 1990. Grant assistance for balance of payments support, $98 million, is almost equal to the deficit. Without USG balance of payments assistance, the GOES would not be able to meet both its import bill and the program targets of reserve accumulation and elimination of arrears.

Consequently, in the absence of USG balance of payments assistance, the GOES would be faced with a hard choice: abandoning the targets of reserve accumulation and liquidation of external arrears, or struggle to meet the targets by restricting credit to the private sector and imposing import controls to bring about a 10% reduction in import demand. The latter option would likely lead to at least a 2% contraction in the real level of economic activity in 1990.

B. Easing the Shock of Adjustment.

Cognizant that the economic adjustment program might, in the short run, have a negative impact on certain sectors of the population, the Mission has worked closely with the Cristiani administration to formulate a "social shock absorber" plan consisting basically of temporary job creation. The jobs created by it afford beneficiary families access to an income source to help them cope, in the short-term, with basic food basket cost increases occasioned by the economic adjustment measures. The society at large is benefitting from the economic and social infrastructure that is being put in place through these public works programs. The MEA, Urban-MEA, Chalatenango '88 and

Oriente '89 activities provide basic infrastructure services to low income areas in a "grass roots" participatory way. In 1989, these efforts culminated in over 60,000 Salvadorans attending 480 open town meetings to select more than an estimated 2,300 basic infrastructure projects. These projects benefited approximately 1.7 million Salvadoran citizens, mostly rural poor. For 1990, similar numbers of participants and beneficiaries are expected.

During 1989, the impact on incomes and employment came less from the adjustment measures than from the November offensive; nonetheless, the above program of activities, along with other Mission projects, generated 214,000 person months of work for Salvador's affected social groups in the last six months of 1989. This program consists of Projects from the Mission's current portfolio (e.g., Public Services Restoration, 0279, and Public Services Improvement, 0320; Rural Electrification, 0358; Earthquake Recovery and Reconstruction, 0333; Health and Jobs for Displaced Persons, 0281), Title II activities, the HCOLC (Host Country Owned Local Currency) funded CONARA Regional Development (Chalatenango 88 and Oriente '89), and Municipalities in Action (MEA) programs as well as new undertakings (e.g., Urban-MEA and AIFLD housing construction). Additionally, the Urban-MEA program was used to provide food, medicines and temporary shelter to approximately 200,000 civilians displaced during the offensive.

In 1990, if the stabilization and adjustment measures bear down hard on the low income groups, these activities will provide some measure of relief. Estimates are that AID's shock absorber program could generate 380,000 person months of temporary employment in 1990.

In addition to the portfolio of employment generating projects, the GOES continues to have access (through the World Food Program and the A.I.D. administered Title II program), to food stocks which were sufficient to serve an estimated 534,000 beneficiaries per quarter during CY 89, and are estimated at 570,000 per quarter during CY 90 and 610,000 per quarter during CY 91. These substantial food resources are applied to a range of "welfare" type of activities (e.g., supplemental school feeding and food basket distributions). These food stocks were used to help the GOES respond quickly to the basic humanitarian needs of people temporarily displaced by the November 1989 offensive.

C. Donor Coordination.

The Mission is supportive of the GOES attempts to involve other donors in the stabilization and adjustment effort. The Mission's policy dialogue with the GOES has encouraged the implementation of major reforms in the exchange and interest rate regimes easing the negotiations with multilateral donors such as the IMF, IBRD and the IDB.

The key to widening donor support will be a successful IMF program in 1990. Current GOES-IMF negotiations have focused on a standby arrangement for 25% of El Salvador's quota in the Fund (about $25 million) and a Commodity Finance Facility of approximately $50 million later in the year. With a letter of intent approved by the IMF Board, the path would be open for a Paris Club rescheduling of about $115 million in bilateral official debt in 1990.

A successfull IMF program in 1990 would also increase official flows in 1991. The IBRD has discussed a program of about $30 million in sector and policy based lending. The program would be developed in 1990 following IMF board approval of the letter of intent, but disbursements would not likely occur until 1991. Although as yet not fully defined, the IDB has outlined several projects and programs of sector lending. Finally, there is the possiblity of forming an IBRD sponsored consultative group which could yield significant loan and grant activity in 1991.

D. Disbursement Schedule.

Upon approval and authorization, the Mission will obligate the entire $98 million. The obligated amount will be disbursed in two equal tranches. The first will occur on or about June 1, 1990 based upon a successful GOES-Mission review of economic performance and the implementation of the adjustment measures that are projected for that date in the GOES Program. The second will take place on or about September 15, 1990, based on a further review of GOES economic performance and satisfactory actions by the GOES if monetary program targets are not being met.

E. Monitoring the GOES-USG Agreement.

The Mission and the GOES have agreed on a set of indicators (reserve levels, annualized rate of inflation, net assets of the BCR, etc...) that will form the basis for periodic GOES-Mission reviews of progress under the 1990 phase of the GOES program. The results of these reviews, as well as a qualitative assessment of the implementation of the adjustment measures, will be reported to AID/Washington by cable on a quarterly basis.

VIII. SPECIAL TOPICS.

A. The Separate Account and Independent Review Mechanisms.

1. Description.

The host country agency responsible for managing the separate account will be the BCR which has been managing the BOP Program since 1980 with assistance from AID-financed contractors. Since 1985, USAID/EL Salvador has been using the separate account concept which became law in 1987. Further improvements in the use of the separate account by the BCR are anticipated through training of BCR staff in the development and operation of their own self-contained control and verification system. The Mission intends to review transactions at leas on a quarterly basis and to contract for an annual independent review to verify that guidelines for use of these funds are fully satisfied.

In view of the changes in the exchange rate regime that have occurred since the system was originally designed and considering the discontinuation of the AID-financed institutional contractor, USAID/EL Salvador is in the process of contracting Ernst and Young to review the existing separate account procedures and to reassess the financial capabilities of the BCR in carrying out its responsibilities for managing the Balance of Payments Support Program. The contractor will evaluate BCR capabilities to comply with FY 1990 accounting, eligibility and reporting requirements. The results of the planned review will guide the management of the 1990 BOP Grant Agreement.

Contingent upon the contractor evaluation, and consistent with available guidelines, it is anticipated that the separate account mechanism will operate along the following lines. USAID will disburse dollar funds directly into a special non-commingled dollar separate account (s) of the BCR. Disbursements to this account will be made based on the schedule included in the Grant Agreement and Mission review of GOES compliance with agreed upon program targets and after the conditions precedent have been met. Before disbursements to finance imports are made from the separate accounts(s), the BCR will determine eligibility for financing in accordance with the established eligibility criteria.

Consistent with the exchange regime that will likely be in place prior to the first disbursement under the 1990 program, it is expected that commercial banks will use their own resources to open short-term letters of credit for importers. Subsequently, the commercial banks may request reimbursement from the BCR for eligible import transactions for which the commercial banks have already paid from their own foreign exchange reserves. * The BCR will review the transaction for applicability of financing from the separate account(s) and, if the transaction is found to be acceptable, will reimburse the commercial bank for the appropriate amount.

Supporting documentation for each import transaction financed under the program will be segregated and on file at the BCR and readily available to AID for independent review and price verification. For final liquidation the BCR will provide the Mission Controller on at least a quarterly basis a certified listing of all transactions reimbursed from the separate account. Full documentation will be available at the BCR to support the eligibility and timeliness of the transactions. A certified annual listing of transactions will be the basis for an independent verification of transactions.

The independent verification may be carried out by randomly

* The AA/LAC approved the Mission request to establish January 31, 1990, the date when the Secretary of State approved final FY 1990 ESF levels for El Salvador, as the eligibility date for financing the purchase of commodities with ESF dollars.

selecting the BCR's listing an appropriate number of transactions to yield an adequate degree of confidence as to the proper determination of eligibility. Those transactions selected from the listing for review will be verified against the import documents on file in the BCR. Should the AID review show unsatisfactory results, under the terms of the Grant Agreement, the BCR is required to promptly refund the amount of the transaction found to be ineligible to the separate account.

Although statutory requirements, including those of Section 604 of the FAA (regarding source, origin and price test) do not apply to the separate account, the Mission will continue to press for the maximum import transactions from the United States consistent with the Salvadoran need. Thus, the Mission proposes to continue with the following eligibility criteria for imports financed under the special account:

--That they be raw materials, intermediate goods, spare parts, agricultural imports, capital goods and petroleum or its derivatives.

--That they be for the use of the private sector in the manufacturing, agriculture, agroindustrial, commercial, construction, transportation, service and energy subsectors of the economy.

2. Source

The Mission proposes to continue with the source eligibility criteria utilized since 1987, i.e., the U.S. and CBI-designated CACM countries for all goods, and geographic code 941 oil producing countries for petroleum and its derivative imports.

3. Price Checking.

The Mission anticipates that price checking will remain in force until such time as the GOES has instituted a unified exchange rate regime in which the rate of exchange responds to market forces. Until then, the BCR will continue to carry out price checking on all transactions, which according to the NAUCA index may be used for possible reimbursement from the separate account. In the same manner, USAID or its designee will continue to check the price checking system a posteriori through a random sample of transactions selected by the BCR for funding from the separate account. All petroleum transactions will continue to be independently verified for eligibility and price by AID or its designee.

4. The Colón Equivalent of ESF Dollars.

The BCR will deposit into a separate local currency account, according to USAID/El Salvador instructions, an amount in colones equivalent to the U.S. dollar disbursement(s) at the highest rate not illegal on the day the dollar deposit is effected. This rate is defined as the inter-bank rate at which banks in El Salvador offer to buy US dollars or, in the event that a unified floating rate has been instituted, the BCR reference rate calculated as the average of transactions in the free market during the previous week.

The colón deposit must occur within two working days from the BCR receipt of a telex or fax from the Controller's Office, or an advice from the correspondent bank, whichever occurs earlier, notifying the BCR that the dollar disbursement has been effected. The BCR must send evidence of the colón deposit to the Controller's Office within five working days from the day the local currency was deposited.

B. The Local Currency Program.

1. Local Currency Uses

1989

FY 1989 local currency from the ESF Balance of Payments (ESF/BOP) and the food aid programs generated a total of $178.5 million local currency of which $138.5 million was ESF, and $40 million was PL 480 Title I. This amount has been jointly programmed to further Mission and GOES objectives as follows (in millions of U.S. dollars): Stabilize Financial Structures, $63.4; Expand and Improve Infrastructure $21.2; Increase Agricultural Production, $8.6; Strengthen the Private Sector, $21.7; Promote Exports, $3.1; Access to Voluntary Family Planning Services, $.2; Improve Health and Child Survival, $5; Improve Educational Opportunity, $3.2; Strengthen Democratic Institutions, $2.1; Other Programs (National Plan, Displaced Persons program), $40.8. An additional $8.9 million went into the USAID OE Trust Fund and $0.3 million for a contract between USAID and Price Waterhouse. This contract will provide financial monitoring and technical assistance to GOES implementing entities under the Extraordinary Budget managed by SETEFE (Technical Secretariat for External Financing).

Of these totals, $63.4 million went into El Salvador's ordinary budget; $30.7 million was programmed as counterpart for A.I.D. projects; $75.2 million was used for other high priority development projects; and $9.2 million for the USAID trust funds. The public sector received $139.2 million of the total $178.5 million while the balance of some $39.3 million was channelled to the private sector, including more than $22 million for credit lines.

1990

Local currency generations from the ESF/BOP program and the PL 480 Title I program in FY 1990 will continue to be programmed for high priority social and economic development projects.

Counterpart for A.I.D. Projects (Health, judicial reform, education, rural electrification)	$21.4 million
Private Sector support (Private sector credit lines and PVOs)	$24.4 million
High Priority GOES Development Projects. ("Social Shock Absorber Plan", CONARA Regional Development, Municipalities in Action, the Land Bank)	$43.0 million
Sectoral Budget Support (Agriculture, health and education.)	$35.7 million
USAID OE and Program Trust Fund	$8.4 million
Total	$132.9 million (equivalent)

2. Local Currency Funds Management

In November 1989, the Mission issued a revised Mission Operations Manual (MOM) on local currency which provides comprehensive guidelines on the programming, management, monitoring and evaluation of activities financed with host country owned local currency HCOLC. The new system clarifies Mission and GOES responsibilities and facilitates achievement of our objectives to: (a) enhance the GOES' capacity to design and management development programs, and (b) ensure appropriate use of funds, while maximizing the potential for economic development impact. The MOM clarifies GOES HCOLC management responsibility; and has led to program efficiencies that have reduced the number of projectized activities from 100 in 1988/1989 to approximately 66 in CY 1990. There are now three HCOLC funding categories: (1) counterpart for A.I.D. Projects, (2) funding for specific high priority projectized activities such as private sector credit lines, or regional development projects and; (3) funding for general budget support to GOES development programs, such as activities in health, education and agriculture and counterpart for other donor projects.

Host Country-Owned Local Currency (HCOLC) is derived from the Balance of Payments/ESF, and PL-480 Title I bilateral agreements. Memoranda of Understanding which determine the uses of local currency generations from each funding source are signed between the GOES and USAID. There are four organizations that channel the HCOLC to the different projects mutually agreed upon by GOES and USAID. These are: (1) The Technical Secretariat for External Financing (SETEFE) for Extraordinary Budget Investment Projects; (2) The Central Reserve Bank (BCR) for the Private Sector Support (Credit Lines); (3) The Ministry of Finance for the GOES Ordinary Budget Support; and (4) USAID for the trust funds (Operating Expenses and Program Support).

The overall management of the Local Currency Program is the responsibility of SETEFE with USAID actively participating in key areas. This management process consists of the following: (a) Programming carried out jointly between SETEFE AND USAID. This results in an Action Plan for each activity; (b) Implementation, which is the responsibility of the individual GOES implementing entities, with SETEFE providing oversight. USAID monitors and participates in financial audits and program evaluations; and (d) Audit, which is conducted on a periodic basis primarily through local affiliates of U.S. CPA firms contracted by SETEFE.

HCOLC is deposited into separate accounts for each agreement at the BCR. Disbursements are authorized by USAID to each of the main beneficiaries, i.e., SETEFE, BCR and MOF. Each of these beneficiaries in turn opens a special, separate account at the BCR from which money is disbursed to implementing entities.

Implementing entities under the Extraordinary Budget managed by SETEFE must open separate accounts in the BCR for each funding source financing a specific project or activity. Implementing entities disburse money from their BCR account based on jointly approved Action Plans. The BCR disburses its funds based on mutually agreed upon uses contained in agreements. For Ordinary Budget support, the Ministry of Finance receives reimbursements for expenditures incurred during a calendar year.

The Mission has taken steps to insure accountability. For example, in CY 1989/1990 Memoranda of Understanding (ESF, and PL-480 Title I), contain specific language requiring that implementing entities be audited periodically and that these audits be conducted in accordance with the auditing standards established by the U.S. Comptroller General. During CY 1989, the Mission had to respond to approximately 100 separate recommendations and findings from the offfices of the Inspector General. The overwhelming audit workload, associated with resolving Federal and non-federal audit recommendations from the Inspector General, as well as meeting the greatly increased accountability requirements for both appropriated dollars and HCOLC, has strained Mission technical and staff offices. In addition, the Mission and the GOES commissioned 53 audits of host country agencies, analysed these reports (62 to date) and negotiated a certification process with the GOES to assure all audit findings are addressed and adequate financial controls exist for jointly-programmed HCOLC. Moreover, in our efforts to enhance the financial management capability of counterpart organizations, the Mission recently embarked on a program to improve the financial control capacity of 80 municipalities.

Under the Technical Support and Policy Analysis Project (519-0349), the Mission is also planning to provide training and technical assistance to SETEFE, the Court of Accounts and the Ministry of Finance to enhance their capacity to address the financial weaknesses of the systems of the GOES.

C. <u>Earning Interest on Local Currency Deposits.</u>

The Mission has consistently argued that it is not practical or advisable to request the BCR to pay interest on the local currency counterpart of the ESF cash transfer disbursements. These deposits are simply too large relative to the domestic money supply. As of March 31, 1989, ESF and PL 480 generated local currency deposits in the BCR amounted to 19 percent of the money stock (M2). If the BCR were required to pay interest on these deposits at a rate equal to the rate paid on monetary stabilization bonds (currently about 14 percent) this would total some 225 million colones, an amount equal to 50 percent of the growth in the money supply from March 1988 to March 1989.

Clearly, interest payments on these deposits would pose a severe burden on a very fragile financial sector. They would add considerably to the financial losses already suffered by a banking system whose credit portfolio is extensively saddled with nonperforming assets. Furthermore, given their size, interest payments would complicate monetary programming, already a formidable task.

The Mission recognizes that paying interest on local currency deposits could in theory be an instrument for maintaining the real value of these assets and a mechanism through which the GOES could contribute to the projects and programs to which these resources are applied. However, this will not be a feasible course of action until key adjustments are made over the next several years that will strengthen the financial sector, and until the USAID local currency program diminishes in size relative to the money supply.

Table 1
Selected Macroeconomic Data

	1984	1985	1986	1987
	(In millions of colones)			
Real GDP (1962 prices)	2935.6	2993.6	3012.5	3093.5
GDP at current prices	11657.2	14330.8	19762.9	23140.6
	(In US dollars)			
GDP at current prices 1/	2331.4	2866.2	3952.6	4628.1
	(Annual percentage change)			
Real GDP	2.3	2.0	0.6	2.7
GDP at current prices (colones)	14.8	22.9	37.9	17.2
GDP at current prices (dollars)	10.1	0.8	6.9	17.2
GDP deflator	12.3	20.6	37.0	14.0
Consumer Price Index	11.7	22.3	31.9	24.9
	(In colones)			
Per capita GDP (nominal)	2381.4	2877.7	3905.7	4493.3

(Continued on next table)

Table 1
Selected Macroeconomic Data

...Cont.

	Actual 1988	Estimate 1989	Projections 1990
	(In millions of colones)		
Real GDP (1962 prices)	3143.8	3173.9	3244.0
GDP at current prices	27365.8	32072.7	38310.0
	(In US dollars)		
GDP at current prices 1/	5473.2	6414.5	7662.0
	(Annual percentage change)		
Real GDP	1.6	1.0	2.2
GDP at current prices (colones)	18.3	17.2	19.4
GDP deflator	16.4	16.1	16.9
Consumer Price Index	19.8	17.6	18.0
	(In colones)		
Per capita GDP (nominal)	5438.9	6242.6	7260.5

Source: Central Reserve Bank of El Salvador.
Selected data from the Monetary Program.

1/ A constant exchange rate of 5 colones per dollar was used.

Table 2
Summary Operations of the Central Government 1/

	1984	1985	1986	1987
	(In millions of colones)			
Total Revenue	1922	2070	3160	3299
Tax Revenue	1349	1658	2579	2515
Direct taxes	341	385	526	711
Income tax	267	298	433	561
Other	74	87	93	150
Taxes on foreign trade	373	533	1168	702
Import taxes	126	170	204	259
Export taxes	247	363	964	443
o/w: coffee	240	357	955	432
Taxes on domestic transactions	635	741	885	1102
Stamp tax	370	433	550	703
Other	265	308	335	399
Adjustment for Tax Arrears 2/	8	-7	42	-25
Non Tax Revenue	197	254	309	213
o/w Transfers from Public Enterprises	70	94	133	29
Grants & Capital Revenue	384	151	314	546
o/w Capital Revenue	1	—	2	—
Expenditure and Net Lending	2223	2457	3438	3593

(Continued on next table)

Table 2
Summary Operations of the Central Government 1/

...Cont.

	1984	1985	1986	1987
Current Expenditure	1770	1909	2567	2762
Wages and salaries	1005	1182	1457	1709
Goods and services	295	271	385	450
Interest 165	172	260	241	
Current Transfers	305	284	465	362
Capital Expenditure	474	542	602	703
Fixed capital formation	345	367	470	529
Capital transfers	128	172	117	171
Other	1	3	15	3
Net Lending	-22	6	269	128
Current Account Balance	-232	10	279	-9
Overall Deficit (before grants)	-684	-538	-590	-840
Overall Deficit (after grants)	-301	-387	-278	-294
Financing of the Deficit	301	387	278	294
Internal Financing (net)	89.9	118.2	-8.0	14.5
External Financing (net)	211.1	268.8	286.0	279.5
(In percent of GDP)				
Revenue	16.4	14.4	16.0	14.3
Expenditure & net lending	19.1	17.1	17.4	15.5
Current account balance	-2.0	0.1	1.4	--
Overall Deficit (before grants)	-5.9	-3.8	-3.0	-3.6
Overall Deficit (after grants)	-2.6	-2.7	-1.4	-1.3

(Continued on next table)

Table 2
Summary Operations of the Central Government 1/

...Cont.

	Actual 1988	Preliminary 1989	Projection 1990
	(In millions of colones)		
Total Revenue	3385.8	3048.5	4241.1
Tax Revenue	2531.9	2453.9	3205.0
Direct taxes	739.0	695.0	811.0
Income tax	560.7	566.0	631.0
Other	178.3	129.0	180.0
Taxes on foreign trade	592.2	457.9	671.0
Import taxes	214.3	320.0	500.0
Export taxes	377.9	137.9	171.0
o/w: coffee	368.3	127.5	171.0
Taxes on domestic transactions	1200.7	1301.0	1723.0
Stamp tax	707.1	800.0	1159.0
Other	493.6	501.0	564.0
Adjustment for Tax Arrears 2/	-30.6	0.0	0.0
Non Tax Revenue	281.3	162.3	270.0
o/w Transfers from Public Enterprises	114.9	44.0	116.0
Grants & Capital Revenue	542.0	432.0	766.1
o/w Capital Revenue	0.0	0.0	20.0
Expenditure and Net Lending	3690.2	4155.8	4888.4

(Continued on next table)

Table 2
Summary Operations of the Central Government 1/

...Cont.

	Actual 1988	Preliminary 1989	Projections 1990
Current Expenditure	3042.2	3480.5	3735.4
Wages and salaries	1821.0	2166.3	2292.5
Goods and services	511.3	539.0	437.0
Interest	243.8	289.4	393.1
Current Transfers	466.1	485.8	612.8
Capital Expenditure	588.0	679.9	1137.0
Fixed capital formation	467.1	644.0	836.3
Capital transfers	119.8	34.6	296.3
Other	1.1	1.3	4.4
Net Lending	60.0	-4.6	16.0
Current Account Balance	-198.4	-864.3	-260.4
Overall Deficit (before grants)	-846.4	-1539.6	-1393.4
Overall Deficit (after grants)	-304.4	-1107.6	-647.3
Financing of the Deficit	304.4	1107.4	456.8
Internal Financing (net)	278.0	124.6	-724.2
External Financing (net)	26.4	982.8	1181.0
Non financed gap	0.0	0.0	190.6
(In percent of GDP)			
Revenue	12.4	9.5	11.1
Expenditure & net lending	13.5	13.0	12.8
Current account balance	-0.7	-2.7	-0.7
Overall Deficit (before grants)	-3.1	-4.8	-3.6
Overall Deficit (after grants)	-1.1	-3.5	-1.7

Source: Ministry of Finance and Central Reserve Bank of El Salvador

1/ Includes extrabudgetary operations.
2/ Unpaid tax revenue in given year.

(Section A)

Table 3
Monetary Data
(In millions of colones)

	December 31 (Actual) 1987	1988	1989	Prog.Target 1990
	Banking System			
Net International Reserves	1509.2	1190.3	1501.5	1657.4
Net Domestic Assests	9532.1	10649.5	11642.9	12844.8
Domestic Credit	8673.1	9491.0	11007.7	13173.5
Credit to Public Sector	2433.0	2359.7	3383.7	4444.1
Central Government (net)	1773.6	1613.9	2595.4	4156.3
Credit	2466.7	2586.5	3679.0	5319.0
Deposits	-693.1	-972.6	-1083.6	-1162.7
Rest of Public Sector	659.4	745.8	788.3	287.8
Official Credit Institutions	711.6	912.8	864.2	489.4
Credit to Private Sector	5528.5	6218.5	6759.8	8240.0
Other (residual)	859.0	1158.5	635.2	-328.7
AID Related Deposits (BCR)	1389.4	1517.7	2027.9	2000.0
Medium/Long TErm Foreign Liabilities	1966.4	1735.9	1933.9	2279.5
Liab. to Private Sector	7685.5	8586.2	9182.6	10222.7
Money	2812.3	3033.1	3383.0	3609.6
Quasi-Money	4873.2	5553.1	5799.6	6613.1
	Central Reserve Bank			
Net International Reserves	1180.6	972.0	1310.1	1510.1

(Section A)

Table 3
Monetary Data
(In millions of colones)

	December 31 (actual) 1987	1988	1989	Prog.Target 1990
	Central Reserve Bank			
Net Domestic Assets	4671.7	5189.8	5764.4	6145.4
Domestic Credit	3800.6	4114.3	2648.5	6630.6
Public Sector (net)	1809.0	1785.4	2560.5	3623.2
Central Government	1422.4	1352.9	2241.2	3476.7
Credit	2077.3	2291.6	3283.3	4597.8
Deposits	-654.9	-938.7	-1042.1	-1121.1
Rest of Public Sector	386.6	432.5	407.3	146.5
Credit	545.2	581.0	525.0	287.8
Deposits	-158.6	-148.5	-117.7	-141.3
Commercial Banks	1097.6	1261.1	2093.4	2279.0
Others Nonbank Financ. Inst.	894.0	1067.8	1022.5	728.4
Other (residual)	871.1	1075.5	147.8	-485.2
AID Related Deposits (BCR)	1389.4	1517.7	2027.9	2000.0
Medium/Long Term Foreign Liabilities	1962.3	1733.9	1932.5	2279.5
Liab. to Commercial Banks	1192.6	1576.7	1525.0	1692.4
Bank Deposits	1135.7	1507.9	1434.5	1596.9
Banks' cash in vault	56.9	68.8	90.5	95.5
Stabilization Bonds	-.-	-.-	-.-	0.0
Liabilities to Nonbank Financial Institutions	10.0	7.3	9.8	5.0
Currency in Circulation	1298.0	1326.2	1727.1	1678.1

Source: Central Reserve Bank.

(Section C)

Table 3
Monetary Data

	Relative Dec.87	Percent. Dec.88	Change Dec.89	Target 1990
		Banking System		
Net International Reserves	20.2	-21.1	26.1	10.4
Net Domestic Assets	4.7	11.7	9.3	10.3
Domestic Credit	8.7	9.4	16.0	19.7
Credit to Public Sector	9.9	-3.0	43.4	31.3
Central Government (net)	8.6	-9.0	60.8	60.1
Credit	7.4	4.9	42.2	44.6
Deposits	4.4	40.3	11.4	7.3
Rest of Public Sector	13.8	13.1	5.7	-63.5
Official Credit Institutions	8.4	28.3	-5.3	-43.4
Credit to Private Sector	8.2	12.5	8.7	21.9
Other (residual)	-23.5	34.9	-45.2	-151.8
AID Related Deposits (BCR)	83.4	9.2	33.6	-1.4
Medium/Long Term Foreign Liab.	-19.9	-11.7	11.4	17.9
Liabilities to Private Sector	7.6	11.7	6.9	11.3
Money	0.6	7.9	11.5	6.7
Quasi-Money	12.1	14.0	4.4	14.0
		Central Reserve Bank		
Net International Reserves	32.6	-17.7	34.8	15.3

(Section C)

Table 3
Monetary Data

	Relative Dec.87	Percent. Dec.88	Change Dec.89	Target 1990
		Central Reserve Bank		
Net Domestic Assets	8.3	11.1	13.9	3.9
Domestic Credit	13.4	8.3	40.1	15.0
Public Sector (net)	7.2	-1.3	48.3	36.8
Central Government	6.3	-4.9	65.7	55.1
Credit	5.5	10.3	43.3	40.0
Deposits	4.0	43.3	11.0	7.6
Rest of Public Sector	10.7	11.9	-5.8	-64.0
Credit	14.8	6.6	-9.6	-45.2
Deposits	26.0	-6.4	-20.7	20.1
Commercial Banks	34.3	14.9	66.0	8.9
Others Nonbank Financ.Inst.	5.7	19.4	-4.2	-28.8
Other (residual)	-9.6	23.5	-86.3	-428.2
AID Related Deposits (BCR)	83.4	9.2	33.6	-1.4
Medium/Long Term Foreign Liab.	-19.6	-11.6	11.5	18.0
Liab. to Commercial Banks	43.2	32.2	-3.3	11.0
Bank Deposits	58.6	32.8	-4.9	11.3
Banks' Cash in Vault	-51.2	20.9	31.5	5.5
Stabilization Bonds	N/A	N/A	N/A	N/A
Liabilities to Nonbank Financial Institutions	-33.3	-27.0	34.2	-49.0
Currency in Circulation	12.2	2.2	30.2	-2.8

Source: Central Reserve Bank

Note: Please put together sections A, and C, Downwards.

Table 4
Summary Balance of Payments

	1984	1985	1986	1987
(In millions of US dollars)				
Current Account (excluding official grants)	-230	-264	-107	-239
Merchandise Trade	-252	-266	-180	-403
Exports (FOB)	726	695	755	591
Imports (CIF)	978	961	935	994
Net Services	-116	-110	-87	-30
Private Transfers	138	112	160	194
Official Grants	177	207	224	379
US Aid	174	201	204	342
Other official	3	6	20	37
Capital Account	61	104	-42	-89
Private and net errors and omissions	-15	32	-32	-51
Government (net)	92	106	64	58
Financial System (net)	-16	-36	-74	-96
Overall Balance	8	47	75	51
(As percent of GDP)				
Current Account Balance (excluding official grants)	-9.9	-9.2	-2.7	-5.2
Trade Balance	-10.8	-9.3	-4.6	-8.7
Official Grants	7.6	7.2	5.7	8.2
Capital Account	2.6	3.6	-1.1	-1.9
Overall Balance	0.3	1.6	1.9	1.1

(Continued on next table)

Table 4
Summary Balance of Payments

...Cont.

	Actual 1988	Estimate 1989	Projections 1990
(In millions of US dollars)			
Current Account			
(excluding U.S. grants)	-191.3	-381.1	-291.2
Merchandise Trade	-398.1	-608.8	-531.2
Exports (FOB)	608.8	497.3	528.6
Imports (CIF)	1006.9	1106.1	1059.8
Net Services	-58.1	-39.2	-30.0
Net Transfers			
(Before U.S.)	264.9	266.9	270.0
Capital Account	-186.3	31.8	187.4
(excluding US assistance)			
Private and net errors			
and ommissions	-160.7	-102.1	0.0
Government (net)	26.0	105.4	112.4
Financial System (net)	-51.6	28.5	75.0
Overall Balance	-377.6	-349.3	-103.8
Financing of the Deficit	377.6	349.3	103.8
U.S. Assistance (net)	284.9	298.6	247.7
(of which, BOP)	155.0	156.5	98.3
Change in Payment Arrears	28.8	68.9	-103.9
Gold revaluation	0.0	35.2	0.0
Change in reserves			
(-=increase)	63.9	-53.4	-40.0
(As percent of GDP)			
Current Account Balance			
(before U.S.)	-3.5	-5.9	-3.8
Trade Balance	-7.3	-9.5	-6.9
Capital Account			
(before U.S.)	-3.4	0.5	2.4
Overall Balance			
(Before U.S.)	-6.9	-5.4	-1.4
U.S. Assistance (net)	5.2	4.7	3.2
o/w BOP	2.8	2.4	1.3

Source: Central Reserve Bank of El Salvador; USAID staff estimates.

Table 5

Exports

(In millions of US dollars and thousands of qq.)

	1984	1985	1986	1987
COFFEE				
Value	450	464	457	352
Volume	3568	3456	2937	3383
$/qq.	126	134	186	104
COTTON				
Value	9	29	5	2
Volume	114	514	132	58
$/qq	80	56	34	39
SUGAR				
Value	26	23	25	12
Volume	1636	2422	2144	821
$/qq.	16	10	12	15
SHRIMP				
Value	20	10	17	21
Volume	5030	2565	4364	3576
$/kgs.	4	4	4	6
CACM				
Value	157	96	91	120
REST OF THE WORLD				
Value	64	74	70	85
TOTAL	726	695	755	591

(Continued on next table)

Table 5

Exports

(In millions of US dollars and thousands of qq.)

...Cont.

	Actual 1988	Estimate 1989	Projections 1990
COFFEE			
Value	358.0	230.0	218.7
Volume	2729.4	2073.5	3125.0
$/qq.	131.2	110.9	70.0
COTTON			
Value	0.3	0.8	0.8
Volume	7.7	17.5	14.5
$/qq	39.0	45.7	55.2
SUGAR			
Value	19.2	13.6	18.5
Volume	1702.2	637.0	864.0
$/qq.	11.3	21.4	21.4
SHRIMP			
Value	16.0	17.6	19.6
Volume	3143.0	3513.8	3928.3
$/kgs.	5.1	5.0	5.0
CACM			
Value	139.8	159.0	181.0
REST OF THE WORLD			
Value	75.5	76.3	90.0
TOTAL	608.8	497.3	528.6

Source: Central Reserve Bank of El Salvador; USAID staff estimates.

1/ Monetary Program.

Table 6

Imports

(In millions of US dollars)

	1984	1985	1986	1987
Consumer Goods	277	259	207	241
Durables	38	48	25	32
Nondurables	239	211	182	208
Raw Materials	569	545	453	501
Industry	455	418	363	394
of which: petroleum	130	133	82	104
Agriculture	57	76	41	39
of which: fertilizers	25	40	25	27
Construction	51	46	44	61
Other	6	6	5	7
Capital goods	132	158	225	252
Industry	43	43	59	72
Agriculture	13	14	10	13
Contruction	5	6	6	11
Transport	53	68	124	124
Other	18	27	26	32
Others	—	—	50	—
Total Imports	978	961	935	994

(Continued on next page)

Table 6

Imports

(In millions of US dollars)

...Cont.

	Actual 1988	Estimate 1989	Projections 1990
Consumer Goods	258.2	280.0	238.0
Durables	33.3	36.1	30.0
Nondurables	224.9	243.9	208.0
Raw Materials	496.2	548.7	550.0
Industry	390.5	423.0	436.0
of which: petroleum	81.0	87.0	98.5
Agriculture	35.9	51.0	38.5
of which: fertilizers	23.5	30.6	23.7
Construction	63.3	66.0	68.8
Other	6.5	8.7	6.7
Capital goods	252.5	267.6	271.8
Industry	79.1	81.0	89.0
Agriculture	8.0	8.8	8.8
Contruction	11.2	14.0	12.0
Transport	121.8	129.3	126.3
Other	32.4	34.5	35.7
Total Imports	1006.9	1106.1	1059.8

Source: Central Reserve Bank of El Salvador; USAID staff estimates.

1/ Monetary Program.

Agency for International Development
Washington, D.C. 20523

LAC-IEE-90-24

ENVIRONMENTAL THRESHOLD DECISION

Project Location	:	El Salvador
Project Title	:	FY 90 ESF Balance of Payments Support Program
Project Number	:	519-0356
Funding	:	$98 million (ESF)
Life of Project	:	1 year (FY 90)
IEE Prepared by	:	John O. Wilson LAC Deputy Environmental Officer
Recommended Threshold Decision	:	Categorical Exclusion
Bureau Threshold Decision	:	Concur with Recommendation
Comments	:	Concurrence based on condition that Program will not provide support for import, purchase, or use of pesticides without first doing an environmental assessment and having it approved by the LAC Chief Environmental Officer.
Copy to	:	Henry H. Bassford, Director USAID/El Salvador
Copy to	:	Edward T. Landau, PDO USAID/El Salvador
Copy to	:	Mark Silverman, LAC/DR/CEN
Copy to	:	Frank Zadroga, REA/CEN
Copy to	:	IEE File

James S. Hester Date APR 20 1990

James S. Hester
Chief Environmental Officer
Bureau for Latin America
and the Caribbean

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Agency for International Development
Washington, D.C. 20523

INITIAL ENVIRONMENTAL EXAMINATION

Project Location:	El Salvador
Project Title:	FY 90 ESF Balance of Payments Support Program
Project Number:	519-0356
Funding:	$98 million (ESF)
Life of Project:	1 year (FY 90)
IEE Prepared by:	John O. Wilson LAC Deputy Environmental Officer

Recommended Threshold Decision:

a. Recommendation:

The project consists of a cash transfer for balance of payments assistance to the Government of El Salvador's to provide critical support for their ongoing stabilization and adjustment efforts. USAID will disburse dollar funds directly into a special, separate, non-commingled dollar account of the Central Reserve Bank. The dollars provided will be used to finance imports of raw materials, intermediate goods, spare parts, agricultural imports, capital goods and petroleum or its derivatives primarily for the use of the private sector, including the manufacturing, agriculture, agroindustrial, and commercial sectors. Local currency proceeds of the Program will continue to be programmed for high priority social and economic development projects. Local currency generations will be used to finance local currency counterpart to selected USAID and GOES development projects, finance private sector credit lines and PVOs, and provide general budget support to GOES development programs in designated sectors, including agriculture, health, and education. Availability of funds under this program is made contingent upon compliance with the conditions mutually agreed upon between the GOES and A.I.D. on the 1990 program.

Pursuant to A.I.D. environmental regulations [22 CFR 216.2(c)(1)(ii)], an IEE is generally not required when:

"A.I.D. does not have knowledge of or control over, and the objective of A.I.D. in furnishing assistance does not require, either prior to approval of financing or prior to implementation of specific activities, knowledge of or control over, the details of the specific activities that have an effect on the physical and natural environment for which financing is approved by A.I.D."

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Moreover, Handbook 3, Chapter 2, Appendix 2D, Section 216.2(c)(2)(vi) states that "Contributions to international, regional or national organizations by the United States which are not for the purpose of carrying out a specifically identifiable project or projects" are not subject to A.I.D.'s environmental procedures. The above exemptions do not apply, however, to assistance for the procurement or use of pesticides.

The FY 1990 Balance of Payments program will not provide support for the import, purchase or use of pesticides. A condition will be placed in the program agreement between the GOES and A.I.D. that no pesticides will be procured or used without first doing an Environmental Assessment and having it approved by the LAC Bureau Environmental Officer.

Based on A.I.D. regulations in Handbook 3, Chapter 2, the A.I.D. Mission to El Salvador recommends that no further environmental study be undertaken for this PAAD and that a "categorical exclusion" be approved.

Concurrence: ______________________
Henry H. Bassford
Director, USAID/El Salvador

5C(1) - COUNTRY CHECKLIST

Listed below are statutory criteria applicable to: (A) FAA funds generally; (B)(1) Development Assistance funds only; or (B)(2) the Economic Support Fund only.

A. GENERAL CRITERIA FOR COUNTRY ELIGIBILITY

1. FY 1990 Appropriations Act Sec. 569(b). Has the President certified to the Congress that the government of the recipient country is failing to take adequate measures to prevent narcotic drugs or other controlled substances which are cultivated, produced or processed illicitly, in whole or in part, in such country or transported through such country, from being sold illegally within the jurisdiction of such country to United States Government personnel or their dependents or from entering the United States unlawfully? **NO**

2. FAA Sec. 481(h); FY 1990 Appropriations Act Sec. 569(b). (These provisions apply to assistance of any kind provided by grant, sale, loan, lease, credit, guaranty, or insurance, except assistance from the Child Survival Fund or relating to international narcotics control, disaster and refugee relief, narcotics education and awareness, or the provision of food or medicine.) If the recipient is a "major illicit drug producing country" (defined as a country producing during a fiscal year at least five metric tons of opium or 500 metric tons of coca or marijuana) or a "major drug-transit country" (defined as a country that is a significant direct source of illicit drugs significantly affecting the United States, through which such drugs **NO**

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are transported, or through which significant sums of drug-related profits are laundered with the knowledge or complicity of the government): (a) Does the country have in place a bilateral narcotics agreement with the United States, or a multilateral narcotics agreement? and (b) Has the President in the March 1 International Narcotics Control Strategy Report (INSCR) determined and certified to the Congress (without Congressional enactment, within 45 days of continuous session, of a resolution disapproving such a certification), or has the President determined and certified to the Congress on any other date (with enactment by Congress of a resolution approving such certification), that (1) during the previous year the country has cooperated fully with the United States or taken adequate steps on its own to satisfy the goals agreed to in a bilateral narcotics agreement with the United States or in a multilateral agreement, to prevent illicit drugs produced or processed in or transported through such country from being transported into the United States, to prevent and punish drug profit laundering in the country, and to prevent and punish bribery and other forms of public corruption which facilitate production or shipment of illicit drugs or discourage prosecution of such acts, or that (2) the vital national interests of the United States require the provision of such assistance?

3. 1986 Drug Act Sec. 2013. (This section applies to the same categories of assistance subject to the restrictions in FAA Sec. 481(h), above.) If recipient country is a "major illicit drug producing country" or "major drug-transit country" (as defined for the purpose of FAA Sec 481(h)), has the President submitted a report to **N/A**

Congress listing such country as one: (a) which, as a matter of government policy, encourages or facilitates the production or distribution of illicit drugs; (b) in which any senior official of the government engages in, encourages, or facilitates the production or distribution of illegal drugs; (c) in which any member of a U.S. Government agency has suffered or been threatened with violence inflicted by or with the complicity of any government officer; or (d) which fails to provide reasonable cooperation to lawful activities of U.S. drug enforcement agents, unless the President has provided the required certification to Congress pertaining to U.S. national interests and the drug control and criminal prosecution efforts of that country?

4. FAA Sec. 620(c). If assistance is to a government, is the government indebted to any U.S. citizen for goods or services furnished or ordered where: (a) such citizen has exhausted available legal remedies, (b) the debt is not denied or contested by such government, or (c) the indebtedness arises under an unconditional guaranty of payment given by such government or controlled entity?

NO

5. FAA Sec. 620(e)(1). If assistance is to a government, has it (including any government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities?

NO. (The GOES has made demonstrable progress toward compensation in the CAESS case.)

6. FAA Secs. 620(a), 620(f), 620D; FY 1990 Appropriations Act Secs. 512, 548. Is recipient country a Communist country? If so, has the President: (a) determined that assistance to the country is vital to the security of the United States, that the recipient country is not controlled by the international Communist conspiracy, and that such assistance will further promote the independence of the recipient country from international communism, or (b) removed a country from applicable restrictions on assistance to communist countries upon a determination and report to Congress that such action is important to the national interest of the United States? Will assistance be provided either directly or indirectly to Angola, Cambodia, Cuba, Iraq, Libya, Vietnam, South Yemen, Iran or Syria? Will assistance be provided to Afghanistan without a certification, or will assistance be provided inside Afghanistan through the Soviet-controlled government of Afghanistan? **NO**

7. FAA Sec. 620(j). Has the country permitted, or failed to take adequate measures to prevent, damage or destruction by mob action of U.S. property? **NO**

8. FAA Sec. 620(l). Has the country failed to enter into an investment guaranty agreement with OPIC? **NO**

9. FAA Sec. 620(o); Fishermen's Protective Act of 1967 (as amended) Sec. 5. (a) Has the country seized, or imposed any penalty or sanction against, any U.S. fishing vessel because of fishing activities in international waters? (b) If so, has any deduction required by the Fishermen's Protective Act been made? **NO**

10. FAA Sec. 620(q); FY 1990 Appropriations Act Sec. 518 (Brooke Amendment). (a) Has the government of the recipient country been in default for more than six months on interest or principal of any loan to the country under the FAA? (b) Has the country been in default for more than one year on interest or principal on any U.S. loan under a program for which the FY 1990 Appropriations Act appropriates funds?

From time to time, the GOES has been in default for more than six months which has resulted in prohibition of obligation of new funds; however, such periods have been of very short duration.

11. FAA Sec. 620(s). If contemplated assistance is development loan or to come from Economic Support Fund, has the Administrator taken into account the percentage of the country's budget and amount of the country's foreign exchange or other resources spent on military equipment? (Reference may be made to the annual "Taking Into Consideration" memo: "Yes, taken into account by the Administrator at time of approval of Agency OYB." This approval by the Administrator of the Operational Year Budget can be the basis for an affirmative answer during the fiscal year unless significant changes in circumstances occur.)

Yes, taken into account by Administration at the time of approval of Agency OYB.

12. FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have relations been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?

NO

13. FAA Sec. 620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the A.I.D. Administrator in determining the current A.I.D. Operational Year Budget? (Reference may be made to the "Taking into Consideration" memo.)

EL Salvador is not in arrears to the extent described in Article 19 of the U.N. Charter.

14. FAA Sec. 620A. Has the President determined that the recipient country grants sanctuary from prosecution to any individual or group which has committed an act of international terrorism or otherwise supports international terrorism? NO

15. FY 1990 Appropriations Act Sec. 564. Has the country been determined by the President to: (a) grant sanctuary from prosecution to any individual or group which has committed an act of international terrorism, or (b) otherwise support international terrorism, unless the President has waived this restriction on grounds of national security or for humanitarian reasons? NO

16. ISDCA of 1985 Sec. 552(b). Has the Secretary of State determined that the country is a high terrorist threat country after the Secretary of Transportation has determined, pursuant to section 1115(e)(2) of the Federal Aviation Act of 1958, that an airport in the country does not maintain and administer effective security measures? NO

17. FAA Sec. 666(b). Does the country object, on the basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. who is present in such country to carry out economic development programs under the FAA? NO

18. FAA Secs. 669, 670. Has the country, after August 3, 1977, delivered to any other country or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards, and without special certification by the President? Has it transferred a nuclear explosive device to a non-nuclear weapon state, or if such a state, either received or NO

detonated a nuclear explosive device? (FAA Sec. 620E permits a special waiver of Sec. 669 for Pakistan.)

19. FAA Sec. 670. If the country is a non-nuclear weapon state, has it, on or after August 8, 1985, exported (or attempted to export) illegally from the United States any material, equipment, or technology which would contribute significantly to the ability of a country to manufacture a nuclear explosive device? **NO**

20. ISDCA of 1981 Sec. 720. Was the country represented at the Meeting of Ministers of Foreign Affairs and Heads of Delegations of the Non-Aligned Countries to the 36th General Assembly of the U.N. on Sept. 25 and 28, 1981, and did it fail to disassociate itself from the communique issued? If so, has the President taken it into account? (Reference may be made to the "Taking into Consideration" memo.) **NO**

21. FY 1990 Appropriations Act Sec. 513. Has the duly elected Head of Government of the country been deposed by military coup or decree? If assistance has been terminated, has the President notified Congress that a democratically elected government has taken office prior to the resumption of assistance? **NO**

22. FY 1990 Appropriations Act Sec. 539. Does the recipient country fully cooperate with the international refugee assistance organizations, the United States, and other governments in facilitating lasting solutions to refugee situations, including resettlement without respect to race, sex, religion, or national origin? **YES**

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B. FUNDING SOURCE CRITERIA FOR COUNTRY ELIGIBILITY

1. Development Assistance Country Criteria

a. FAA Sec. 116. Has the Department of State determined that this government has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, can it be demonstrated that contemplated assistance will directly benefit the needy?

NO

b. FY 1990 Appropriations Act Sec. 535. Has the President certified that use of DA funds by this country would violate any of the prohibitions against use of funds to pay for the performance of abortions as a method of family planning, to motivate or coerce any person to practice abortions, to pay for the performance of involuntary sterilization as a method of family planning, to coerce or provide any financial incentive to any person to undergo sterilizations, to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning?

NO

2. Economic Support Fund Country Criteria

a. FAA Sec. 502B. Has it been determined that the country has engaged in a consistent pattern of gross violations of internationally recognized human rights? If so, has the President found that the country made such significant improvement in its human rights record that furnishing such assistance is in the U.S. national interest?

Yes. The President has certified that El Salvador continues to make significant progress toward improving its human rights record.

b. FY 1990 Appropriations Act Sec. 569(d). Has this country met its drug eradication targets or otherwise taken significant steps to halt illicit drug production or trafficking?

While the country does not have drug eradication targets, it has taken steps to halt illicit drug trafficking and fully cooperates with relevant international authorities.

c. FY 1990 Appropriations Act Title II. Has the President reported to the Congress on the extent to which the Government of El Salvador has made demonstrable progress in settling outstanding expropriation claims of American citizens in compliance with the judgement of the Salvadoran Supreme Court.

YES

3(A)2 - NONPROJECT ASSISTANCE CHECKLIST

The criteria listed in Part A are applicable generally to FAA funds, and should be used irrespective of the program's funding source. In Part B a distinction is made between the criteria applicable to Economic Support Fund assistance and the criteria applicable to Development Assistance. Selection of the criteria will depend on the funding source for the program.

CROSS REFERENCES:	IS COUNTRY CHECKLIST UP TO DATE? HAS STANDARD ITEM CHECKLIST BEEN REVIEWED?	Yes, updated by the AID El Salvador Desk. Yes.

A. GENERAL CRITERIA FOR NONPROJECT ASSISTANCE

1.	FY 1990 Appropriations Act Sec. 523; FAA Sec. 634A. Describe how authorization and appropriations committees of Senate and House have been or will be notified concerning the project.	Through a congressional notification.
2.	FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?	Past experience demonstrates that ratification can be expected within 2-3 weeks.
3.	FAA Sec. 209. Is assistance more efficiently and effectively provided through regional or multilateral organizations? If so, why is assistance not so provided? Information and conclusions on whether assistance will encourage developing countries to cooperate in regional development programs.	No.

4. FAA Sec. 601(a). Information and conclusions on whether assistance will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.

Yes. Imports from the U.S. for use by the Salvadoran private sector will be financed.

Local currency generations will be used to support items b, c, d, e, and f

5. FAA Sec. 601(b). Information and conclusions on how assistance will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

Yes. See above.

6. FAA Sec. 121(d). If assistance is being furnished under the Sahel Development Program, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of A.I.D. funds?

N/A

B. FUNDING CRITERIA FOR NONPROJECT ASSISTANCE

1. Nonproject Criteria for Economic Support Fund

a. FAA Sec. 531(a). Will this assistance promote economic and political stability? To the maximum extent feasible, is this assistance consistent with the policy directions, purposes, and programs of Part I of the FAA?

Yes.

Yes.

b. FAA Sec. 531(e). Will assistance under this chapter be used for military or paramilitary activities?

No.

c. FAA Sec. 531(d). Will ESF funds made available for commodity import programs or other program assistance be used to generate local currencies? If so, will at least 50 percent of such local currencies be available to support activities consistent with the objectives of FAA sections 103 through 106?

Yes.

Yes.

d. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?

N/A

e. FY 1990 Appropriations Act, Title II, under heading "Economic Support Fund," and Sec. 592. If assistance is in the form of a cash transfer: (a) Are all such cash payments to be maintained by the country in a separate account and not to be commingled with any other funds?

Yes.

(b) Will all local currencies that may be generated with funds provided as a cash transfer to such a country also be deposited in a special account, and has A.I.D. entered into an agreement with that government setting forth the amount of the local currencies to be generated, the terms and conditions under which they are to be used, and the responsibilities of A.I.D. and that government to monitor and account for deposits and disbursements?

Yes. A MOU will be signed setting forth uses of LC generations. Grant specifies exchange rate to be used in making LC deposits.

(c) Will all such local currencies also be used in accordance with FAA Section 609, which requires such local currencies to be made available to the U.S. government as the U.S. determines necessary for the requirements of the U.S. Government, and which requires the remainder to be used for programs agreed to by the U.S. Government to carry out the purposes for which new funds authorized by the FAA would themselves be available?

Yes.

(d) Has Congress received prior notification providing in detail how the funds will be used, including the U.S. interests that will be served by the assistance, and, as appropriate, the economic policy reforms that will be promoted by the cash transfer assistance?

Notification to be sent before obligatior

2. <u>Nonproject Criteria for Development Assistance</u>

N/A - ESF FUNDED

a. <u>FAA Secs. 102(a), 111, 113, 281(a)</u>. Extent to which activity will: (1) effectively involve the poor in development, by expanding access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (2) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and otherwise encourage democratic private and local governmental institutions; (3) support the self-help efforts of developing countries; (4) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (5) utilize and encourage regional cooperation by developing countries?

b. <u>FAA Secs. 103, 103A, 104, 105, 106, 120-21</u>. Is assistance being made available (include only applicable paragraph which corresponds to source of funds used; if more than one fund source is used for assistance, include relevant paragraph for each fund source):

(1) [103] for agriculture, rural development or nutrition; if so (a) extent to which activity is specifically designed to increase productivity and income of rural poor; [103A] if for agricultural research, account shall be taken of the needs of small farmers, and extensive use of field testing to adapt basic research to local conditions shall be made; (b) extent to which assistance is used in coordination with efforts carried out

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under Sec. 104 to help improve nutrition of the people of developing countries through encouragement of increased production of crops with greater nutritional value; improvement of planning, research, and education with respect to nutrition, particularly with reference to improvement and expanded use of indigenously produced foodstuffs; and the undertaking of pilot or demonstration programs explicitly addressing the problem of malnutrition of poor and vulnerable people; and (c) extent to which activity increases national food security by improving food policies and management and by strengthening national food reserves, with particular concern for the needs of the poor, through measures encouraging domestic production, building national food reserves, expanding available storage facilities, reducing post harvest food losses, and improving food distribution.

(2) [104] for population planning under Sec. 104(b) or health under Sec. 104(c); if so, extent to which activity emphasizes low-cost, integrated delivery systems for health, nutrition and family planning for the poorest people, with particular attention to the needs of mothers and young children, using paramedical and auxiliary medical personnel, clinics and health posts, commercial distribution systems, and other modes of community outreach.

(3) [105] for education, public administration, or human resources development; if so, (a) extent to which activity strengthens nonformal education, makes formal education more relevant, especially for rural families and urban poor, and strengthens management capability of institutions enabling the poor to participate in development; and (b) extent to which assistance provides advanced education

and training of people of developing countries in such disciplines as are required for planning and implementation of public and private development activities.

(4) [106] for energy, private voluntary organizations, and selected development problems; if so, extent activity is:

(i)(a) concerned with data collection and analysis, the training of skilled personnel, research on and development of suitable energy sources, and pilot projects to test new methods of energy production; and (b) facilitative of research on and development and use of small-scale, decentralized, renewable energy sources for rural areas, emphasizing development of energy resources which are environmentally acceptable and require minimum capital investment;

(ii) concerned with technical cooperation and development, especially with U.S. private and voluntary, or regional and international development, organizations;

(iii) research into, and evaluation of, economic development processes and techniques;

(iv) reconstruction after natural or manmade disaster and programs of disaster preparedness;

(v) for special development problems, and to enable proper utilization of infrastructure and related projects funded with earlier U.S. assistance;

(vi) for urban development, especially small, labor-intensive enterprises, marketing systems for small producers, and financial or other institutions to help urban poor participate in economic and social development.

(5) [120-21] for the Sahelian region; if so, (a) extent to which there is international coordination in planning and implementation; participation and support by African countries and organizations in determining development priorities; and a long-term, multidonor development plan which calls for equitable burden-sharing with other donors; (b) has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of projects funds (dollars or local currency generated therefrom)?

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