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UNCLASSIFIED

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

EL SALVADOR

PROJECT PAPER

FREE ZONE DEVELOPMENT

AID/LAC/P-512

Project Number: 519-0323

UNCLASSIFIED

AGENCY FOR INTERNATIONAL DEVELOPMENT

PROJECT DATA SHEET

1. TRANSACTION CODE: A (A = Add, C = Change, D = Delete)

Amendment Number

DOCUMENT CODE: 3

COUNTRY/ENTITY: EL SALVADOR

3. PROJECT NUMBER: 519-0323

4. BUREAU/OFFICE: LAC 05

5. PROJECT TITLE (maximum 40 characters): FREE ZONE DEVELOPMENT

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM 08 DD 15 YY 93

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

A. Initial FY 88 B. Quarter 4 C. Final FY 90

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

A. FUNDING SOURCE	FIRST FY 88 B. FX	C. L/C	D. Total	LIFE OF PROJECT E. FX	F. L/C	G. Total
AID Appropriated Total						
(Grant)	(1,000)	(4,755)	(5,755)	(8,775)	(17,225)	(26,000)
(Loan)	(---)	(---)	(---)	(---)	(---)	(---)
Other U.S. 1.						
Other U.S. 2.						
Host Country	---	1,000	1,000	---	13,439	13,439
Other Donor(s)						
TOTALS	1,000	5,755	6,755	8,775	30,664	39,439

9. SCHEDULE OF AID FUNDING ($000)

A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECH. CODE 1. Grant	2. Loan	D. OBLIGATIONS TO DATE 1. Grant	2. Loan	E. AMOUNT APPROVED THIS ACTION 1. Grant	2. Loan	F. LIFE OF PROJECT 1. Grant	2. Loan
(1) SDA	730	840		---	---	5,755		6,000	
(2) ESF	840	730		---	---	---	---	20,000	
(3)									
(4)									
TOTALS				---	---	5,755	---	26,000	

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each): 800 | 831 | 920

11. SECONDARY PURPOSE CODE

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

A. Code	BMW	PVON				
B. Amount	19,000	4200				

13. PROJECT PURPOSE (maximum 480 characters)

TO DEVELOP PRIVATE FREE ZONES IN EL SALVADOR THROUGH THE ESTABLISHMENT OF A REVOLVING CREDIT FACILITY FOR PRIVATE FREE ZONES, AND TO IMPROVE THE ADMINISTRATION AND SERVICES OFFERED BY THE SAN BARTOLO FREE ZONE.

14. SCHEDULED EVALUATIONS

Interim MM 06 YY 90 | MM YY | Final MM 09 YY 93

15. SOURCE/ORIGIN OF GOODS AND SERVICES

[X] 000 [ ] 941 [X] Local [ ] Other (Specify) CBI-designated CACM

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

Methods of implementation and financing are hereby concurred with:

G. Franklin Latham
Controller, USAID/El Salvador

17. APPROVED BY

Signature

Title: Henry H. Bassford
Director, USAID/El Salvador

Date Signed: MM 06 DD 30 YY 88

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION

MM DD YY

PROJECT AUTHORIZATION

Name of Country/Entity: El Salvador

Government of El Salvador, and the Salvadoran Foundation for Economic and Social Development (FUSADES)

Name of Project: Free Zone Development

Number of Project: 519-0323

1. Pursuant to Sections 106 and 531 of the Foreign Assistance Act of 1961, as amended, I hereby authorize the Free Zone Development Project for El Salvador, encompassing grants to the Government of El Salvador and the Salvadoran Foundation for Economic and Social Development (FUSADES) and involving planned obligations of not to exceed Twenty Six Million United States Dollars ($26,000,000) in grant funds over a five year period from the date of authorization, subject to the availability of funds in accordance with the A.I.D. OYB/allotment process and administrative approvals, to help in financing the foreign exchange and local currency costs of the Project. The planned life of the Project is five years from the date of the initial obligation.

2. The Project consists of technical and financial support for the development of free zones to assist in the expansion of nontraditional exports from El Salvador, thereby generating productive employment and foreign exchange for the country.

3. The Project Agreements, which may be negotiated and executed by the officer to whom such authority is delegated in accordance with A.I.D. regulations and Delegations of Authority, shall be subject to the following terms and conditions, together with the terms and conditions as A.I.D. may deem appropriate.

a. Source and Origin of Commodities, Nationality of Services

Commodities financed by A.I.D. under the Project shall have their source and origin in the United States, or in El Salvador or other member countries of the Central American Common Market, except as A.I.D. may otherwise agree in writing. Except for ocean shipping, the suppliers of commodities or services shall have the United States, El Salvador, or other

member countries of the Central American Common Market as their place of nationality, except as A.I.D. may otherwise agree in writing. Ocean shipping financed by A.I.D. under the Project shall, except as A.I.D. may otherwise agree in writing, be financed only on flag vessels of the United States.

b. Conditions Precedent to Initial Disbursement - GOES

The following Conditions Precedent will be included in the Grant Agreement with the Government of El Salvador:

1. Prior to the disbursement of Project funds under the Grant Agreement with the Government of El Salvador, or the issuance by A.I.D. of documentation pursuant to which disbursement will be made, the Grantee shall, except as A.I.D. may otherwise agree in writing, furnish in form and substance satisfactory to A.I.D.:

(i) An opinion of counsel acceptable to A.I.D. that this Agreement has been duly authorized and/or ratified by and executed on behalf of the Grantee, and that it constitutes a valid and legally binding obligation of the Grantee in accordance with all of its terms;

(ii) A statement of the name of the person holding or acting in the office of the Grantee specified in Section 4.1, and of any additional representatives, together with a specimen signature of each person in such statement.

(iii) Evidence that the GOES has established a separate colón-denominated bank account to control the receipt and disbursement of Grant funding for other than the Credit Fund.

c. Conditions Precedent to Subsequent Disbursements - GOES

1. Prior to the disbursement of Project funds under the Grant Agreement with the Government of El Salvador for the Free Zone Development Credit Fund, or the issuance by A.I.D. of documentation pursuant to which disbursement will be made, the Grantee shall, except as A.I.D. may otherwise agree in writing, furnish in form and substance satisfactory to A.I.D.:

(i) Evidence that a separate dollar account has been established in the United States to control the receipt and disbursement of dollar funding for the Credit Fund under the Grant;

(ii) Evidence that the GOES has established a separate colón-denominated bank account to control the receipt and disbursement of Grant funds; and

(iii) Evidence that credit procedures have been established by the Central Reserve Bank which include: the grace periods, repayment periods, and interest rates of both long-term and working capital loans; criteria upon which the selection of commercial banks to participate in the Credit Fund will be based; loan forms and documentation required of loan applicants; the loan approval criteria of the Central Reserve Bank; and assurance of the availability of foreign exchange for subborrowers under the Credit Fund.

d. Covenants - GOES

1. The cooperating country covenants that A.I.D. will be able to brief and debrief consultants, participants and invitational travelers financed under the Agreements and will be furnished copies of reports produced by such persons.

2. The cooperating country covenants to make available foreign exchange, either from this Project's resources or from its own resources, for the foreign exchange needs of private zone developed under this Project or for the public institutions involved in the provision of infrastructure external to said zones.

3. The GOES will make its best efforts to enact measures to improve the administration of the San Bartolo Free Zone.

4. The GOES will make its best efforts to increase rental rates for facilities at the San Bartolo Free Zone for new contracts and contract extensions.

e. Special Provisions - FUSADES

Prior to the disbursement of Project funds under the Cooperative Agreement with FUSADES, or the issuance by A.I.D. of documentation pursuant to which disbursement will be made, the Grantee shall, except as A.I.D. may otherwise agree in writing, furnish in form and substance satisfactory to A.I.D.:

(i) A statement by the Board of Directors of FUSADES in which it names the person(s) empowered to act on behalf of FUSADES for all purposes relevant to the grant, and of any additional representatives, together with a specimen signature of each person so designated; and

(ii) Evidence that FUSADES has established separate dollar and colón-denominated bank accounts to control the receipt and disbursement of Grant funds.

f. Covenants - FUSADES

1. FUSADES covenants to maintain, in accordance with GAO Standards for Audit of Governmental Organizations, Programs, Activities, and Functions, consistently applied, books and records related to this Agreement, adequate to show without limitation, the receipt and use of all goods and services

acquired under this Agreement. Such books and records will be audited annually, in accordance with generally accepted auditing standards and be maintained for at least three years after the date of the last disbursement by FUSADES under this Agreement.

2. FUSADES covenants that A.I.D. will be able to brief and debrief consultants, participants and invitational travelers financed under the Agreements and will be furnished copies of reports produced by such persons.

_____

Henry H. Bassford
Director
USAID/El Salvador

_____

Date

Drafted by: ISmyer, RLA/MSDugan, PRJ
Cleared by: DKennedy, PRJ_____ Date_____
JStephenson, PRE_____Date_____
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FLatham, CONT_____Date_____
WKaschak, ADPP_____Date_____
RArchi, DDIR_____Date_____

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FREE ZONE DEVELOPMENT
PROJECT No. 519-0323

PROJECT DATA SHEET
DRAFT PROJECT AUTHORIZATION
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LIST OF ACRONYMS

AID	Agency for International Development
ANDA	National Administration of Aqueducts and Sewerage
ANTEL	National Administration of Communications (national telephone company)
BCR	Central Reserve Bank of El Salvador
CABEI	Central American Bank for Economic Integration
CBI	Caribbean Basin Initiative
CEL	Lempa River Executive Hydroelectric Commission (national electric company)
CENTREX	One-Stop Export Documentation Center
CODEXI	Export and Investment Development Committee
DEES	Department of Economic and Social Studies at FUSADES
DIVAGRO	Agricultural Diversification Program at FUSADES
ESF	Economic Support Fund
FEPADE	Private Foundation for Educational Development
FORTAS	Association Strengthening Program at FUSADES
FUSADES	Salvadoran Foundation for the Social and Economic Development
GOES	Government of El Salvador
GDP	Gross Domestic Product
IDB	Inter-American Development Bank
IRD	USAID Infrastructure, Regional Development & Earthquake Reconstruction Office
MICE	Ministry of Foreign Trade
MIPLAN	Ministry of Planning
NBCCA	National Bipartisan Commission on Central America
PID	Project Identification Document
PP	Project Paper
PRE	Private Enterprise Office, USAID/El Salvador
PRIDEX	Export and Investment Promotion Program at FUSADES
SBFZ	San Bartolo Free Zone
SFB	Standard Factory Building
USAID	United States Agency for International Development

AID	Agencia para el Desarrollo Internacional
ANDA	Administración Nacional de Acueductos y Alcantarillados
ANTEL	Administración Nacional de Telecomunicaciones
BCR	Banco Central de Reserva de El Salvador
BCIE	Banco Centroamericano de Integración Económica
CBI	Programa de Apoyo para la Iniciativa de la Cuenca del Caribe
CEL	Comisión Ejecutiva Hidroeléctrica del Río Lempa
CENTREX	Centro de Trámites de Exportación
CODEXI	Comité para el Desarrollo de las Exportaciones e Inversiones
DEES	Departamento de Estudios Económicos y Sociales de FUSADES
DIVAGRO	Programa de Diversificación Agrícola de FUSADES
ESF	Fondo de Apoyo Económico
FEPADE	Fundación Empresarial para el Desarrollo Educativo
FORTAS	Fortalecimiento de Asociaciones de FUSADES
FUSADES	Fundación Salvadoreña para el Desarrollo Económico y Social
GOES	Gobierno de El Salvador
BID	Banco Interamericano de Desarrollo
IRD	Oficina de Infraestructura, Desarrollo Regional y Reconstrucción del Terremoto
MICE	Ministerio de Comercio Exterior
MIPLAN	Ministerio de Planificación
NBCCA	Comisión Nacional Bipartita de Centro América
PIB	Producto Interno Bruto
PID	Documento de Identificación del Proyecto
PP	Documento del Proyecto
PRE	Oficina de la Empresa Privada, USAID/El Salvador
PRIDEX	Programa de Promoción de Inversiones y Exportaciones de FUSADES
SBFZ	Zona Franca San Bartolo
SFB	Edificio Industrial Estándar
USAID	Agencia de los Estados Unidos para el Desarrollo Internacional

Project Development Committee

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James Stephenson, Chief, Private Enterprise Office
Beatriz Peralta, Project Assistant, Private Enterprise Office
Juan Buttari, Economist, Development Planning and Program Office
Hector Diez de Medina, Evaluation Officer, Development Planning and Program Office
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I. SUMMARY AND RECOMMENDATIONS

The proposed Free Zone Development Project complements the Mission's and the Government of El Salvador's (GOES) efforts to promote nontraditional exports, foreign investment, and employment generation. As a part of the Mission's private sector strategy, the five-year Project will consist of $26.0 million in SDA and ESF grant funds to provide credit, technical assistance, and training to promote the development and improvement of free zones[1] in El Salvador. The Project is consistent with the recommendations of the National Bipartisan Commission on Central America to focus on export-led economic growth and recovery and the Mission's objectives of promoting exports and strengthening the private sector. The goal of the proposed Project is to increase productive employment opportunities and foreign exchange earnings in the export sector, thereby assisting the country's economic stabilization and recovery efforts. The purpose of the Project is to develop private free zones in El Salvador through the creation of a revolving fund for private zone development, and to improve the administration and services offered by the Government of El Salvador's free zone at San Bartolo.

The target group for Project inputs includes Salvadoran or foreign individuals or corporate entities interested in developing private free zones in El Salvador, and the public sector entities involved in the management and administration of San Bartolo or in the private free zone designation approval process. Direct beneficiaries of the Project will be the persons (primarily women) gaining employment and increased incomes. There will also be indirect job generation, as backward linkages with the local manufacturing/industrial sector and service sectors are developed.

It is estimated that over the Life of the Project, Project resources will have led to the creation of 32,083 person years of employment, $30.9 million in GDP generated, a net increase of $23.6 million in foreign exchange earnings, and 35 new local and foreign export operations.

Under the Private Zone Development component, $20.0 million in long-term financing will be made available to private free zone developers for permanent working capital, construction, and basic infrastructure within the zones. In addition, $2.14 million for technical assistance for pre-feasibility studies as well as for training in zone management, administration, and planning will be provided to zone developers by PRIDEX, the Investment and Export Promotion Program at FUSADES, the Salvadoran Foundation for Economic and Social Development. $200,000 in operational support for PRIDEX, and $260,000 for AID Project Management costs are also included under this component.

Under the Promotion/Marketing component, $1.16 million for technical assistance and promotion activities will be provided to PRIDEX. Private zone developers will benefit from PRIDEX's promotional efforts and will be able to access funds for zone-specific promotion under the Project.

The Project also provides $700,000 to contribute to the construction costs of the new FUSADES office building.

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[1] Also known as export processing zones or industrial free zones, the term "free zones" herein refers to zones designed to stimulate export-oriented assembly, light manufacturing, and certain services, such as data entry/processing. Such zones are geographically delineated areas within a country offering investors duty-free movement of goods in and out of the zone, and other fiscal, regulatory, and investment incentives.

The Infrastructure and Institutional Support component will enable the GOES to improve its support of the one existing public sector free zone as well as of new private free zones. $300,000 has been budgeted for assistance to the San Bartolo Free Zone (SBFZ) to improve its administration, management, and planning capabilities. $160,000 will be provided for public sector training, focusing on personnel from the GOES institutions involved in free zone designation and regulation, and on zone management, administration, and planning. $400,000 to establish a Project Coordination Unit within the Ministry of Foreign Trade is also included under this component. In addition, the local currency equivalent of $6.0 million in counterpart funds will be provided to finance public infrastructure (water, electricity, telephone lines, etc.) up to the gate of the new private zones.

Implementing entities were identified during the project development. The Project will build upon the capabilities of FUSADES, the Ministry of Foreign Trade (MICE), the Central Reserve Bank (BCR), and the Ministry of Planning (MIPLAN), developed under ongoing AID Projects. Further discussion of these entitees can be found in the Institutional Analysis and the Project Description.

The primary constraint identified in the PID (the lack of the free zone implementing regulation) has been alleviated. However, while the free zone reglamento setting forth the legal and regulatory framework for private free zones has been approved, there are other constraints to the growth of the export manufacturing/light industrial sector in El Salvador which this Project seeks to address. Among the most important are: inefficiencies and information gaps within the institutions that regulate and administer free zones in El Salvador, the absence of a zone promotional program and marketing strategy, the need for affordable long-term financing for industrial development initiatives within the export sector, and the lack of sufficient facilities to meet the demand for industrial space.

Annex A provides a cross reference to the PP sections in which the issues raised in the PID guidance cable are discussed.

The project development process included numerous consultations with various individuals, groups and business associations, and the banking community, among others; observational travel for key public and private sector actors to visit free zone operations in other countries; and close coordination with the proposed implementing entities. Enthusiasm and momentum for the private free zones is readily apparent. As a result of the analysis contained herein and Salvadoran support for the Project, the Mission recommends AID/W approval of the Project as designed.

SUMMARY PROJECT BUDGET
($000's)

	A.I.D.	GOES Counterpart	Private Sector Counterpart	Total
1. Private Zone Development	$22,600	---	$7,307	$29,907
2. Promotion/Marketing	$ 1,860	---	---	$ 1,860
3. Infrastructure, Inst.Support	$ 860	$6,132	---	$ 6,992
4. Capital Expenditures (FUSADES)	$ 700	---	---	$ 700
5. Evaluation/Audit	$ 330	---	---	$ 330
6. Contingencies	$ 350	---	---	$ 350
TOTAL	$26,000	$6,132	$7,307	$39,439

II. PROJECT BACKGROUND AND RATIONALE

A. Country Setting

The major factors currently affecting El Salvador are the economic situation, the guerilla conflict, the earthquake and its aftermath, and social divisions and polarization. In 1988, El Salvador entered the tenth year of a guerilla insurgency while it continued the struggle to recover from the worldwide economic recession of the early 1980's. The civil conflict has caused extensive damage to infrastructure and has severely disrupted production. While the Salvadoran Armed Forces have been successful in containing the conflict -- demonstrating greater expertise and professionalism -- the insurgency continues; the guerillas persevere in their efforts to destabilize the economy through terrorist acts and attacks on infrastructure. Though diminishing, the security problem is still widespread and handicaps economic growth, as significant public sector resources must be dedicated to resolving the conflict, and the private sector is hesitant to make capital investments or assume real or perceived risks in this unstable political environment. The conflict is the most significant negative factor affecting the country's investment climate for both foreign and domestic investors, and increased private investment is critical to economic growth.

On the social side, El Salvador has historically exhibited a highly skewed distribution of wealth and political power as the majority of the Salvadoran population was denied the chance to fully participate in the political system and the economy. While progress is being made in opening up the political process, as evidenced by the democratically elected President, national assembly, and municipal leaders currently in office, polarization between the Government and the private sector, and divisions between elements of the private sector continue to affect efforts to stimulate the economy.

Exacerbating the situation is the aftermath of the devastating October 1986 earthquake. The earthquake left nearly 1,000 dead, approximatelty 10,000 injured, and close to 240,000 without shelter. The earthquake also caused massive damage to infrastructure, public utilities and productive assests, primarily in downtown San Salvador. The damage estimate approaches $1.0 billion and includes housing for 40,000 families, 40 public buildings, hospitals, schools, bridges, utilities and light industry. In spite of major donor assistance, the earthquake destabilized the economy, and recovery efforts continue to be a major GOES priority.

B. Recent Economic Performance

The growing political turmoil in the region in the 1970's and early 1980's, and particularly in El Salvador, choked domestic and foreign investment flows that had, in large part, propelled the Salvadoran economy to historically high economic growth rates in the 1960's and 1970's. In 1981, industrialized nations, the major market for Salvadoran exports, entered a long recession during which time prices of traditional commodity exports, such as coffee and cotton, fell sharply and the demand for El Salvador's growing nontraditional export sector dried up. Between 1979 and 1982, there was a 38.3% fall in export earnings, a 41% decline in private investment, and considerable capital flight. As a consequence, per capita GDP fell by almost 40%, significantly reducing the living standards of the majority of the populace.

Between 1983 and 1986 the economy continued to register very low levels of economic activity, with an annual average growth of about 1.4%. While other countries of the region began to recover from the political and economic shocks of the late 70's and early 80's, El Salvador's export sector, especially its nontraditional export sector which had begun to show considerable dynamism in the late 1970's, continued to stagnate. Worse yet, at year-end 1986 the economy showed signs of increasing instability, with inflation averaging 32.1% for the year, and real GDP growth slipping to an officially recorded 0.6%. The balance of payments weakened even further, in spite of relatively high coffee prices and lower oil prices.

At year end 1987 there were several indications that the Salvadoran economy was beginning to turn around. The GOES succeeded in framing an economic program which was designed to cope with the economic crisis left in the wake of the events of 1986. The target of the 1987 Plan was to achieve a real growth rate of 2.2% while holding inflation to 25-27% and imparting some dynamism to the export sector. To achieve this target, the Plan included, in addition to benchmarks on money and credit growth, measures to encourage export expansion and diversification. Exporters of nontraditional products were: (a) to be able to retain their export proceeds in foreign currency deposit accounts to meet import requirements or to sell to other industrial manufacturers with import requirements (the so-called paralelito); (b) to receive tax credit certificates; and (c) to receive certificates for early surrender of export proceeds. The GOES achieved its principal program targets for 1987; real GDP growth in 1987 was 2.6%, in spite of a significant decline in coffee export earnings. The sectors most contributing to GDP growth were agriculture (2.5%), manufacturing (3.0%), and construction (14.0%). In addition, inflation was held to 25%. However, the GOES did not carry through with its program of export incentives.

GDP Composition. Agriculture remains the key sector in terms of contribution to GDP growth in El Salvador, representing 23.9% of GDP in 1987. Coffee is such a predominant economic activity that its price continues to be a major determinant of El Salvador's balance-of-payments position and the overall performance of the economy. Coffee remains the principal foreign exchange earner; in 1987, coffee sales were valued at $347 million, or 59% of total exports. Although prices were rising in June 1988, export volume is restricted under an international quota system, thereby restraining the country's revenues from coffee sales. Sugar, which accounted for 4% of total commodity exports during 1983-87, will continue to face relatively low world prices, and its quota in the U.S. market -- already sharply reduced over the last few years -- faces possible further reductions. The volatility of traditional agricultural commodity prices and the price elasticity thereof have caused Salvadorans to search for nontraditional agricultural and industrial exports as a means to reduce the country's vulnerability to international prices for a few traditional agricultural commodities.

In terms of 1987 GDP composition, agriculture is followed by manufacturing, commerce and government services, representing 17.6%, 16.2%, and 14.2% of GDP respectively. The percent of GDP represented by manufacturing has remained relatively constant (+/- 1.3%) over the past decade, reflecting the overall downturn in the economy and the demise of the Central American Common Market.

The Export Sector. Traditional Salvadoran exports have been coffee, sugar, and cotton. Nontraditional products such as shellfish, electrical/mechanical goods, textiles and articles of clothing, footwear, fruits and vegetables, meat, paper products, medical instruments, and toys, are also exported, primarily to the U.S. and to the CACM. It is noteworthy that while total exports decreased by 21.7% in 1987, the value of nontraditional exports increased by 23.5%., as shown in the following table on merchandise exports since 1984.

Value of Merchandise Exports (f.o.b.)
(U.S.$ millions)

	1984	1985	1986	1987	Est. 1988
Total Exports (f.o.b.)	725.9	695.1	754.9	590.9	629.0
- Coffee	443.9	457.9	539.1	347.3	348.0
- Cotton	9.1	29.0	4.5	2.3	4.0
- Sugar	25.9	23.2	25.3	12.1	12.0
- Ocean Shrimp	20.2	9.8	17.0	20.5	25.0
- Nontraditional Exports[1]	226.8	175.2	169.0	208.7	240.0
Exports to CACM	157.2	95.7	91.0	119.6	137.5
Extra-regional Exports	69.6	79.5	78.0	89.1	102.5

Source: Central Reserve Bank and USAID/El Salvador data.

[1] Includes value-added from drawback industries ($34.6 million in 1985, $16.7 million in 1986, $17.5 million in 1987, and an estimated $19.3 million in 1988.)

The Central American Common Market. Since the 1960's, the Central American Common Market has been an important destination for El Salvador's nontraditional exports, particularly of manufactured goods. Even after the sharp decline in intra-CACM trade in the 1980's, El Salvador's exports to the CACM averaged 18% of total commodity exports during 1983-87. Under a new, relatively free payments regime among trading partners, intra-CACM trade rose in 1987, for the first time since 1980. This, however, only meant that El Salvador regained part of the market that it lost early in the decade. Although the regional GDP growth rate is rising, and the new payments regime will relieve a significant constraint to trade, opportunities for increasing exports to CACM countries are limited as the easy import substitution opportunities are exhausted. A strong revival of intra-CACM trade to earlier levels would require major actions among the trading partners to extend the new payments regime to all countries (Costa Rica and Nicaragua currently do not participate), remove quantitative restrictions on trade that have been imposed in recent years, and rationalize the common external tariff. In addition, there are obvious political constraints at the present time to increasing regional cooperation.

Extraregional Markets. Approximately 70% of all Salvadoran exports are destined for the United States or the CACM. The remainder are exported to Europe, principally West Germany; South America; and the Caribbean.

Importance of the Industrial Sector. As the second leading GDP contributor, the industrial sector must be utilized to spur economic reactivation and growth. During the 1960's, the industrial sector was a significant engine of economic growth, achieving average annual growth rates of 9%. These economic growth rates were facilitated by the protection afforded by the policies of the CACM. As a result, a number of relatively inefficient and capital intensive consumer goods industries supplying the Central American region developed. In recent years, the shrinking and unreliable CACM market, combined with the country's civil war, terrorism, and economic problems have led to a major drop in manufacturing output and contribution to GDP. Declining real wages have also resulted.

The most significant industrial activities are in light manufacturing: textiles, clothing, non-metallic products, beverages, and food processing. Most are small and concentrated in the San Salvador metropolitan area. As an important element of the industrial sector, "drawback" operations are expanding. "Drawback" in El Salvador currently consists of production/assembly of the following: PVC pipe; plastic and packing material; miscellaneous leather goods; men's, women's and children's clothing; lingerie; bed linens and curtains; shoe parts; ceramics; electrical components/items; medical tools; miscellaneous sporting goods; and other items.

As with other small countries, El Salvador's small domestic market means the country depends on exports to foster growth. The country has faced problems with idle capacity and failures to adjust to external market requirements, as many plants were built with an eye to CACM markets that have been unable to absorb their output. Factors limiting growth in the sector today include the deficiencies in the policy matrix and the poor investment climate. In addition, industrial output is affected by the economic situation in and protectionist policies of industrialized countries.

The transformation of the sector from an import-substitution model aimed at domestic and CACM markets toward a more balanced, efficient industrial sector is clearly an enormous task and a gradual process which will require heavy investment; the opening of new markets, and matching the quality and composition of the product mix to the demands of the marketplace; more cost-effective production processes; and simplified export and import processes and paperwork. While the GOES and USAID pursue the objective of reactivating and reorienting the economy, an immediate response to the country's underemployment and economic problems is needed; promotion of light manufacturing/assembly operations and free zones is a viable option.

Employment. Analyses of both the 1985 National Household Survey and the 1986 Multipurpose Household Survey undertaken by the Ministry of Planning have provided the USAID Mission with a better appreciation of the unemployment situation in El Salvador. Open unemployment is not as serious a problem as previously thought; both surveys indicated that only 7-8% of the labor force is actively seeking work but cannot find it. This visible unemployment figure, however, masks the real problem, which is disguised unemployment and underemployment resulting from jobs so irregular or unproductive that they provide inadequate income to cover the worker's basic needs. According to the 1986 survey, median earnings among men measured 702 colones ($125) a month; 13% of the men reported earnings of less than 479 colones ($96) a month. Among women, half earned less than 479 colones ($96) a month; almost a third earned less than 300 colones ($60) monthly. Fully 35% of the urban employed earn less than the minimum wage, currently 450 colones per month. Wages in the rural areas are far more depressed.

These statistics indicate that the quality of employment, as evidenced by the low earnings of a significant part of the labor force, rather than employment per se, poses a serious problem for the development of El Salvador. The quality of employment is a function of productivity, the contribution to total output per average hour of work. With the stagnation in investment in the 1980's, the quantity and quality of capital goods available to the labor force to produce goods and services has deteriorated. With this deterioration came stagnation in the value of output, and hence in nominal wages. With the general price level rising faster than nominal wages, the real wage, a measure of the working persons' ability to purchase goods and services, falls.

Sustainable, productive jobs in the modern sector are needed if incomes and the quality of life of Salvadorans are to be improved. Given the land-population ratio in El Salvador, and projections for world prices for agricultural exports, industry will have to play a leading role in the absorption of labor into higher productivity employment. The pressing need for El Salvador, therefore, is a higher rate of industrial investment and output growth than has characterized the recent past.

C. Opportunities for and Constraints to Free Zone Development

While El Salvador suffers from a number of obvious difficulties (most notably the war) and a dubious reputation in investment circles, it does have positive aspects as well. The country has demonstrated its prowess in the industrial sector, and, until the demise of the Central American Common Market, was the leading manufacturer in Central America. It possesses a low-cost, eager and readily trainable work force, offering the potential for very high productivity. Several multinational companies operating in El Salvador today offer testimonial to this. El Salvador offers all the benefits of the Caribbean Basin Initiative, plus quick access to U.S. markets. The business class, many of whom have been educated in and frequently travel to the United States, is poised to take advantage of export opportunities such as free zone development/operations. An Export Promotion Law was passed in March 1986, and the related implementing regulations have all been approved. In addition, the Foreign Investment Guarantee Law, passed in April 1988, further clarifies the "rules of the game" for those interested in investing in the export sector.

The legal/regulatory constraint to achievement of Project objectives identified at the PID stage has been resolved; the free zone regulation promulgated under the Export Promotion Law that was considered a sine qua non for the Project was signed by the Acting President of El Salvador in May 1988. Nevertheless, the following constraints to the successful free zone development/investment remain:

Institutional Constraints. The only existing free zone in El Salvador is managed and overseen by the Ministry of Foreign Trade (MICE). MICE and the San Bartolo Free Zone administration, are weak, lack experience in free zone development, do not have sufficient institutional resources or financial autonomy to play a stronger role, and do not have a private sector orientation towards cost recovery, provision of services, or marketing and promotion. Although the Mission has provided assistance to San Bartolo under its dollar and local currency programs, this is viewed as a short-term, interim response to a demonstrated demand for free zone space before private zones are built.

Financing Constraints. El Salvador's financial market currently cannot support the financing requirements of new free zones, nor is foreign commercial finance available for free zone development. Free zone projects require large capital outlays and have long (8-20 years) payback periods. Many zones in developing countries have been financed with loans from bilateral or multilateral institutions, including AID. Some private zones have been financed from commercial sources or a combination of commercial and concessional donor resources on terms. Most term lending is provided by lines of credit and rediscount facilities funded by AID or other donors or multilateral agencies. To facilitate expansion of the free zone sector, long-term financing must be provided to prospective investors.

In addition, the GOES current fiscal situation does not permit large capital outlays for public works and infrastructure up to the gate of new private free zone(s). Although the GOES has supported the development of private free zones and has agreed to utilize ESF and PL-480 generated local currency counterpart resources for this purpose, it must be recognized that given its current fiscal and economic situation and the budgetary pressures of the war and the earthquake damage, the GOES has severely limited resources to assist private sector efforts to develop free zones.

Physical Space Constraints. There is currently no available space at the SBFZ for firms interested in a free zone location. Under the GOES portion of Project 519-0287 and the Mission's FY 1988 Local Currency Program, resources have been provided to finance the construction of approximately 24,000 m^2 (square meters) at the SBFZ this year. It is expected that the additional space will be fully occupied upon completion by existing clients who have requested space or by new zone clients who are waiting for space to become available.

The principal alternative to locating in a free zone is the establishment of a factory operating under recinto fiscal (bonded warehouse). However, the current market for industrial real estate/factory space is extremely limited, in part due to damage sustained in the October 1986 earthquake. A 1987 survey of industrial space carried out by FUSADES/PRIDEX identified a total of 17,622 m^2 in 29 sites, of which 43% was in the San Salvador area. Of these sites, only 8 (or 13,000 m^2) were over 1,000 m^2, normally the minimum for an export manufacturer. The lack of available factory space is a critical disincentive to potential investors, both Salvadoran and foreign.

Human Resource Constraints. Both public and private sector human resource constraints have been identified. Experience with the San Bartolo Free Zone and MICE indicate the dearth of the human resources required to plan, manage and promote a free zone. With the signing of the free zone reglamento in May 1988, MICE and other GOES institutions will acquire new responsibilities with respect to the designation and regulation of private free zones. None of the GOES entities are presently prepared to assume these responsibilities. In addition, while the Central Reserve Bank and the commercial banks are interested in playing a role in the development of private free zones in El Salvador, it must be recognized that their respective staffs have not been trained to perform financial analysis of free zone developments. Moreover, the national banking system has at times been characterized as slow and bureaucratic. On the private sector side, Salvadorans lack experience in free zone development.

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In summary, although El Salvador has made significant progress in improving the legal and regulatory framework for investment in the export sector in general and in free zones in particular, institutional, financial, physical space, and human resource constraints to free zone development still remain. The policy matrix, however, is generally adequate in terms of promoting investment and exports. With the exception of the fixed exchange rate and the overvalued colón, macroeconomic policy in El Salvador does not represent a significant deterrent to the success of this Project.

D. Relationship to A.I.D. Policies and Strategy

The proposed Project is consistent with the Agency's efforts to develop the private sector, and to increase its participation in the economy. AID is also assisting developing nations in their efforts to diversify their economies and to promote exports, particularly of nontraditional goods. By building upon efforts of other AID-financed projects with FUSADES and MICE, the Project is consistent with AID's emphasis on institution building. Lastly, the Lautenberg and Bumpers Amendments (PD-15) have been taken into account and are addressed in Section V.F of this PP.

The Project is consistent with the revised AID Policy Paper on Private Enterprise Development (March 1985), as the ultimate beneficiaries will be the poor majority who will gain productive employment and increased incomes; the Project is consistent with the Mission's policy dialogue efforts to promote economic stabilization and recovery and increased private sector participation in the economy; legal and regulatory constraints have been considered; management improvements and technology transfer through advisory services and training for the indigenous private sector is a key project input; and the terms of financing are appropriate for new, risky activities that involve the transfer of new technology.

The proposed grant is also consistent with the Guidelines on Terms of A.I.D. (June 1985), as the government-to-government grant for credit, technical assistance and training entails a high risk activity, and is politically sensitive in El Salvador; the provision does not apply to the grant for technical assistance and training to essentially transfer technology to FUSADES, as it is a nonprofit PVO operating primarily for social welfare, educational or charitable purposes. The interest rate to the ultimate borrower will be at prevailing local interest rates.

The goals of AID assistance to El Salvador are: (1) to stabilize the economy and a deteriorated political and social situation (including earthquake reconstruction starting in 1987); (2) to facilitate structural adjustments to achieve sustained economic recovery and growth; (3) to broaden the benefits of growth for the majority of the populace; and (4) to strengthen institutions which underpin the democratic process. These goals are consistent with the recommendations of the National Bipartisan Commission on Central America (NBCCA). The proposed Project corresponds directly to the first, second, and third goals, as it will promote key economic activity, offer substantial employment and foreign exchange generations, and increased incomes for new free zone workers.

Under the private sector element of AID's country strategy, long-term objectives are to increase employment and foreign exchange earnings, domestic and foreign investment, and per capita income. AID's short-term focus is on

re-export or "drawback" industries, and on providing incentives to increase private sector participation in the economy. The establishment of private free zones and improvements in the existing GOES zone responds directly to both the long-term and short-term focus of this strategy.

E. Relationship to Mission Projects and Programs

This Project is designed to build upon the groundwork, experiences, and successes of AID's ongoing private sector activity in El Salvador. A major focus of the Mission's strategy to promote economic growth led by the private sector is increasing nontraditional exports to extra-regional markets.

A cornerstone of the Mission's strategy is the Industrial Stabilization and Recovery Project, No. 519-0287, which consists of public and private sector components. The private sector component, implemented by FUSADES, provides technical assistance and credit to exporters of nontraditional manufacturing/light industrial and agribusiness/agricultural products. Agribusiness and nontraditional agricultural activities are supported with credit and technical assistance under the FUSADES component of the Agrarian Reform Sector Support Project, No. 519-0265; the Water Management Project, No. 519-0303; and the Agribusiness Development Project, No. 519-0327. Other Projects with FUSADES, such as Association Strengthening Activities, No. 519-0316, and Private Sector Initiatives, No. 519-0336, have provided additional support to Salvadoran business associations to institutionally strengthen them and increase their export orientation, and for economic and policy research, which includes an economic model for export-led growth. The public sector component of Project No. 519-0287 provides assistance to the Ministry of Foreign Trade, in recognition of its crucial role in formulating and implementing the policy and legal framework for investment and exports. Under this component, the Project has also financed training, technical assistance, equipment and supplies, infrastructure, and factory shell construction for the San Bartolo Free Zone.

Promotional activities financed under the proposed Project are designed to complement and augment the ongoing efforts of MICE and PRIDEX and will take into account the planned three year extension and $22.0 million[1] increase in LOP funding for the Industrial Stabilization and Recovery Project (519-0287), as articulated in the Mission's FY 1989-1990 Action Plan. Under Project No. 519-0287, PRIDEX currently carries out both general and sector specific promotional activities. Promotional activities include publications, videos, participation in trade fairs and other events, and maintenance of an U.S. office. The Free Zone Development Project will build on PRIDEX' capabilities by providing funding for an additional sector specialist and logistical support for this individual, and preparation and dissemination of informational materials on free zones, their impact in other countries, Salvadoran laws affecting free zone investment, and investment opportunities.

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[1] $15.0 million of the planned $22.0 million increase is for the light industry/assembly operations credit facility. The Project's current PACD is September 30, 1989; the planned PACD extension would be through 1992.

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Other Mission-funded activities, such as the counter-terrorism insurance fund and the local currency credit program utilize P.L. 480 and ESF Balance-of Payments local currency generations to encourage foreign and domestic investment and the export of nontraditional products. Local currency totalling ₡242,000,000 ($48.4 million) has been channeled to PROINVER, the counter-terrorism insurance fund which provides coverage of fixed assests, raw materials, semi-processed and processed goods against material damages due to civil unrest, malicious acts, and terrorism. Eligible firms are those exporting at least 10% of total output; as such, free zone firms are eligible to participate in the program.

To date, ₡832,250,000 ($166 million) has been provided through the credit lines for industry and agroindustry, national reconstruction, small and microenterprises, export of services, agriculture, and a special credit line for the reactivation of the Eastern zone. Under the Industry and Agroindustry Credit Line, financing is available for temporary and permanent working capital and investment capital requirements of industrial/manufacturing or agroindustrial firms producing nontraditional exports for extra-regional markets. It is expected that some of the free zone client firms will avail themselves of this facility, which has received approximately ₡220,000,000 ($44 million) to date, including ₡65,000,000 ($13 million) under the 1987 local currency program. However, given the tremendous demand for resources under the Industry Credit Line and the heavy financing needs of free zone projects, additional resources are needed to ensure adequate credit on terms appropriate to free zone development. The credit facility under the proposed Project will fill a void in El Salvador's capital markets, as long-term financing on terms needed for free zone development currently does not exist.

Related training is currently being carried out under the Training for Productivity and Competitiveness Project, No. 519-0315, with FEPADE, the Private Foundation for Entrepreneurial Development. The Project finances the following: (a) vocational-technical training, consisting of short modular courses designed in response to private sector demand, with special attention given to the immediate training needs of the construction industry and the nontraditional export subsectors; (b) management-administrative training, aimed at meeting the needs of the private sector in this area, consisting of short courses and seminars; (c) quick-start training needed by companies initiating operations or expanding production of nontraditional exports to world markets, short training programs are offered in-plant or in local institutions; and (d) scholarships-educational credit, providing scholarships to instructors and administrators of the participating vocational-technical institutes for training outside of El Salvador.

In reviewing FEPADE's program, two types of training planned or underway directly address the worker training needs of the Free Zone Development Project: vocational-technical and exports. To date, FEPADE has identified eleven specific sub-sectors in which they plan to start providing training immediately; these sub-sectors include textiles, surgical materials, electricity, masonry, transportation, mechanics, carpentry, plumbing, and graphics arts. The worker training contemplated in the Free Zone Development PID would replicate FEPADE's efforts. Therefore, it has been deleted from the present Project. The Mission will work closely with FEPADE to ensure free zone-related training is carried out in an expeditious fashion under Project No. 519-0315.

F. Relationship to GOES Activities

The proposed Project is consistent with the GOES's stated development goals which include: promoting new productive investment; expanding and diversifying the export sector; and designing a program for nontraditional export development that includes, in addition to fiscal and exchange incentives, a strategy for penetration of foreign markets.

There is increasing recognition of the need to promote nontraditional exports and investment through a joint GOES-private sector effort. The passage of the Export Promotion Law in 1986 signaled the crossing of a critical threshold by both the government and the private sector. Since that time, the GOES has continued to work on creating the desired legal structure to encourage and support foreign investment and export development in general. Six implementing regulations have been issued relating to: registration of exporters, benefits and sanctions, barter and counter trade, customs, and a one-stop export documentation center (CENTREX), and free zones. In addition, in April 1988 the National Assembly passed the Foreign Investment Guarantee Law, another success of joint private-public sector efforts. Additional evidence of the GOES commitment to investment promotion and nontraditional export development is the recently signed free zone reglamento.

Perhaps the most significant positive development in the policy dialogue framework has been the creation of the Export and Investment Development Committee (CODEXI), a high-level informal steering committee made up of public and private sector leaders. Chaired by the Minister of MICE, CODEXI has proven to be especially effective in expediting progress in matters related to export expansion. CODEXI members were largely responsible for the drafting and approval of the free zones reglamento, which sets forth the implementation procedures and regulatory framework for private zone development in El Salvador.

It is important to mention that the GOES views the expansion of its free zone, San Bartolo, as a priority. Utilizing counterpart funds, MICE plans to build 24,000 square meters of under-roof space, of which 4,000 are currently under construction. The plans for the additional 20,000 square meters have been prepared. It is expected that construction of these buildings will start in late-1988.

G. Other Donors

The Central American Bank for Economic Integration (CABEI) loaned the GOES $11.5 million in 1978 for the construction of the main access road and entrance to the San Bartolo Free Zone. As noted earlier, the majority of the tenants in the early 1980's left the free zone because of the ongoing guerilla insurgency in general, and targetting of private businessmen in particular. Because of the resulting excess capacity at the free zone and the immediate need to deal with the coffee rust problem, the GOES transferred $10.0 million out of the $11.5 million to the BCR to control coffee rust in 1980. CABEI has fully disbursed the $1.5 million to MICE. No immediate plans are reported by CABEI to provide funds to the GOES for the development of new public free zones.

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The Inter-American Development Bank (IDB) is financing two pre-feasibility studies for the construction of free zones, one in Comalapa and one in Acajutla, as requested by MICE in September, 1987. However, the IDB believes that given the delays encountered in the terms of reference preparation process, it will not be able to obligate funds for this purpose before the end of its fiscal year (July 31, 1988). In addition, the IDB is in the most preliminary stages of considering providing $50 million for the financing of future public sector free zone(s). However, if the IDB project is approved, it is unlikely activity will commence during the life of the AID Project. Consequently, the lack of industrial space would continue to be a significant constraint to promoting invesment in El Salvador if other efforts are not made to solve this problem in the short to medium-term at a minimum.

III. DETAILED PROJECT DESCRIPTION

A. Project Goal and Purpose

The goal of the Project is to increase productive employment opportunities and foreign exchange earnings in the export sector, thereby assisting the country's economic stabilization and growth efforts. The purpose of the Project is to develop private free zones in El Salvador through the creation of a revolving credit facility for private zone development, and to improve the administration and services offered by the GOES free zone at San Bartolo.

B. Expected Achievements

Estimated LOP outputs are as follows:

Private Zone Development:

- approximately five pre-investment studies,
- construction of approximately 70,000 m^2 of free zone space,
- 7,000 new jobs at minimum wage or better,
- $18,000,000 in new investment in export manufacturing,
- 35 new local and foreign firms producing for export,
- $49,000,000 in new exports,
- a net increase of $8,890,000 in foreign exchange earnings, and
- 2-3 private free zone managers trained.

Public Sector Involvement in Free Zone Development:

- public infrastructure for Project-financed private zones in place,
- improved operations at the SBFZ and establishment of an autonomous corporation to manage the zone, and
- All relevant GOES entities trained to carry out their respective responsibilities under the free zone reglamento.

C. Assumptions

The following assumptions were utilized in formulating the strategy and the design of this Project:

(1) the legal/regulatory environment for free zones and exports will not change significantly over the life of the Project;

(2) the military situation will not deteriorate over the short run, and will improve over the medium term;

(3) the upcoming scheduled election will take place in a democratic fashion;

(4) the new administration to assume office in June 1989 will continue to support export initiatives and private free zones;

(5) public/private sector relations will continue to improve; and

(6) exporters from El Salvador will continue to find reasonably profitable marketing opportunities.

D. Project Strategy

1. Overall Strategy

No one project or program can successfully address all of a particular country's developmental problems. With this in mind, the strategy of the Project is to respond expeditiously to the void of technical, financial, and human resources needed to initiate a successful free zone program in El Salvador. The overall strategy, then, is to provide the necessary inputs throughout the LOP, to the GOES entities involved in free zones and to the private sector. Simultaneous training, technical assistance, and promotional activities will bring public and private sectors up to speed, so to speak, in free zone development. A credit facility with terms appropriate for the long-term nature of free zone development will be established, with sufficient capital to permit the rapid development of one - two private free zones, thereby alleviating the financing constraint and thereby permit the rapid development of one - two private free zones.

This Project seeks to address structural problems in the economy. By facilitating investment in the nontraditional export sector, the Project will assist GOES efforts to not only increase exports but also to diversify the export sector. Benefits to the economy will be increased jobs and income, foreign exchange earnings, and investment. Jobs created under the Project will be productive and sustainable -- a key point given the significant underutilization of labor and low wages in El Salvador. Sustainable, productive jobs and the corresponding increased wages require capital investment. The underlying rationale for this Project is to provide key actors with the inputs (credit, technical assistance, training, operational support) needed to address identified constraints -- thereby facilitating investment in the export sector.

2. Public Sector Participation in the Project

Although the thrust of the Project is on supporting the private sector, free zone-related public sector entities will also receive assistance. In El Salvador, perhaps more so than in other countries, the support of the government is critical. In order for any private free zone to succeed, the GOES needs to be facilitative of private zone developments, recognizing the positive role the private sector can play in generating employment and foreign exchange.

At the same time, it must be recognized that the existing public zone at San Bartolo is an asset to be developed. While imperfect, it's existence should not be ignored as a vehicle for fomenting investment and exports. USAID's strategy for San Bartolo is to provide resources in 1988 to construct additional space for current effective demand, and to promote the establishment of the zone as an autonomous institution over the medium to long term. Accordingly, the MICE component of the Industrial Stabilization and Recovery Project is currently financing technical assistance and training to improve zone operations, to improve the GOES' promotional capabilities, to increase rental rates to cover costs, and to improve the export and investment environment. USAID assistance to San Bartolo is a short-term response to immediate demand for space in the Zone. Therefore, additional AID resources for infrastructure, construction, or operating costs are not contemplated. (Further detail on current assistance to the SBFZ is contained in Section II.E of this Project Paper.)

Any assistance to San Bartolo under the Free Zone Development Project is predicated on submission, in form and substance acceptable to AID, of a timetable for rental rate increases, and evidence of the GOES' commitment in the form of concrete plans to make the SBFZ fiscally and operationally autonomous. Even under these conditions, this Free Zone Project will only finance a limited amount of the technical assistance required to bring about the proposed zone improvements.

Potential competition between San Bartolo and the new private zones and the seeming inconsistency of this two-pronged approach is an obvious issue. The Market Assessment and Demand Analysis contained in Annex G and summarized in Section VI.B of this Project Paper concludes that the impact of the existence of the SBFZ, with its subsidized rates, on the viability of the private zones will be marginal. This assessment is based primarily on the very high demand for under-roof free zone space. In other words, the Mission is confident that there is more than enough demand for the expanded space at San Bartolo as well as for all the industrial space to be constructed under this Project. The domestic demand survey also illicited information on tolerance levels for various rental rates. Entrepreneurs surveyed expressed the willingness of exporters polled to pay up to twice the current rate at San Bartolo for an improved product; the average optimal rental rate expressed was $2.40 -- 58 percent higher that San Bartolo rates. The exporters and potential exporters expressed great interest in the convenience and efficiency of the services that could be offered by a free zone. Most of the current expansion at San Bartolo will be occupied by existing SBFZ clients, making the option of locating there moot for most investors. However, the Mission will coordinate closely with the GOES to ensure that any future GOES expansion of industrial space does not have a detrimental effect on private zones.

E. Inputs and Outputs by Project Component

The Project consists of three interrelated components designed to provide the credit, technical assistance, training and institutional support required to foment successful free zone development in El Salvador. The first component, Private Zone Development, provides long-term financing and technical assistance to Salvadoran investors to promote the successful establishment of private free zones. Under the second component, Promotion and Marketing, the Project will provide technical assistance, training and operational support to PRIDEX to promote El Salvador's free zone program both domestically and internationally. The Infrastructure and Institutional Support component has been designed to help improve the operations and management of the San Bartolo Free Zone, fortify the government's information program and to assist in establishing an efficient regulatory framework for zone development throughout the country. In addition, counterpart funding will be made available by the GOES under this component to install the required external infrastructure for the private free zone(s). Lastly, the Proejct will provide funding to contribute to the construction costs of the new FUSADES office building. The anticipated inputs and outputs for each of the Project components are discussed below and are shown in the following matrix.

1. Private Free Zone Component ($22.60 million AID, $7.307 million counterpart)

The Salvadoran Export Promotion Law of 1986 authorizes the establishment of private free zones in El Salvador by foreign and domestic developers. Until passage of this law, only the Salvadoran government was allowed to undertake free zone development, and the results were disappointing. Despite an auspicious beginning, the single public free zone,

MATRIX OF PROJECT INPUTS, ACTORS, TARGET GROUPS AND OUTPUTS

COMPONENT 1: PRIVATE FREE ZONE DEVELOPMENT.....TARGET GROUP: PRIVATE FREE ZONE DEVELOPERS.

INPUT/ELEMENT	DESCRIPTION OF ACTIVITY	ACTOR	OUTPUT
Credit	($20.0 million AID, $6.6 million counterpart) term credit for working capital, fixed asset investment, and zone-specific promotion.	BCR, commercial banks	2-3 private free zones, with approximately 70,000 m^2 of under-roof space.
Technical Assistance	($2.02 million AID, $ 667,000 counterpart) pre-investment studies of proposed private zones.	PRIDEX/FUSADES	5 pre-invest. studies; (2 feasibility studies, 3 smaller studies).
Training	($120,000 AID, $40,000 counterpart training for private free zone managers/ administrators.	PRIDEX/FUSADES	2-3 zone managers trained
Operational Support	($200,000 AID) funding for hiring and training of free zone specialist and for advisory services.	PRIDEX/FUSADES	FZ specialist hired and trained.
	($260,000 AID) funding for AID Project Manager position, including free zone-related training and travel.	USAID/El Salvador	Trained Project Manager for LOP.

COMPONENT 2: PROMOTION/MARKETING.....TARGET GROUP: PUBLIC AND PRIVATE FREE ZONES.

INPUT/ELEMENTS	DESCRIPTION OF ACTIVITY	ACTOR	OUTPUT
Program Support	($860,000 AID) assistance to augment PRIDEX' promotional program to include emphasis on investing in locating in free zones in El Salvador.	PRIDEX/FUSADES	Effective free zone promotion in place.
	($300,000 AID) advisory services to develop a free zone promotional strategy and other project-related T.A. needed by PRIDEX.	PRIDEX/FUSADES	Free zone promotion strategy developed.

COMPONENT 3: INFRASTRUCTURE AND INSTITUTIONAL SUPPORT.....TARGET GROUP: RELATED GOES ENTITIES.

INPUT/ELEMENTS	DESCRIPTION OF ACTIVITY	ACTOR	OUTPUT
Technical Assistance	($300,000 AID) support for GOES efforts to improve SBFZ, to develop a master plan for public zone development, and to establish an effective regulatory and supervisory system for private zones.	MICE/SBFZ	Improved operations at SBFZ and establishment of an autonomous corporation to manage the zone.
Training	($160,000 AID) training for BCR, commercial bank, customs, MICE and others to facilitate private free zone development.	MICE	GOES entities able to carry out responsibilities relating to free zone reglamento.
Financing	(C30,000,000 counterpart) support for GOES efforts to facilitate private free zone development.	SETEFE, CEL, ANDA, ANTEL, MOP.	Public infrastructure up to gates of new private zones in place.
Operational Support	($400,000 AID, $132,000 counterpart) establishment of a Project Coordination Unit within MICE for all public sector assistance; training of its personnel.	MICE	Effective Project coordination.

COMPONENT 4: CAPITAL EXPENDITURES (FUSADES BUILDING CONSTRUCTION).....TARGET GROUP: FUSADES.

INPUT/ELEMENTS	DESCRIPTION OF ACTIVITY	ACTOR	OUTPUT
Financing	($700,000 AID) contribution to the construction costs of FUSADES' new office building.	FUSADES	Partial financing of building construction.

Evaluation/Audit	(330,000 AID)
Contingencies	(350,000 AID)

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San Bartolo (SBFZ), has languished in recent years due to the detrimental impact of the uncertain political and social climate on foreign investment and, perhaps more importantly, the lack of attention directed toward the zone by the GOES.

The enactment of the Export Promotion Law, together with the implementing reglamento provides private investors in El Salvador with their first opportunity to undertake their own free zone initiatives. However, if free zone projects are to be effectively realized, especially in the Salvadoran context, careful pre-investment analysis and design work, long-term financing at attractive terms and conditions, and effective management and administration once operational are required. As discussed in Section II.C of this Project Paper, El Salvador currently possesses human resource and capital market constraints to developing private free zones. Accordingly, this project component provides as inputs the financing required to facilitate private zone development in El Salvador, and the technical assistance needed to ensure that the such zones are viable.

The Project will provide $20 million for the Central Reserve Bank of El Salvador (BCR) for the establishment of a colon-denominated rediscount facility for term lending to eligible private free zone developers. AID will review subloans only to ensure compliance with environmental procedures and Section 611 of the FAA. Housed in the BCR, the revolving credit facility will establish a credit line open to all qualified intermediate credit institutions (ICIs), including registered foreign banks, for onlending to eligible sub-borrowers for the development and construction of private free zones, and to meet their working capital requirements. The counterpart funding under this element will be the equity contributions of the sub-borrowers; the credit facility will finance up to 75% of the total development costs of any one private free zone. Total funding for this element, including counterpart, is $26.6 million.

Fifteen (15) hectares is generally considered the minimum practical size for free zone/industrial estates in order to achieve economies of scale in their development and operation (that is, both design and construction and ongoing management, facilities, and services provision). The size of the "typical" free zone to be funded under this Project, as presented in the financial and economic analyses summarized in Section VII, has been estimated at 20 hectares. Precise cost data are not available because sites have not been specified, and targeted industrial sectors and accompanying facilities and services requirements have not been identified. However, based on the detailed cost analysis containd in Annex H, it is estimated that the $20.0 million in AID funding for credit under this Project component will finance the establishment of at least two free zones in El Salvador.

Training in zone management and operations for private free zone managers and key staff will also be funded under this component. The AID contribution to zone management training is $120,000 for two to three zone managers, or 75% of the training costs. Trainees will contribute 25% of the training costs, estimated at $40,000.

In addition, this component includes technical assistance for the preparation of requisite pre-investment studies (market assessments, demand analyses, feasibility studies and the like) for individual zones. The technical assistance will be implemented through PRIDEX, the Export and

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Investment Promotion Program of FUSADES. AID funding for this element is $2.02 million, with $667,000 in counterpart contributions to be provided by the recipients of the technical assistance.

Lastly, this component includes operational support to establish and maintain a PRIDEX free zone specialist as well as the AID Project Manager. Total funding, including counterpart, for the Private Zone Development Component is $29.907 million. Further information on these elements follows.

Free zones are essentially industrial estates which offer special tax, tariff and regulatory benefits to their users. Like any other sizeable industrial project, they require extensive pre-investment studies if they are to be successfully developed and implemented. Given the riskiness of the investment climate in El Salvador for undertaking long-term development initiatives, the Private Free Zone Development component of this Project will provide grant funding to finance up to 75% of the total cost of the pre-investment analysis conducted for private free zones.

The costs for conducting the full spectrum of design planning and feasibility analyses for a proposed free zone can range from $500,000 to $1 million, depending on its size and characteristics. The following types of studies will be financed under this component:

* selection/locational analyses to determine the optimal site for zone development based upon an assessment of the physical, social and economic attributes of the various locations under consideration. [1]

* prefeasibility studies to assess the zone's viability, including an analysis of the institutional setting and the competitive environment, market demand analysis, optimal zone configuration, management analysis, and environmental analysis. Physical design work is carried out to a conceptual level, including administrative and common facilities to be offered, number and size of industrial/commercial buildings, internal infrastructure requirements, and the development of a preliminary Master Plan. These studies also provide a construction schedule and preliminary financial projections for the proposed zone. A positive prefeasibility analysis is generally considered sufficient documentation of the project's viability to obtain external financing.

* Feasibility studies covering essentially the same areas as the prefeasibility study but to a level of detail sufficient to initiate zone construction, and an environmental impact assessment to identify and address any potential negative impact of the zone development. Financial projections are established with a degree of accuracy within +/- 15% and detailed architectural and engineering design work is conducted.

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1 Under some circumstances, Project funds may be used for this item. However, since locational analyses are a requirement of zone pre-qualification by the GOES, the majority of these studies will be funded by the respective developers.

It is estimated that a total of five pre-investment studies can be conducted with the $2,020,000 in AID resources budgeted for technical assistance: two full feasibility analyses and three smaller studies. The feasibility studies will be sufficiently detailed to be used as the basis for beginning the construction on two zones, should their results be positive.

As mentioned before, the technical assistance provided under this component will be coordinated by PRIDEX. PRIDEX will bear the responsibility for assessing the development plans of the various private groups -- a number of which have already expressed serious interest -- and arranging for the outside technical assistance required for analysis of the proposed zones deemed to merit further investigation. Although PRIDEX is well-versed in the execution of feasibility studies for individual industrial and commercial enterprises, their experience in the area of industrial real estate development and, specifically, free zone development is limited. This component of the Project, therefore, as well as the marketing and promotion component discussed below, involves institutional strengthening. On the most basic level, this entails developing the capability to screen potential applicants for technical assistance to ensure that they are serious investors and that their proposals merit further consideration.

In order to effectively administer and coordinate the technical assistance encompassed in this component, PRIDEX will hire a full-time staff member to specialize in the development and support of free zones. This person should be a college-educated Salvadoran, experienced in business and familiar with free zones, and possessing a thorough knowledge of the export manufacturing sector. In addition, PRIDEX may contract the services of a consulting firm experienced in free zone development to both train the in-house specialist and to help coordinate and execute the technical assistance and related marketing and promotion discussed below. The training of the zone specialist will include enrollment in an established free zone/industrial park management course. By drawing upon the resources and expertise of an outside firm, quick start-up can be facilitated and the additional staffing requirements for PRIDEX minimized. Any equipment furnished to PRIDEX under the Project will remain with PRIDEX after the LOP to strengthen the institution's marketing and promotional capabilities.

2. <u>Marketing and Promotion Component</u> ($1.16 million AID)

The Marketing and Promotion Component is designed to provide private sector free zones in El Salvador with the promotion/marketing required to successfully attract and retain foreign and domestic investment. PRIDEX' lack of experience in free zone promotion and marketing was identified as a human resource constraint to zone development in El Salvador. Therefore, this component consists of technical assistance, training and operational support to PRIDEX to initiate a domestic and international promotional effort for the Salvadoran free zone program.

Based on current PRIDEX costs and the cost of similar promotion programs in the region, AID funding for this component is estimated at $1.160 million. AID will provide $860,000 to enable PRIDEX to increase the scope of its present activities to encompass a concentrated free zone promotional effort. PRIDEX will also receive $300,000 to contract outside technical assistance to assist in the formulation and execution of a zone promotional strategy and the development of promotional materials. The total budget for the Marketing and Promotion Component is $1.16 million.

PRIDEX has already established a solid institutional foundation for promoting investment opportunities in El Salvador and the development of export-based production activities within the country. As a part of this Project, USAID will provide resources to PRIDEX to enable it to undertake a multi-faceted promotional effort in support of the free zones of El Salvador. There will be no duplication of effort, as resources provided will be for free zone promotion specifically, as opposed to general investment promotion. These activities will not be specifically targeted toward the individual private free zones envisioned under this Project, but rather will promote the advantages of investing in a Salvadoran free zone location -- public or private. Representative outputs under this component are presented below. Although they appear in roughly chronological order, clearly certain activities can be conducted simultaneously or will overlap in their execution.

* Basic Information on Free Zones. As a part of its ongoing efforts to promote and expand Salvadoran export activity, PRIDEX will prepare and distribute informational material on free zones in other countries, and the benefits they can bring to El Salvador. These publications will fill the need to develop a basic awareness within both the public and private sectors of the rationale behind zone development and pave the way for the more targeted assistance to follow.

* Promotional Literature on Salvadoran Laws Governing Free Zone Activity. Both foreign and domestic firms considering free zone locations require clear, concise information on the legal basis for their investment. Countries which gather all rules pertaining to zone investment in one package or, ideally, in one document have a valuable edge over the competition. PRIDEX will prepare basic information for foreign investors and local exporters on the basic laws and regulations relevant to free zone development and investment in export operations. Pamphlets will be in both Spanish and English and will include a listing of sources to turn to for additional information.

* Conference on Investing in Private Free Zones. PRIDEX will sponsor a conference highlighting the new opportunities for private free zone development in El Salvador. Information on the AID Project will be distributed. Representatives from MICE and the Ministry of Finance will explain the application review process and the rules governing zone development and operation. Likewise, the BCR and commercial banks will discuss the terms and conditions under which financing for private free zones will be offered. Panels will be held featuring owner/operators of successful regional zones, zones users and experts on zone development.

* Demand Analyses to Identify Target Sectors for Salvadoran Free Zones. With over 41 free zones already operating in the CBI region, new zones must pay careful attention to pinpointing the most probable geographic and sectoral origins of demand for their facilities. By targetting sectors in advance, promotional material will be prepared to attract those industries which can benefit most from locating in a Salvadoran free zone, including information regarding trade agreements, quota restrictions, and operating cost estimations directly related to their activities.

* Promotional Campaign for Salvadoran Free Zones. This will include: a targeted promotional strategy to attract the industrial sectors identified in the demand analyses; sector-specific promotional material for distribution (in English and Spanish); a data base on local subcontracting and joint venture opportunities for foreign investors; participation in regional and international conferences to publicize Salvadoran free zone

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opportunities; and local media events to promote the successes achieved by free zones in El Salvador.

The operational support funded by AID is for the materials, facilities, and logistical support needed to undertake this effort. The ongoing involvement of an outside contractor will enhance the coordination of the numerous activities comprehended under this component ranging from preparation of promotional literature to conference organization. The cumulative effect of these activities will be to develop a new area of specialization within PRIDEX in support of free zone development and to establish a solid promotional foundation for the growth and development of the Salvadoran free zone program.

3. Infrastructure and Institutional Support Component ($860,000 AID, $6.132 million counterpart)

A free zone's prospects for success are limited without the full support of the government as a free zone relies on government cooperation to facilitate the licensing of businesses, the entry and exit of goods, and the efficient operation of industrial activities, and a business is unlikely to invest in a zone if the government-determined "rules of the game" are uncertain or subject to change. In this light, the role of the GOES in this Project is crucial, for it determines the framework within which all Salvadoran free zones will operate.

Historically, MICE has directed little effort to the development of free zones in El Salvador. The performance of the SBFZ has improved in recent years, despite the inattention of MICE. However, with the passage of the reglamento and given the activities encompassed by this Project, MICE will soon find that its ability to effectively regulate zone development in El Salvador is critical. In this light, this component will direct technical assistance to MICE in three areas: (i) regulation and supervision of the nationwide public and private free zone program; (ii) zone development; and (iii) management and operations of San Bartolo. Counterpart resources will be utilized to fund the external infrastructure of the new private zones.

Institutional Support. This component is comprised of GOES assistance to the private sector zone developments, and AID assistance to the GOES. AID will fund technical assistance and training to improve the ability of MICE to manage the SBFZ, and to encourage the GOES to redefine its role in public free zone projects. Personnel from the BCR and the commercial banks will be trained in credit and financial analysis of free zone development projects. Customs personnel assigned to the private free zones will also be trained to facilitate smooth processing of paperwork and shipments. Moreover, this component encompasses support for the private sector free zones by the GOES in the form of external infrastructure required by the zones.

i. Regulation and Supervision of the Nationwide Zone Program

AID will provide $460,000 to MICE for the technical assistance and public sector training under this Component, and $400,000 to establish and train a Project Coordination Unit within the Ministry. The technical assistance will support GOES efforts to increase the effectiveness of its existing free zone, develop a master plan for public zone development, and to establish an effective regulatory system for assessing and supervising the development of private free zones in El Salvador. Should the GOES make significant progress toward increasing the effectiveness and autonomy of the SBFZ, up to $300,000 may be provided to finance the technical assistance

needed to help San Bartolo improve its operations and management, or to study the possibilities of future public zone development. If sufficient GOES interest in developing a new public free zone is manifested and should AID determine future public zone development is desirable, up to $100,000 of the $300,000 may be used to finance a detailed pre-investment analysis of a new public free zone. Training for the SBFZ staff in zone management and planning techniques and for MICE personnel involved in zone regulation, as well as for the BCR and the commercial banks, and for Customs personnel involved in free zones will also be financed under this component, estimated at $160,000.

Up to $400,000 in Project resources has been budgetted for the salaries of the Project Coordination Unit, consisting of a manager, assistant, and secretary, as well as related office and logistical support, technical assistance, and training. The Grant Agreement with the GOES will stipulate that the AID approval of these individuals will be required. Thereafter, as discussed in Section V.C of this PP, AID will execute direct contracts for these individuals and other MICE procurements. Total funding for the GOES under the Project, then, is $860,000.

With respect to the regulation and supervision of the nationwide zone program, MICE will draw in the outside assistance to develop an efficient application review process, assist in evaluating proposals, and set forth a workable system of ongoing supervision of approved zones.

ii. Future Free Zone Development

The GOES has expressed an interest in investigating new zones and undertaking increased industrial development activities. A strategy document, setting forth its goals for public free zone development in El Salvador will be prepared, detailing the steps to be taken to increase the autonomy of San Bartolo before this Project's resources finance a study of a new free zone in El Salvador.

iii. San Bartolo Free Zone Management and Operations

Finally, this component encompasses technical assistance and training to be provided to MICE to improve the performance of San Bartolo. A portion of the technical assistance will be devoted to a comprehensive evaluation of the present management and operational structure of the zone. Important issues to be addressed will include: methods to increase management responsiveness, the establishment of rental rates which cover costs, effective marketing, planning for expansion, and infrastructure, facilities and services improvements. Based upon the recommendations of the study, funding will be provided to the SBFZ for training of key staff members in such areas as standard business practices, property management, client-tenant relations, and innovations in facilities and services design in free zones in other locations. The combined result of the technical assistance and training will be a more profitable free zone and a better trained management force.

Infrastructure. In addition to the above AID-financed activities under this component, the GOES has set aside the colón equivalent of $6 million for the installation of the external infrastructure for the private free zones. Although the precise costs of installing telephone, water and sewer, and electrical hookups are not known, as sites have not been pre-selected, the GOES has assured that it will make requisite funding available for the zone(s). Upon approval of a private free zone application, MIPLAN will authorize the relevant utilities, ANTEL (telecommunications), ANDA

(water and sewer), and CEL (power supply) to undertake Project-financed engineering and design work required prior to installation. These plans will be reviewed with the zone developer and AID to ensure that they meet the requirements of the project. MIPLAN will then authorize disbursements of local currency resources to finance the installation of the infrastructure. Private zone developers will bear responsible for on-site hookups.

4. Capital Expenditures (FUSADES Building Construction) ($700,000 AID)

A principal objective of A.I.D. assistance to FUSADES has been the long-term viability of the Foundation. Accordingly, AID projects with FUSADES were structured to address the long-term needs of FUSADES as well as to enable FUSADES to provide assistance to the private sector, by providing for funds for non-project specific costs of FUSADES. AID funded 100% of the technical assistance, training, seminars and conferences, etc., and the contributions from beneficiaries of such activities went into the general funds of FUSADES. A minimun of 25% is sought by FUSADES when it approves an assistance activity.

This placement of beneficiary contributions in the general funds of FUSADES, as opposed to being applied to the cost of the individual assistance activities, was questioned by the RIG in its 1987 Audit of FUSADES. As a result, a legal opinion was sought from the GC/LAC. The legal opinion issued July 11, 1988 found nothing illegal or counter to A.I.D. policy in this practice and stated that the beneficiary contributions were not subject to allowable costs principles of A.I.D.'s monies, as articulated in OMB Circular A-122. However, the GC/LAC recommended that, because of the potential for abuse or conflicts of interest on the part of FUSADES when approving financing for activities, the practice be discontinued. Consistent with this legal opinion, the current Project Agreements with FUSADES will be amended to state that all income from beneficiaries will be utilized for further assistance activties under the Projects.

FUSADES has used the beneficiary contributions to establish a fund to finance the construction of an office building for the Foundation; FUSADES currently rents office space in four different buildings in San Salvador. The cost of the building and furnishings is estimated at $2.9 million. The building makes sense from both the financial and organizational standpoint, as commercial rents are high in El Salvador, and FUSADES has been unable to locate sufficient space to house its staff in one building, both results of the devastating 1986 earthquake in the capital. Furthermore, the building is viewed by FUSADES as critical to the institution's permanence. (The land for the building was purchased with FUSADES' own funds.)

It is in A.I.D.'s interest to assist FUSADES in its efforts to become a financially viable organization, thereby maximizing the impact of the A.I.D. resources that have been granted to FUSADES. Therefore, Mission representatives and LAC Bureau staff have studied the options over the past two weeks and met with the AA/LAC and DAA/LAC, and have agreed that, consistent with A.I.D.'s private sector strategy in El Salvador and its institutional strengthening efforts, A.I.D. will finance up to $2.6 million of the cost of the new FUSADES office building. A line item of $700,000 in the Project budget for the Free Zone Development Project, based on the estimated 25% that FUSADES would have received from beneficiaries over the LOP. In addition, other ongoing Projects with FUSADES will be amended to include a similiar provision. Prior to the obligation of funds with FUSADES in August 1988, the Mission will review the cost estimates and plans for the building, consistent with Section 611 of the FAA, as amended.

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IV. COST ESTIMATE AND FINANCIAL PLAN

A. LOP Project Funding

LOP funding has been increased by $2.0 million over the PID level as a result of the in-depth assessment of needs and costs analysis that were conducted during the project development process. The recent investment climate survey conducted by Coopers and Lybrand, evaluation of FUSADES prepared by Development Associates, Inc., and the analysis and experience of the Project Paper consultants all highlighted the need for a concerted overseas promotion effort to counter the negative perception of El Salvador as an investment location.

Of total Project funding, the largest category, totalling $26.6 million or 67.5% of total Project resources, is for the credit activity. Of this amount, $20.0 million, or 76.9% of the AID contribution to the Project will be used for the establishment of a colón-denominated credit facility at the BCR. The total counterpart contribution to the credit element is estimated at the local currency equivalent of $6.6 million, or 49.1% of total counterpart contributions and reflects equity contributions of sub-borrowers.

The Project will be funded from ESF and SDA funds. It is estimated that $20.0 milllion of the $26.0 million will come from ESF resources, with the remaining $6.0 million coming from the SDA account.

Technical assistance to augment the promotional capabilities of PRIDEX, and to assist the GOES in its efforts to improve operations at the San Bartolo Free Zone will also be provided. In addition, training will be provided to the relevant GOES entities to enable them to effectively carry out their respective responsibilities under the free zone reglamento. The total Project funding for both private and public sector technical assistance and training is $2.9 million.

Counterpart contributions will be cash and in-kind and will be provided by a number of different participating entities. The GOES will provide the equivalent of $6,000,000 in local currency generations for public infrastructure upgrades external to the private zones developed under the Project, as well as $132,000 in in-kind contributions (office space and equipment, related support) for the Project Coordination Unit to be established within MICE. Private sector individuals receiving technical assistance for pre-investment studies will contribute a minimum of 25% of the cost of the studies; those receiving training in zone management/ administration will also contribute 25% to the cost of such training. Total private sector contributions to the technical assistance and training activities are estimated at $707,000. In addition, private developers will contribute a minimum of 25% to the cost of zone development, or an estimated $6,600,000 -- including the cost of the land as an equity contribution.

A total of $860,000 will be provided to the GOES for technical assistance, training, and operational support to establish the Project Coordination Unit; this represents 3.3% of the total AID funding for the Project. Funding for the Project Coordination Unit will cover the salaries office equipment and supplies, travel, training, and technical assistance of the personnel assigned to the Project.

B. Summary Financial Plan

The following is the estimated financial plan for the Project. Further detail is provided in Annex M, Detailed Budgets.

SUMMARY FINANCIAL PLAN
(in $000's)

Component	AID a/ US$	AID a/ Colones	Total AID	Total Counterpart	Project Total
A. Private Zone Devt					
1.Credit	5,000	15,000	20,000	6,600 b/	26,600
2.TA-private zones	1,700	320	2,020	667	2,687
3.Zone Mgmt Training	120	--	120	40 d/	160
4.PRIDEX Op. Support	31	169	200	--	200
5.AID Project Manager	62	198	260	--	260
subtotal	6,913	15,687	22,600	7,307	29,907
B. Promotion/Marketing					
1. PRIDEX promotion	400	460	860	--	860
2. T.A. for PRIDEX	250	50	300	--	300
subtotal	650	510	1,160	--	1,160
C. Infrastructure, Institutional Support					
1.Public Sector Training	120	40	160	--	160
2.Public Sector T.A.	275	25	300	--	300
3.Infrastructure	---	---	---	6,000 c/	6,000
4.Proj.Coordination Unit	147	253	400	132	532
subtotal	542	318	860	6,132	6,992
D. Capital Expenditures (FUSADES Building)	300	400	700	--	700
E. Evaluation/Audit	170	160	330	--	330
F. Contingencies	200	150	350	--	350
T O T A L	8,775	17,225	26,000	13,439	39,439

a/ Foreign exchange/local currency breakdown is an estimate that may be adjusted during project implementation, as appropriate.
b/ Sub-borrowers' Contribution.
c/ GOES counterpart from local currency generations.
d/ Contribution to training costs from participating zone managers.

The Grant Agreement with the GOES will include Life-of-Project funding of $21,010,000 for public sector training, technical assistance, and credit. The major AID Project input is credit, representing 77% of AID resources, and 51% of total Project funding.

The Cooperative Agreement with FUSADES will be for $4,990,000, or 19% of the total AID contribution to the Project and 13% of total Project resources. Of the AID contribution, $2,020,000 is for pre-investment studies

on potential private free zones to be arranged by PRIDEX; $200,000 to support the establishment of a free zone specialist position within PRIDEX; $120,000 for training of private free zone managers to be arranged by PRIDEX; $1,160,000 is to mount a promotion and information campaign; and $700,000 to contribute to the construction costs of the new FUSADES office building.

The Cooperative Agreement with FUSADES will also include financing for the Project-funded AID Project Manager position (salary, benefits, office equipment and support, training, project vehicle), at an estimated cost of $260,000 for the five year life-of-project. Funds have also been budgeted for the Project evaluations and audits. In terms of audits, the Corte de Cuentas will conduct normal oversight of MICE, while the Superintendency of Banks will oversee the BCR and the commercial banks. FUSADES will continue to arrange for annual audits by a local affiliate of a U.S. CPA firm.

SUMMARY PROJECTION OF EXPENDITURES UNDER THE AID GRANT
(by Calendar Year, in $000's)

Component	1988	1989	1990	1991	1992	1993	TOTAL
A. Private Zone Development							
1. Credit	--	2,000	3,000	5,000	8,000	2,000	20,000
2. Technical Assistance	300	1,000	400	220	100	--	2,020
3. Training	--	40	60	20	--	--	120
4. PRIDEX Op. Support	8	40	38	40	39	35	200
5. AID Project Manager	16	72	48	46	47	31	260
	324	3,152	3,546	5,326	8,186	2,066	22,600
B. Promotion/Marketing							
1. PRIDEX - promotion	80	200	200	200	100	80	860
2. T.A. for PRIDEX	80	120	100	--	--	--	300
	160	320	300	200	100	80	1,160
C. Infrastructure, Institutional Support							
1. GOES - Training	10	60	40	30	20	--	160
2. GOES - T.A.	--	100	50	50	50	50	300
3. Project Coor. Unit	17	102	93	84	59	45	400
	27	262	183	164	129	95	860
D. Capital Expenditures (FUSADES Building)	350	350	--	--	--	--	700
E. Evaluation/Audit	--	--	155	--	--	175	330
F. Contingencies	--	40	100	120	40	50	350
TOTAL	861	4,124	4,284	5,810	8,455	2,466	26,000

Recurrent Costs

This Project, in theory, could generate recurrent costs for three groups: private zone developers; public sector entities (MICE, Customs, and the BCR and the commercial banks); and FUSADES.

On the zone level, the financial analysis contained in Annex H demonstrates that free zone development is financially viable. Excluding depreciation, which is included in the analysis per accounting standards, a developer of a "typical" zone will have sufficient cash flow to cover costs throughout a projected twenty year period and beyond. Moreover, maintenance costs over a 20 year period, estimated at 1% of total physical assets through year 10, and 2% thereafter, were included in the financial analysis. As

profit-making ventures, zone developers will cover recurrent costs out of net income, and debt and equity financing.

There will be no recurrent costs to the GOES. The Project Coordination Unit will successfully train MICE staff throughout the LOP to assume responsibilities within MICE's Free Zone Division after the Project. No additional permanent personnel will be hired by MICE, the Ministry of Finance, the BCR, or the commercial banks. Instead, these institutions will assign current staff to activities related to private zone development. In addition to MICE, the Customs Service is involved in free zone regulation. The free zone reglamento stipulates that private developers provide office space to Customs personnel assigned to the zone. Customs will assign existing personnel to the zones, and will not, therefore, incur any recurrent costs.

Since private free zone development will be a new activity, FUSADES will concentrate its resources in the early and middle years of the Project to provide information to Salvadoran and foreign investors on free zones and the benefits they represent, and on developing published materials on free zone investing in El Salvador for overseas promotion. This pattern of expenditures has few implications for recurrent costs. Since the promotion/marketing is designed to get the free zones going and PRIDEX will serve as a channel for informational materials on free zones during and after the Project, there will be no additional costs to FUSADES after the Project.

C. Assessment of Methods of Implementation and Financing

Two project agreements will be signed, a cooperative agreement with FUSADES, and a grant agreement with the Ministry of Planning, the Central Reserve Bank, and the Ministry of Foreign Trade as signatories for the GOES. While MICE, the BCR, and FUSADES will manage Project funds, AID will retain cash management responsibilities to ensure that disbursements from appropriated funds are for immediate needs. FUSADES and the GOES will be charged with responsibility for sound cash management and fiscal control of funds disbursed directly to them, including detailed accounting and reporting.

Initial disbursements of AID funds will be placed in non-interest bearing accounts. Reflows of principal will be returned to the credit facility for new lending in keeping with Project purposes and placed in an interest bearing account at the Central Bank. AID funds will be drawn down before reflows are utilized.

Evaluation of Need for Audit

The portion of the Project undertaken by FUSADES will be audited annually, utilizing GAO auditing standards, by a local affiliate of a U.S. CPA firm. Since procurement for public sector technical assistance and training will be done by means of direct AID contracting, no audit is warranted for this activity. It is unlikely that an audit of the credit facility will be needed because: (A) all Salvadoran banks have been assessed by Price Waterhouse under supervision by RIG/A/T; (B) this assessment will be followed by a concurrent audit of the banks under the Earthquake Reconstruction Project; (C) funds have been budgeted under the present Project to provide training to the banks to strengthen their capability to manage the sub-projects; and (D) only a few large loans are anticipated. Because of the small number of loans, The Mission will be in a position to provide adequate oversight. Nevertheless, in keeping with AID/W's guidance transmitted in STATE 274267 dated August 23,1988, $200,000 has been added to the Evaluation/Audit line item to cover any required Project audit.

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SUMMARY METHODS OF IMPLEMENTATION AND FINANCING

Inputs	Implementation	Financing	Amount ($000)
A. Private Zone Development			
Credit.	ICI.	periodic advance with direct reimbursement.	$20,000
Technical Assistance, Training, Building.	Cooperative Agreement with indigenous PVO.	periodic advance with direct reimbursement.	$3,040
B. Promotion/Marketing			
Promotion, Technical Assistance.	Cooperative Agreement with indigenous PVO.	periodic advance with direct reimbursement.	$1,160
C. Infra., Inst. Support			
Training (GOES), Tech. Assist.(GOES), Project Coor. Unit	Profit-Making Contractor, AID Procurement.	direct pay.	$ 860
Infrastructure	Memorandum of Understanding with GOES.	periodic advances from SETEFE, with direct reimbursement.	$6,000*
D. Evaluation/Audit	Profit-Making Contractor, AID Procurement.	direct pay.	$ 330
E. Contingencies	to be determined.	to be determined.	$ 350
F. AID Project Mgr.	PSC, AID Procurement.	direct pay.	$ 260

* local currency equivalent.

D. Revolving Credit Facility

To support the goal of increasing employment opportunities and foreign exchange earnings in the export sector through the development of private free zones in El Salvador, this Project will establish a colon-denominated rediscount facility in the Central Reserve Bank to meet the term lending and working capital requirements of eligible private free zone developers. The credit facility will be capitalized with a $20.0 million AID grant. As discussed in the Constraints Analysis, the facility will fill a gap in the country's capital market, as adequate term financing at terms and conditions appropriate for free zone development do not exist.

1. The Central Reserve Bank of El Salvador

The Department of Credit of the BCR, which currently implements forty-two credit lines, including AID-financed local currency lines, will be responsible for oversight of this new credit facility. Disbursements to the facility over the life of the Project will be based on ninety day needs for approved subloans.

The involvement of the BCR will be limited. Participating ICIs will be responsible for project analysis, forwarding a request for funding to the BCR with a facesheet outlining the basic characteristics of the proposed investment. The Central Bank will verify that the proposed zone credit fits within the Project's general eligibility criteria and has a valid private free zone designation. The Central Bank will review but not duplicate the credit and financial analysis performed by the ICI.

2. Intermediate Credit Institutions (ICIs)

In general terms, all Salvadoran-registered commercial banks (public, private, and mixed enterprises) and registered branches of foreign banks -- acting individually, or through syndication, will be eligible to participate in the credit facility. Written approval by AID of the specific eligibility criteria for the participating banks will be required as a Condition Precedent to Disbursement for the credit activity. Suggested criteria include: (a) full compliance with the provisions of the Credit Institutions and Auxiliary Organizations' Law of July 1986 (LICOA) and other relevant Salvadoran banking rules and regulations; (b) evidence of sound financial condition; (c) credit and investment project analysis capabilities; and (d) adequate audit monitoring and control systems, adequate staff to manage the portfolio, and adequate controls for monitoring the use of credit.

ICIs, either individually or in a syndication, wishing to participate in the facility will submit a request for qualification to the BCR. The BCR and AID will retain the right to disqualify ICIs over time if their performance or financial condition should so warrant.

3. Eligible Sub-borrowers

Any existing or new Salvadoran or foreign private legal entity or individual, whose expressed purpose is the development of a private free zone under the Export Promotion Law of March 1986, and its implementing regulations, will be eligible to participate in the facility. Compliance of the proposed free zone with the reglamento, and legal designation of the free zone, will be established through the review and approval by MICE, the Ministry of Finance, and AID prior to accessing financing.

4. Eligible Uses

Potential private developers who have received a valid free zone designation may borrow up to 75% of the total cost of free zone construction and development. Eligible uses include:

- working capital needs (including promotion activities);
- site improvement (clearing, grading, landscaping, etc.);
- construction of basic interior infrastructure (interior road network, water, sewerage, electricity, solid and liquid waste disposal/treatment);
- construction of standard factory buildings (SFBs) and office buildings;
- installation of related internal infrastructure and equipment (telecommunications, security and fire-fighting systems, street lighting, perimeter fence, etc.); and
- any other capital equipment and services facilities (such as day care facilities, health clinic, exhibition areas, cafeteria, etc.).

The rediscount facility's debt financing will be used to cover a maximum of 75% of a sub-project's total development costs. Counterpart equity funding will come from the ultimate sub-borrowers.

5. Dollar Availability

The credit facility will be colón-denominated, as the majority of the free zone development and operating costs will be payable in colones. However, free zone developers will have certain foreign exchange requirements such as imported inputs and ongoing marketing and promotional activities. To ensure access to dollars for the foreign exchange component of the free zone sub-projects, AID will disburse to a special BCR account to be established in the United States.

The issue of priority access to foreign exchange was raised at the PID review. While a substantial portion of the free zone construction and development costs will be local inputs, guaranteed access to dollars for the foreign exchange component (construction equipment and materials, steel pre-fabricated buildings, air conditioners, back-up power generators, lighting, security systems are possible uses) is critical to the credibility of the facility in the eyes of the Salvadoran private sector. The Project Agreement with the GOES will include a covenant stipulating that foreign exchange will be made available, either from this Project or from its own resources, to finance the foreign exchange needs of the private zones developed under the Project as well as of public institutions involved in the provision of infrastructure external to said zones. Therefore, the Project will enable the Central Reserve Bank to make available a limited amount of dollars to finance imported items such as substations, transformers, other electrical equipment necessary for the required external infrastructure. Public sector entities do not have easy access to dollars; under the AID Balance of Payments program, the BCR only provides the private sector with dollar access. It is estimated that no more than $2.0 million in imported inputs will be needed to complete the infrastructure upgrades throughout the life of the Project.

The credit mechanism will utilize a special account mechanism, similar to that used in the ESF Balance of Payments Support Program. Based upon projected demand, AID will instruct the U.S. Treasury to place dollar 90-day advance deposits in a BCR account at a U.S. Federal Reserve Bank.

Within two working days, the local currency equivalent of the dollar advance will be placed by the BCR in a special separate account at the BCR in El Salvador, forming the basis of the colón credit line to be onlent by ICIs to sub-borrowers.

6. Reflows

One of the objectives of the Project is to institutionalize the mechanism as a continuing source of credit for private free zone development. Accordingly, reflows of subloan principal will be placed in a separate account at the BCR, and will be made available for new lending. Analysis of the cash flow of the credit facility indicates that there will be sufficient resources to finance an additional free zone(s) or zone expansions after the LOP, as well as working capital throughout the twenty year projections. To maintain flexibility, reflows will be available for expansion of existing private zones

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as well as for new private free zones, depending upon demand in the out years. To ensure that the credit fund has sufficient resources to finance additional private free zones or free zone expansion after the LOP, the Grant Agreement with the GOES will stipulate that up to 25% of the reflows in the facility at any one time may be used to make working capital loans to private free zone developers.

7. Terms of Subloans

Subloans for zone construction and development will be available with a 15 year maturity and a 5 year grace period. The sub-borrower will repay the ICI the principal within 20 years from the date of the first disbursement of the subloan in 15 approximately equal annual installments of principal and interest. All payments of interest and principal will be made in colones. Sub-borrowers may pre-pay, without penalty, all or any part of the principal. Disbursements to sub-borrowers will be made via ninety day advances based on the anticipated needs of the sub-borrowers.

Subloans for working capital related to free zone financing will be available with a five year term and no grace period. As with the term lending, approximately equal annual installments of principal and interest will be paid.

8. Spreads and Interest Rates

Currently, preferential local currency funding through credit lines for long-term (15-17 years) projects carry an average interest rate of 13% - 18% per annum. In general, commercial banks are allowed an interest rate spread of about 2% - 3% on short-term credits using BCR resources; margins of 5% or higher are allowed for loans using ICIs' resources.

The interest rate structure proposed was based upon the consideration of three factors: the specific requirements of free zone projects; the interest rate spread required by participating ICI's; and the prevailing interest rate policy of the BCR. As long-term industrial projects, with long (3-6 years) construction periods, large capital costs ($10-$20 million) and long payback periods, free zone projects require long-term financing, with repayment periods of more than 10 years, and a 2-5 year grace period. The second factor is the spread required by ICIs. In several cases, financial intermediaries discontinued onlending funds due to a gradual erosion in their lending margins. Finally, consideration was given to the overall interest rate policies of the BCR. Because of the serious obstacles facing private sector development in El Salvador, the Salvadoran financial system has followed the practice of negative real interest rates as a means of fostering private investment. As interest rates are completely determined by the Monetary Board, "market" interest rates must be imputed. The proposed interest rate structure of the credit mechanism will offset the initial subsidy aspect of the negative real interest rate over time. AID resources will be made available to private developers at a fixed 15% annual interest rate; the interest rate charged on subloans made out of reflows may vary, depending upon prevailing interest rates at such time. The BCR will retain 4-5% of the spread on the initial loans, with the remaining 6-7% spread going into the credit facility to further capitalize the fund. The ICIs will receive a fixed interest spread of 4%.

The possibility of utilizing variable interest rates pegged to subloan tranches was rejected for a number of reasons, including the tightly controlled interest rate policy of BCR (interest rate ceilings are set by the Monetary Board). Currently, there are no variable interest rates offered for long-term credit and the possibility of truly variable rates in the near future is remote. Moreover, both local banks and potential sub-borrowers queried expressed considerable concern over variable rates given the perceived riskiness of free zone development. The proposed 15% rate, however, is a commercial rate, competitive with the cost of comparable funds available through other credit lines in El Salvador.

The interest rates will be applied on the balance of a subloan's principal (and any interest) outstanding. Interest on the subloan will accrue from the date of the first disbursement, and will be payable annually. The first payment of interest will be due and payable no later than twelve months after the first disbursement on a date to be specified by the participating ICI. The payment of interest by the ICI to the BCR on an outstanding subloan will be due on the prescribed due date regardless of whether funds have been collected from the final beneficiary.

The Grant Agreement with the GOES will stipulate the terms and conditions of Project lending. While the interest rate will be set at 15%, the Grant Agreement will also stipulate that the BCR, with prior AID approval, may modify the interest rate over time. This will enable AID to support future efforts of the Monetary Board to move towards interest rates that are positive in real terms. If the interest rate ceilings on comparable long-term colón credit lines are increased by the BCR over time, the interest rate applicable for new free zone loans under this credit facility may be adjusted upward upon negotiated agreement between the BCR and USAID.

The issue of negative interest rates was raised at the AID/W review of the PID. The GOES has made substantial progress in reducing inflation from 25% in 1987, to an estimated 20% in 1988. This trend is expected to continue. Assuming that inflation is reduced over the long-term (it is estimated that inflation will fall to an effective annual rate of 10.7% over the 20 year life of a free zone project), the proposed interest rate for the subloans will be positive over time.

9. Risk Assumption

In high risk environments such as El Salvador, private borrowers often perceive as unacceptable the risk of a devaluation or unavailability of foreign exchange to service dollar-denominated debt. By providing grant financing to the BCR, the credit mechanism ameliorates the foreign exchange risks for participating ICIs and end-users. Lending in colones greatly enhances access to the facility. Conversion of dollars into colones at the highest lawful exchange rate prevailing at the time of the transaction effectively "locks up" the foreign exchange rate at the time of disbursement and minimizes potential devaluation risk.

10. Alternative Arrangements

The design of the credit mechanism was arrived at after careful evaluation of alternate financing facilities, considering the general requirements for free zone financing in general and for El Salvador

specifically. Options considered include: providing the BCR with P.L.480 or ESF local currency generations to establish a credit line; a dollar-denominated BCR facility; a combination of dollar and colón lending, and the FUSADES credit facility.

The first alternative considered was the establishment of a dollar-denominated rediscount facility credit facility in the BCR. Although this has the advantage of guaranteeing access to foreign exchange and maintaining the value of the credit facility over time, it is not feasible in the Salvadoran context, given the GOES' reluctance to incur dollar debt, the lack of commercial bank experience in dollar term lending, and the unwillingness on the part of ultimate sub-borrowers to assume the exchange risk by incurring dollar liabilities.

A second option would be to provide the BCR with colones to establish a local currency credit line for onlending through ICIs. The primary constraint of this approach, however, is insufficient access to foreign exchange. Additionally, the value of a colones-denominated credit fund would decrease in dollar terms over time, given the negative real interest rates and the likelihood of a devaluation.

A third alternative would be to allow term lending in both colones and dollars. The facility would be maintained as a dollar-denominated account at the BCR, but would be available to be onlent in both dollars and colones, with the end-user assuming the foreign exchange risk. This alternative offsets many of the disadvantages noted above. Dollar access would be possible, assuming developers will be able (and willing) to incur dollar debt. The value of the fund would be maintained over time because the fund would be placed in a dollar-denominated separate account. However, this alternative was rejected as too risky in the Salvadoran context. Free zone developers will not assume a dollar liability because of the devaluation risk. Dollar earnings are not guaranteed because a substantial number of potential zone tenants will be local industries who will pay in colones. Dollars earned cannot be adequately utilized because of the limitations on the permissible uses of exporters' foreign exchange accounts.

A final alternative considered was the offshore credit facility established for dollar lending to nontraditional export businesses by AID and FUSADES under the Industrial Stabilization and Recovery Project, No. 519-0287, and the Agribusiness Development Project, No. 519-0327. While offering a number of advantages (e.g., greater efficiency and experience in project term lending by FUSADES; institutionalized access to hard currency without foreign exchange risk, etc.), the alternative was rejected because the fund only offers dollars. Moreover, the Mission is trying to institutionalize a free zone development facility within the Salvadoran banking sector.

None of the alternatives considered adequately meet the requirements for the design of an effective, workable credit facility in the Salvadoran context. The proposed facility design detailed in the preceeding pages combines features which respond most positively to several elements of the problem and offers the best hope for successful zone development while strengthening the capabilities of the Salvadoran financial sector.

V. IMPLEMENTATION ARRANGEMENTS

A. Obligating Instruments

$5,655,000 in SDA funds will be obligated in FY 1988, $2,000,000 with FUSADES, and $3,655,000 with the GOES. ($3,500,000 of the $3,655,000 obligated with the GOES in FY 1988 has been budgetted for the credit fund.) Funds will be obligated via a cooperative agreement with FUSADES for technical assistance and promotion activities, and a grant agreement with the GOES for credit and public sector technical assistance and training. Signatories to the GOES Agreement will be the Ministry of Planning, the Central Reserve Bank and the Ministry of Foreign Trade. In addition, the 1988 Memorandum of Understanding between AID and the Ministry of Planning on the local currency program included the full local-currency counterpart of C30 million for external infrastructure. MIPLAN will serve as the GOES coordinating entity for this assistance, which will be provided to CEL, ANDA, ANTEL and/or the Ministry of Public Works to upgrade electric facilities, water and sewerage, telephone/telecommunications, and roads external to the private free zones, as needed.

B. Project Management and Coordination

1. Responsiblities of USAID

On the AID side, principal project oversight and management will be exercised by the Mission's Private Sector Office (PRE). Given the current workload of the PRE office and the time that this Project will require, a new Project Manager position will be created to manage the Project. The Project Manager, who will be Project-funded, will be responsible for the following:

- Attend regular meetings with implementing entities and provide guidance on AID regulations and policies, as requested.
- Take action as needed on Project correspondence.
- Review and give administrative approval to disbursement requests.
- Make periodic visits to Project sites.
- Review semi-annual reports prepared by FUSADES, MICE, and the BCR and report on the Project to Mission Management as appropriate.
- Review annual implementation action plans of MICE and FUSADES and initiate action for the Mission review and approval thereof.
- Review reports prepared by Project-financed consultants.
- Review the annual audits of the Project.
- Monitor Project activity, ensuring compliance with the Cooperative Agreements, taking action as necessary.
- Arrange for and supervise evaluation activities.
- Track procurements and conduct periodic end-use checks of Project-financed goods and services.

Other USAID offices will assist in Project implementation and oversight, as detailed below:

- The Office of Projects will monitor implementation status and compliance with the terms and conditions of the Agreements and Amendments thereto.

- An engineer from the Mission's Office of Infrastructure, Regional Development, and Earthquake Reconstruction will review free zone proposals to ensure that designs and supporting infrastructure are adequate, and that AID environmental concerns have been met.

- The Contracting Office will assist in procurement actions, especially for those of GOES technical assistance and training, which will be effected by means of AID direct contracts.

- The Controller's Office will effect disbursement and reimbursement actions in conformity with AID regulations, and will ensure that adequate financial controls are exercised.

- The Office of Development Planning and Programs will assist in budgeting funding increments for the Project, as well as in scheduling Project evaluations and in preparing evaluation scopes of work.

2. Responsibilities of Implementing Entities

Assistance to the public sector will be channeled through and coordinated by the Free Zones Division of the Ministry of Foreign Trade. This office will be responsible for the overall supervision of public and private free zone development throughout the country. To effectively execute these tasks, technical assistance will be financed under this Project to assist MICE in the creation and staffing of this Division. It is anticipated that three people will be hired for this purpose: a coordinator, an assistant and a secretary.

Local currency resources destined for infrastructure upgrades will be managed by SETEFE, MIPLAN's internal unit responsible for administering and managing the GOES Extraordinary Budget and the negotiation and contracting of external financing.

On the private sector side, the Export and Investment Promotion Program (PRIDEX) at FUSADES will manage technical assistance and training activities. Given the present organizational structure and staffing pattern of PRIDEX, an additional "sector specialist" will be hired. This individual will serve as the contact point within PRIDEX for free zones and will bear the responsibility for developing and implementing the Project-funded promotional activity. A U.S. consulting firm will be contracted by PRIDEX for training and technical assistance in free zones development.

All credit will be channeled through the Central Reserve Bank for onlending to Salvadoran and foreign commercial banks meeting the basic eligibility criteria to be developed as a CP to Disbursement for the Credit Activity. As articulated in the Institutional Analysis, overall responsibility for managing this type of credit facility within the BCR resides with the Departments of Financial Analysis and Credit. The procedures currently being used for the existing AID-financed credit lines will be followed by the BCR for this Project. However, the AID counterpart will be

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the Special Assistant to the President of the BCR. At the commercial bank level, the credit department of each of the participating banks will be responsible for managing the bank's participation in the credit facility. The Project will train at least one person at each commercial bank participating in the Project and one or two persons at the BCR in free zone credit analysis in order to expedite the review/approval process.

MICE will coordinate all training to be provided to public institutions (BCR, Ministry of Finance) involved in the free zone designation and regulation processes. MICE will be involved in the implementation of the Project, as "free zone pre-designation" from MICE is required before the private investor can start to develop detailed plans for construction of a free zone. Furthermore, MICE approval of the final proposal for the development of a free zone project needs to be obtained before the developer can submit an application for financing to a commercial bank. MICE's present organization will be restructured to create a "Free Zones Division" which will house the San Bartolo Free Zone Administration and the Supervising Unit of free zone development throughout the country.

C. Procurement Plan

Assistance provided by AID to this Project can be divided into: credit ($20.0 million); and technical assistance, which includes training, promotion activities, and operational support ($6.0 million). Credit will be used primarily for the procurement of construction materials, services and supervision. Other Project elements will be used by both the private and public sectors for the procurement of a broad range of inputs. The following represents current best estimates of the procurement to be undertaken:

Technical assistance and training arranged by PRIDEX will be accomplished using FUSADES' procurement regulations approved by AID and in use under ongoing AID Projects. FUSADES experience under ongoing AID Projects indicates they are able to identify competent and suitable technical advisors using competitive methods. AID approval will be required only for activities in excess of $100,000, or when waivers of source/origin/nationality are needed.

Procurements will have as their source, origin, and nationality the United States or the Central American Common Market, including El Salvador. Any deviation from the Project's authorized procurement source, origin, or nationality will require a waiver approved by the Mission Director, on a case-by-case basis.

As a relatively new Ministry, MICE lacks the trained staff to effectively undertake the large number of procurement actions contemplated under the Project. Moreover, given the Ministry's limited human and financial resources, it would distract attention from critical activities in support of export and investment. Therefore, it is anticipated that procurement for MICE of technical assistance and training for the GOES will be accomplished using direct-AID contracting procedures. Procurement by the ultimate private sector beneficiaries will be in accordance with the requirements established by AID Handbook 1, Supplement B for sub-borrowers of intermediate credit institutions and the lender's own requirements. Language on procurement provisions will be included in the loan agreements between the ICIs and the sub-borrowers. Procurements financed with AID funds will be tracked, and spot-checking on procurements to verify compliance with AID regulations and policies will be performed throughout the Project by the AID Project Manager.

PROCUREMENT ACTIVITY

Activity	Amount (Thousands)	Begin	End	Responsible Entity
PRIDEX Technical Assistance, Training:				
Technical assistance to zone developers for feasibility studies and design:	2,000	10/88	12/90	FUSADES
Hiring and training of PRIDEX free zone specialist:	200	09/89	08/93	FUSADES
PRIDEX promotion of free zones including publications, seminars, mailings, videos and travel:	1,160	10/88	08/93	FUSADES
Training for free zone managers:	120	09/89	12/92	FUSADES
MICE Technical Assistance and Training:				
Operational support, training and technical assistance for the Project Coordination Unit:	400	10/88	08/93	AID
Technical Assistance to San Bartolo Free Zone to improve administration:	200	08/89	06/93	AID
Technical Assistance to MCP, Customs, and banks to facilitate implementation:	160	11/88	12/92	AID
Study of one additional public zone:	100	06/90	12/90	AID
Private Sector:				
Procurement of construction services materials and supervision:	20,000	03/89	08/93	Private Borrowers
FUSADES Building:	700	10/88	10/90	FUSADES
Other:				
AID Project Manager	260	08/88	08/93	AID
Evaluation	130			AID
Contingency	550			
TOTAL	26,000			

[illegible] ACTIVITY PROGRAMMING

COMPONENT	1988		1989				1990				1991				1992				1993			
	3	4	1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4	1	2	3	4
A. PRIVATE ZONE DEVELOPMENT																						
1. Credit			*	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	**	
2. TA-private zones	*	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***						
3. Zone Management Trg.					*	***	***	***	***	***	***	***	***	***	***	***	***	***				
4. PRIDEX Operational Sup.	*	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	**	
5. AID Project Manager	**	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***
B. PROMOTION/MARKETING																						
1. T.A. to PRIDEX	*	***	***	***	***	***	***	***	***	***												
2. Promotion Activities		***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	**	
C. INFRAST., INST. SUPPORT																						
1. Public Sector Trg.		**	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***				
2. Public Sector T.A.						*	***	***	***	***	***	***	***	***	***	***	***	***	***	***		
3. Infrastructure			***	***	***	***	***	***	***	***	***	***	***	***								
4. Project Coord. Unit		**	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	***	**	
D. EVALUATION									***													***

D. Schedule of Major Events

July 31, 1988	Project authorized.
August 31, 1988	Grant Agreements with FUSADES and GOES signed.
August 30, 1988	Memorandum of Understanding with GOES signed.
September 30, 1988	FUSADES and GOES meet initial Conditions Precedent.
December 15, 1988	Draft action plans for 1989 received from FUSADES and MICE.
December 31, 1988	GOES meets Conditions Precedent to Disbursement for the Credit Activity.
January 31, 1989	Action Plans for 1989 received from MICE and FUSADES.
March 01, 1989	First loan approved and disbursement of credit made.
June 30, 1989	GOES meets Conditions Precedent for Assistance to the San Bartolo Free Zone.
December 15, 1989	Draft action plans for 1990 received from FUSADES and MICE.
January 31, 1990	Action Plans for 1990 received from MICE and FUSADES.
June 30, 1990	Mid-term evaluation conducted.
December 15, 1990	Draft action plans for 1991 received from FUSADES and MICE.
January 31, 1991	Action Plans for 1991 received from MICE and FUSADES.
December 15, 1991	Draft action plans for 1992 received from FUSADES and MICE.
January 31, 1992	Action Plans for 1992 received from MICE and FUSADES.
December 15, 1992	Draft action plans for 1993 received from FUSADES and MICE.
January 31, 1993	Action Plans for 1993 received from MICE and FUSADES.
August 15, 1993	Project completed.
October 31, 1993	Final Project evaluation completed.

E. Environmental Impact

The IEE for the Project included as Annex L has a positive determination on the potential impact of the Project. However, since the free zone sites to be developed have not been pre-selected, an environmental assessment was not possible at the PP stage. Project funds have been included under the technical assistance activities of FUSADES to finance environmental assessments once sites have been identified and zone designations approved.

During the AID/W review of the PP in August 1988, it was determined that an environmental assessment was not necessary, and that environmental analysis on proposed zone sites could be performed locally. The LAC Bureau's Chief Environmental Officer provided language on the enviromnental analysis.

Sites selected for free zone development under this Project will be environmentally acceptable. Forested land, wetlands or other undergraded wildland sites, or sites that would require new access through such lands, will not be eligible for credit financing under the Project. Access to solid sanitary waste disposal facilities, or adequate on-site capacity of the land on which a free zone is to be developed to properly handle waste disposal will also be required.

F. Application of PD-15 and the Lautenberg Amendment

The Bumpers Amendment, section 209 of the Urgent Supplemental Appropriations Act of 1986, subsequently incorporated into the FY 1987 and FY 1988 legislation, prohibits, as interpreted by Agency guidance, AID financing of activities that "are likely to have a significant impact on exports of U.S. agricultural commodities to third country markets." It is estimated that firms locating in the free zones will be light industrial/assembly operations; it is unlikely that agricultural commodities will be processed in the free zones developed under the Project.

The Lautenberg Amendement, also included in the FY 1987 Continuing Resolution, prohibits AID from directly procuring feasibility studies, prefeasibility studies, or project profiles of potential investments for the manufacture of "import sensitive articles" for export to the U.S. or to third countries in direct competiton with U.S. exports, or from directly assisting in establishing facilities for the export of such items. Import sensitive items are defined as textile and apparel articles, footwear, handbags, luggage, flat goods, work gloves, and leather wearing apparel. Completely hand-made cottage industry textiles and "drawback " industry (Section 807) programs in CBI countries are exempted. Only activities that result in exports to third countries in direct competition with U.S. exports or to the U.S. are prohibited. Agency interpretation of this provision is that it only applies to direct AID assistance or procurement for such activities.

The free zone facilities to be financed under the Project are designed to foment export production of manufactured goods in general, not of "import sensitive" items specifically. Consistent with other Projects with FUSADES, AID approval will be required only for activities (i.e. studies) in excess of $100,000. AID will not approve requests to approve the financing of studies which would be considered "import sensitive" vis-a-vis the Lautenberg provision. Activities in excess of this amount will represent only a small portion of Project-financed activities. Furthermore, AID will have no involvement in the selection of zone clients, as this is a matter for the zone developer. The major Project activity is credit, in local currency, through the Central Reserve Bank and ICIs. AID will not approve the subloans for the construction of facilities or working capital, and will not, therefore, be providing direct assistance to zone developers. According to Agency interpretation, this does not qualify as direct assistance under the provisions of the Lautenberg Amendment.

It is anticipated that most of the industries that locate in the prospective free zones will export to the CACM and outside the region, principally to the U.S. These exports are expected to encompass a broad range of products, but it is reasonable to assume that a large portion will be apparel. Most apparel operations will fall under the 807 categorization

(re-export to the U.S. of items assembled from pieces of U.S. origin). El Salvador presently has no quota established for either GAL's (Guaranteed Access Levels) or DCL's (Direct Consultation Levels), as the volume of exports to the U.S. is so small. Even if some items covered by the Lautenberg provision were manufactured in the free zones, it is unlikely that they would be competitive in terms of quality, product specifications, or volume. Therefore, the impact of any direct competition with U.S. products would be negligible. Free zone clients other than apparel will most likely include industrial, electric and electronic assembly -- activities not covered by the Lautenberg Amendment.

G. Application of Section 611 of the Foreign Assistance Act of 1961

Sec. 611(a)(1) of the FAA as amended requires that prior to any grant in excess of $500,000, which requires substantive technical or financial planning, engineering, financial, and other plans necessary to carry out such assistance, and a reasonably firm estimate of the cost to the United States Government of providing assistance will have been obtained. The portion of this Project to which the above mentioned section applies is the $20 million in credit to be provided to private sector developers for the construction of free zones. Firm estimates of the costs of free zone construction have been obtained and are contained in Annex K. These analyses are based upon the known elements in free zone development and construction and information on construction costs obtained from sources in El Salvador and the Central American and Caribbean region. The financial analyses are based upon the development and construction of a free zone in El Salvador and contain sensitivity analyses of various development plans. Prior to the obligation of funds with FUSADES in August 1988, detailed engineering designs, financial and development plans for the new FUSADES office building will be reviewed and approved by AID.

Section 611(a)(2) requires that no grant in excess of $500,000 shall be made if legislative action within the recipient country is required to permit the orderly accomplishment of the purposes of the grant, unless such legislative action may be reasonably anticipated to be completed in time. The Mission's experience is that legislative ratification of AID Projects occurs in a timely fashion -- usually within 4 -6 weeks of submission to the Assembly.

Section 611(c) requires that to the maximum extent practicable, all contracts for construction outside the U.S. made in connection with any agreement or grant subject to Section 611(a) shall be made on a competitive basis. All construction contracts will be competed pursuant to guidance contained in AID Handbook 1, Supplement B.

Section 611(e) requires that no assistance shall be furnished with respect to any capital assistance project estimated to cost in excess of $1,000,000 until the head of the agency primarily responsible for administering part I of the Act has received and taken into consideration a certification from the principal officer of such agency in the country in which the Project is located as to the capability of the country (both financial and human resources) to effectively maintain and utilize the Project taking into account, among other things, the maintenance and utilization of Projects in such country previously financed or assisted by the United States. A 611(e) Certification is contained at Annex D.

VI. SUMMARIES OF PROJECT ANALYSES

A. Technical Analysis

The Project design is consistent with the body of knowledge on free zone development, taking into account the factors contributing to the success of other free zones. While credit is the primary input financed, the Mission realizes that technical capacity must accompany enthusiasm to promote private free zones. When the capabilities of the relevant private and public entities in other countries have not been upgraded, success has been limited. Similarly, the credit line will be colón-denominated, in recognition of the reluctance of commercial banks and sub-borrowers to engage in dollar lending. Demand for dollar term credit for private zones has been limited in recent free zone projects in the region.

Another lesson from other free zone/industrial parks is the need to build and develop in phases, and to be flexible, not building too much infrastructure, or having too many empty buildings at any one time. Therefore, the zones will be designed to be constructed in phases, responding to effective demand for space. Plans will be flexible, as it is much easier to change things on paper. This Project will finance 50% of two free zones, allowing for future year expansion.

Sufficient demand for both free zone development and occupancy is not contingent upon foreign investment in this Project, although this is considered highly desirable. It is recognized that it is most likely that the free zone developers financed under the Project will be Salvadoran, as will the majority of the initial zone clients. The very strong local demand for free zone space discussed in the demand analysis and the aggressive, entreprenurial nature of the Salvadoran business class indicate significant local participation. While foreign investment in desirable in terms of access to markets and technology, experience indicates that greater local participation in zones brings about a higher value-added. This is understandable, as Salvadoran zone developers and clients naturally have stronger ties to the local economy than do foreign investors.

El Salvador, with the exception of the guerilla insurgency, has the elements commonly considered among the most important to influence foreign investment decisions: favorable terms of profit transfer and capital repatriation, no discrimination against foreign ownership and control, and freedom from burdensome regulations. According to a number of sources, it is the predictability of conditions, as opposed to any one factor, that is the most important element for investors, who are able to adapt to virtually any conditions, as long as the "rules of the game" are clearly established in advance and are followed thereafter.

Lastly, experience in other countries has demonstrasted that the zone location is all important. This is precisely the reason why the Mission did not pre-select free zone locations, leaving the decision up to the private developers. When the location is determined by political or regional development criteria, such as the desire to create a regional development pole, the success of the free zone is dubious, as development and external infrastructure costs are often inordinately high. Since the private developers will be required to perform site/locational analysis to obtain a free zone designation, and will incur substantial debt financing, they are in the best position to determine the optimal location for their respective zones.

The demand, economic, and financial analysis summarized on the following pages and expounded upon in the Annexes demonstrate that the Project is viable and worthwhile. When coupled with the social analysis which indicates the significant potential impact of the Project on El Salvador's labor underutilization problem and on women, the developmental impact of the Project is even clearer.

B. Demand Analysis

The Central American and Caribbean region is host to the most dynamic free zone programs in the world today. The successes of regional zones; the programs presently underway in countries such as Costa Rica, Jamaica, and the Dominican Republic; the rising levels of investment by U.S. and Asian manufacturers seeking new production locations; and the increasing diversity of zone economic activity, are all reflections of growing demand for regional zone facilities. An analysis of demand for private free zones in El Salvador was undertaken to determine what portion of this market facilities developed under this Project can expect to attract. The following is a summary of the demand analysis undertaken during the development of this Project; further detail on background, methodology, and results are contained in Annex E to this Project Paper.

The demand analysis was comprised of two sections: a market assessment, determining the competitive position of the private free zones to be developed under the Project and identifying target industrial sectors; and the demand analysis itself, consisting of demand trend extrapolation and direct market sampling. Finally, conclusions about the Project's viability, taking into consideration the potential impact of the San Bartolo Free Zone expansion and the recinto fiscal option on projected demand, have been made.

An assessment of the overall strengths and weaknesses of El Salvador as a location for free zone investment was undertaken to identify its competitive position relative to regional free zones. These characteristics were then used to define the types of industries that would appear to benefit from locating in a private Salvadoran free zone. Potentially viable industries were then evaluated to determine their specific locational, operational, facilities and service requirements. Finally, the various requirements of target industries were compared to locational characteristics to identify sectors most likely be attracted to private Salvadoran free zones. The resulting analysis provided a preliminary assessment of the market position of the zones to be developed under the Project and was the basis for determining which firms to contact directly through the survey.

The internal variables affecting demand (the guerilla insurgency, the investment climate, the legal and regulatory framework for investment and exporting, market access, basic factors of production such as land and buildings, labor, capital, transportation facilities, infrastructure, utilities and services), were examined. External factors such as the overall "health" of the global economy, and especially the U.S. economy, the evolution of production technology that often displaces labor-intensive processes, the regional supply of zone facilities, and competitors were also considered.

El Salvador is confronted with a difficult task in altering the pervasive perception that it is a risky location for investment; a perception that has virtually obscured the numerous attractions that the country has to

offer foreign investors. The productive and competitive labor force, attractive investment incentives, well-developed international transport infrastructure and services, and geographic location are all valuable assets that can help to attract new investment to a private free zone project in El Salvador. The availability of trained managers and technicians is an important factor in a region where most firms are forced to fill such positions with costly expatriates. Based upon the investment identification criteria developed and the analysis of industry requirements, the firms that appear best suited to locating in a private free zone in El Salvador are those engaged in apparel manufacturing and electronics production. On a broader level, because of the negative perceptions of El Salvador's political stability, it is likely that initial demand for zone facilities will come from local exporters.

The direct market survey instruments employed were designed to give a representation of demand for private free zone space in El Salvador within specific manufacturing sectors. A total sample of 63 firms were interviewed, primarily from the two priority sectors. Thirty-five firms in the apparel sector, 20 electronics firms, and 8 firms engaged in various other types of light manufacturing export activities in El Salvador were selected. The foreign companies, located in the U.S. and Hong Kong, were selected on the basis of size, the suitability of their products for offshore manufacture or assembly, and the scope of their international operations. Of the 63 firms interviewed, 27 were located in the United States (including Puerto Rico), 21 were Salvadoran firms, and 15 firms were located in the Far East.

Telephone interviews were employed for firms located in the United States and the Far East; face-to-face interviews were used for Salvadoran firms which took place in May 1988. The survey instruments were designed to assess not only interest in the El Salvador free zone project and subsequent spacial needs over the near term, but also to roughly gauge investment sensitivity to factors such as rental rates and the availability of space in public free zones and recintos fiscales.

Foreign apparel firms were generally more inclined to express interest in further investigating the possibility of investing in a Salvadoran free zone, largely due to the fact that apparel operations require less of a capital investment than do other industry sectors such as electronics. The Far Eastern companies contacted during the course of the survey were all apparel manufacturers. The entirety of the demand discovered in the overseas market survey (7,000 m^2) originated from Far East apparel manufacturers.

The primary factors discouraging firms from considering offshore investment in a private free zone in El Salvador, as cited, were: highly volatile political and social climate leading to loss of control over investment; fear of inconsistent policy application regarding foreign investment and exporting/importing processes; and unreliable transportation and communication links. In general, firms of U.S. origin were disinclined to further investigate offshore manufacturing in El Salvador as a result of the perceived instability in El Salvador and the region. The majority of Far Eastern firms were not interested in setting up operations in El Salvador because they were unfamiliar with the region. The awareness of political unrest and instability in El Salvador among Far Easterners was generally far lower than their U.S. counterparts.

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A total of 21 firms in apparel, footwear, pharmaceuticals, machine parts, and others presently operating in El Salvador were interviewed during the market survey. Most of the firms contacted were looking for space to expand and were extremely interested in investigating the possibility of establishing operations in a private free zone in El Salvador. Clearly, firms presently operating in El Salvador have a vastly different perspective than their foreign-based counterparts regarding political stability in the country. The general attitude exhibited by these manufacturers is positive, their businesses are growing and they are planning to expand their operations and are not discouraged by the investment climate. This holds true for foreign-owned businesses in El Salvador as well as Salvadoran operations. The diligence and high-quality of local labor was generally agreed to be the most important contribution to productivity in El Salvador. Market access to the U.S. under the TSUS 806.3/807 program was a crucial element of the market strategy of the apparel exporters. Other firms using locally sourced goods were exporting under the CBI. Of the 21 firms surveyed, the average level of interest expressed in locating in the project within the next 12 months was 6.5 on a scale of 1-10. Of the interested firms (13 of the 21 surveyed), the weighted average level of interest was a stunning 9.50.

It is important to note that the majority of the firms surveyed were either operating out of recintos fiscales or in the San Bartolo Free Zone. Eight of the "highly interested" firms, or 62%, surveyed were operating out of recinto fiscales. Present users of the San Bartolo Free Zone had little interest in the Project due, in large part, to the phenomenally low rental rates they are presently paying, although two SBFZ firms did indicate an interest to expand into the zone. Occupants of the recintos fiscales were very much attracted to the Project even though they are already enjoying many of the benefits that apply to users of the free zone. For the most part, they are interested in two things: (i) consolidating their operations in one location for centralized control, which is difficult in the present shortage of industrial space and resulting tight market for facilities; and (ii) achieving economies of scale through the shared services such as day care centers, worker transport, energy generation, and telecommunications that would be possible in a free zone. They view the free zone as a means to enhance their production environment at a cost shared by users.

The major conclusions from the market survey were the following:

- Salvadoran-based firms are the primary source of demand for free zone space. Over 87% of the space requirements revealed in the survey come from Salvadoran firms, totalling 45,900 m^2.
- Of the foreign (U.S. and Far Eastern) firms contacted, only the apparel manufacturers expressed high levels of interest in the Project. Responses from electronics firms were disappointing. Total foreign demand for free zone space uncovered was 7,000 m^2, all in the apparel sector.
- 73% of the local demand evidenced is for expansion of existing production operations. Only 27% of the space requirements represents relocations of existing operations.
- 62% of the Salvadoran firms expressing interest in the Project are presently operating in a recinto fiscal. The effect of recintos fiscales on the demand for free zone space appears limited.

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- Most firms surveyed that are presently operating in the San Bartolo Free Zone have little interest in relocating or expanding outside the zone, primarily because of the rental rate which is far below market levels (for some firms as low as ₡3.50/m^2/month).
- The demand for free zone space evidenced in El Salvador is cross-sectoral, encompassing apparel, footwear, pharmaceuticals, packaging, and machine parts.

The immediate demand for private free zone space in El Salvador will come primarily from firms already operating here, based on the results of the survey. Over the medium-term, if the investment climate stabilizes in the eyes of foreign manufacturers, El Salvador could also expect to attract new foreign investment in the apparel sector. In any event, immediate demand of 52,900 m^2 uncovered in a survey of this size is remarkable and bodes well for the future of the Project. The demand forecasts resulting from trend extrapolations and estimations of unmet demand for industrial facilities in general and free zone facilities in particular arrive at a projected potential demand for 100,000 m^2 of free zone space in El Salvador for calendar year 1988 alone. Given the tremendous current demand and the absence of attractive facilites or a promotional campaign, it is reasonable to assume that the demand will far outspace supply of under-roof industrial space for the life of the Project, ensuring healthy demand for space in the private free zones.

In summary, there is significant immediate demand for private free zone facilities in El Salvador, even taking into consideration the planned expansion at San Bartolo, which is expected to be occupied by current zone clients. It is noteworthy that such strong demand exists in the absence of a zone promotion program and specific sites. This Project thus is well-positioned to capitalize on the current backlog in demand for industrial space in El Salvador. With the establishment of attractive private zone facilities and a promotion program under the Project, the private free zones will be ensured of healthy demand for under-roof space.

C. Financial Analysis

Financial analysis on a "typical" free zone to be developed was conducted to determine the financial viability of the Project. The analysis, included herein as Annex H, indicates that the Project is viable as a long-term investment, with a positive cash flow to the developer in year five, a financial rate of return of 18.4% over a twenty year period, and a return on equity of 24.1% over the same period in the base case scenario. The base case scenario and sensitivity analyses are presented in Annex H.

D. Economic Analysis

Economic analysis consisting of estimating and comparing the flow of economic benefits and costs with and in the absence of the Project under certain assumptions and alternative scenarios to test the sensitivity of the economic internal rate of return (EIRR) was conducted. The objective of this analysis was to estimate and interpret the EIRR implicit in the assumptions of the demand and financial analyses presented in the PP and to estimate the Project's potential impact on GDP, employment, and foreign exchange.

The results of the economic analysis indicate that the Project is economically worthwhile, with acceptable EIRRs (14%) and potentially strong impacts on GDP, employment, and foreign exchange earnings. The economic analysis is included herein as Annex I.

E. Institutional Analysis

Once the statement of the problem which this Project seeks to address was articulated and the constraints were identified, a number of private and public sector entities were considered as possible participants in the Project. Since the majority of the financing needed is local currency credit, all locally owned banks have been nationalized, and an objective of the Project is to create a revolving fund to finance free zone development, there was no viable alternative to the Central Bank and the commercial banks for credit activity. Since the free zone regulation and Salvadoran law stipulates which GOES entities are involved in public and private zone development and regulation, there is no alternative to MICE, the Ministry of Finance, or Customs. Private sector business associations and private Salvadoran enterprises were considered for promotion activities and as a conduit for the technical assistance and training destined for private zone developers. However, none had the management capabilities or experience needed to carry out such crucial Project activities. Moreover, since this Project essentially augments PRIDEX' promotion efforts under ongoing AID Projects, utilizing FUSADES is the most cost-effective option.

1. Central Reserve Bank and Commercial Banks

The BCR is the institution charged with the implementation of policies formulated by the Monetary Board -- the highest policy decision-making organization of El Salvador in this area. The BCR's organizational structure reflects its functions; the major divisions are: the Departments of Exchange Control, Exterior, Deposits and Agencies, Financial Analysis, Credit; the Technical Department of Economic Studies; and the Monetary Board staff.

Credit operations are supervised and implemented by its Departments of Financial Analysis and Credit. The Financial Analysis Department analyzes and submits for Credit Committee and Board of Directors' approval all credit applications received from the commercial banks, while the Credit Department is in charge of the operational aspects of lending (contracting, disbursements, monitoring, and collecting interest and principal payments from the commercial banks). To date, the Departments of Financial Analysis and Credit have proven to be relatively capable in operating approximately 42 special lines of credit (coffee, cotton, sugar cane, cereals, livestock, working capital for the industrial manufacturing sector, export and pre-export, and export of capital goods), with a staff of approximately 55 employees, including 36 professionals. The Economic Development Fund, which finances some 15 different types of investment, is also handled by these Departments. Given the size of the staff of these Departments and the lending portfolio currently managed, the addition of a free zone credit line represents a marginal increase in responsibilities for the BCR. With the training in credit and financial analysis of free zone development to be provided under the Project, the BCR will be able to effectively implement the credit facility with current staff.

There are ten commercial banks in El Salvador, including one foreign owned bank, and a mortgage bank (Banco Hipotecario). The nine locally owned commercial banks are all nationalized. Four of them (Banco Agrícola Comercial, Banco Cuscatlán, Banco de Comercio and Banco Salvadoreño) handle approximately 80% of the aggregate portfolio of the eleven banks. Together

with the Banco Hipotecario, they accounted for approximately 62% of the net credit outstanding for the entire financial system in 1985, and for 66% in 1986. The Mortgage Bank is not nationalized per se, but its president is appointed by the President of El Salvador

As with the BCR, the commercial banks have the human resources to conduct credit analyses of traditional investment projects but lack the institutional capability to analyze financing proposals for free zones. Through this Project, training in free zone project credit analysis will be provided to one or two financial analysts at each commercial bank interested in the Project and at the BCR to avoid excessive delays or uninformed decisions regarding the financial viability of the projects.

2. Ministry of Foreign Trade (MICE)

The Ministry of Foreign Trade was created in 1981 to consolidate government operations related to foreign trade. With the formation of MICE, the activities formerly discharged by the Salvadoran Institute of Foreign Trade (ISCE) and the duties of the Ministry of Economy relating to international trade were brought together. The Salvadoran Customs Service, however, is housed within the Ministry of Finance. As originally established, MICE was viewed as a foreign trade Ministry with both regulatory and promotional activities, with the basic objective of regulating, monitoring, and promoting foreign trade.

At the operational level, MICE's organization has been modified several times. Currently, MICE has three Directorates: Planning, Exports Promotion, and Administration; and five divisions not linked with any Directorate, Free Zone Management (San Bartolo); One-Stop Export Documentation Center (CENTREX), Capital and Technology Transfer Division, Fiscal Incentives Unit, and the Commercial Information Center.

As mentioned in the Constraints Section, experience with the SBFZ management and MICE indicate the dearth of skilled staff to plan, manage and promote a free zone. Moreover, MICE has not developed the capability to promote foreign and domestic investment in general. Accordingly, this Project will provide MICE with technical assistance and operational support to establish a Project Coordination Unit. This unit will be housed in the Free Zone Division, which oversees private and public free zone development. The individuals contracted as Coordinator and Assistant will train MICE staff assigned to the Division to effectively assume full responsibility for the free zone movement after the Project.

3. Ministry of Planning (MIPLAN)

MIPLAN is the GOES institution charged with the design and supervision of the government's strategy for national development. Working with the other GOES ministries, MIPLAN's objective is to coordinate and guide the activities and programs undertaken by the government in order to ensure their effective realization. MIPLAN serves both as an advisor and facilitator within the executive branch. Specific duties discharged by MIPLAN include policy analysis in the area of economics and national finance, the development of budgetary policy/coordination of the financial and economic planning commision sponsored by the private sector, and on a national, regional and international level; and the study, management and administration of the technical assistance provided to El Salvador by bilateral and multilateral

development programs. MIPLAN performs this last task through the Technical Secretariat for External Financing, SETEFE, the liaison office between the GOES and all external donors.

To date, SETEFE's 58 person unit has proven capable of handling complex financial and inter-institutional programs. SETEFE will be directly involved in the proposed Project, serving as the coordinating agency for the various utilities and the Ministry of Public Works who will install the requisite external infrastructure for the private sector zone(s). These include: CEL, the Comision Ejecutiva Hidroeléctrica del Río Lempa, the national power company, for installation of power lines for zone hookup; ANTEL, the Administración Nacional de Telecomunicaciones, the telephone, telex, radio and television service, for installation of communications lines up to the zone site; ANDA, the Administración Nacional de Acueductos y Alcantarillados, which will provide water and sewer lines up to the zone; and MOP, the Ministry of Public Works, which is in charge of planning, construction, and maintenance of the public infrastructure of the country (roads, highways, and bridges). Given SETEFE's current responsibilities and competent, trained staff, no problems are foreseen with respect to the institution's involvement in the Project.

4. Other GOES Entities

The Ministry of Finance is the GOES agency responsible for administering the national budget and for the regulation of national financial policy and procedures. It is relevant to this Project as the Ministry which houses Customs and because it is involved in the private free zone designation process. Current Ministry staff will participate in the review of the free zone applications, and current Customs personnel will be assigned to the new zones.

While an increase in staff to implement this Project will not be necessary, both Customs and Ministry personnel assigned to review the free zone applications will need assistance in order to execute the institution's responsibilities under the free zones reglamento. Given the technical nature of much of the data contained in the application which lies outside the Ministry's area of expertise, a portion of the technical assistance and training contemplated under the Project will be devoted to this purpose.

5. Salvadoran Foundation for Economic and Social Development (FUSADES)

FUSADES is a private, non-profit organization founded in 1983 by a group of Salvadoran businessmen. The institution's purpose is to bring together the resources of the Salvadoran business community in an organization with the technical and financial capability to work toward the improvement of the country's social and economic conditions and to stimulate national economic growth.

The program activities of FUSADES are designed, managed and implemented through six technical departments: Economic and Social Studies (DEES), Agricultural Diversification (DIVAGRO), Association Strengthening (FORTAS), Small and Micro Enterprises (PROPEMI), Investment and Credit Finance (FIDEX), and Export and Investment Promotion (PRIDEX).

The capabilities of FUSADES have expanded considerably over the past five years, with the financial and technical assistance from AID Each technical department has a great deal of autonomy and a proven ability to execute its projects. The specific department which will implement the technical assistance to be provided to private free zones as well as the promotion activities under the Project is PRIDEX.

The Program was launched in January 1985. It's initial staff consisting of an Executive Director, four project managers and two support personnel; its present organizational structure includes both administrative staff and six sector specialists in the following areas of textiles/apparel; agroindustry; services, electronics, metal-mechanics; artisan crafts and pharmaceuticals; and footwear, leather goods, wood, plastic, and minerals.

Since its inception, PRIDEX has provided direct assistance to over 130 clients through its sector analyses, business plan development, market studies and feasibility studies for non-traditional business development. It has sponsored the participation of local companies in international conferences and trade fairs as well as trade missions of Salvadoran businessmen leaders abroad.

Given the present organizational structure of PRIDEX and its staffing patterns, a sector specialist in free zone development should be enough to manage and implement Project activities to be executed through PRIDEX. Free zone analysis, however is different from the industry-specific assistance now provided by the PRIDEX managers and project officers. The technical assistance required to conduct pre-investment analyses encompasses a knowledge of locational analysis, long-term financing, and property management principles, in addition to the market studies, demand analyses, and promotional strategy development upon which the efforts of the PRIDEX program are presently focussed. Therefore, the optimal approach appears to be to hire a college-educated Salvadoran with a background in business who is familiar with free zones and experienced in nontraditional export activities, and train this individual in the specifics of free zone development. Drawing from a roster of outside consulting firms, free zone specialists, and engineering/construction companies, PRIDEX can contract for both the training of its new staff member and for ongoing technical assistance in the execution of the free zones program. Working with a contractor will conserve resources and fast-track the program in a manner which would otherwise be impossible were PRIDEX to endeavor to develop the full spectrum of capabilities internally.

Other Alternatives

COEXPORT, which is discussed in Annex J, the Institutional Analysis, is the most relevant, capable Salvadoran business associations which could be considered to provide the support to private developers and to undertake the promotion activities. However, it does not have the staff, experience, or local or foreign capacity to effectively undertake the role that will be assumed by PRIDEX under the Project. There are no other private entities involved in investment promotion or free zones in El Salvador. The possibility of contracting a U.S. or Salvadoran firm to carry out promotional activities was considered and discarded for several reasons. One, augmenting PRIDEX' existing capacity is much more cost effective. Second, problems of duplication and gaps have arisen in other countries when more than one entity

was involved in promotional activities. Three, one objective of the Project is to develop the capacity of a Salvadoran organization to effectively support and promote investment in free zones; utilizing a contractor does not develop institutional capabilities. Lastly, evaluations of PRIDEX have been very positive of its work; it make sense to go with a proven program rather than with an unknown.

F. Social Soundness Analysis

The Project is designed to take advantage of one of El Salvador's best resources: plentiful, low-cost labor, with a strong work ethic. In doing so, the country's serious employment and low wage problem is being addressed.

Direct beneficiaries will be the persons (primarily women) gaining employment and income as a result of the direct job generation in addition to increasing female labor participation rates and wages. By creating jobs that are at least minimum wage, the Project offers significant opportunity for increased wages for free zone employees. Child care and major medical services provided by the free zones are additional benefits to women and children under the Project. Training and technical assistance to upgrade skills are further benefits for male and female project participants. There will also be some indirect job generation, as backward linkages with the local manufacturing/industrial sector are developed. The nation as a whole will benefit from the Project's employment and foreign exchange generations and increased wages, and from the attraction of new foreign and domestic investment in El Salvador. The only perceived impact of the Project is positive, and that impact will extend beyond the life of the Project.

No major social issues were identified during the project development process. However, PRIDEX will establish a data gathering program on project beneficiaries to monitor the Project's impact throughout the life of the Project. Information on: employment rates for males versus females; education, work history, and other background on employees; employee salaries by sex; employee tasks by sex; employee training by task and sex; loans made and businesses established by sex; and types of businesses established by sex. In addition, a sample of indirect beneficiaries by background, age, and sex will be undertaken during the evaluations of the Project. This data will be analyzed and, if necessary, adjustments will be made during project implementation to ensure that social issues that may be uncovered are dealt with.

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VII. SPECIAL PROVISIONS

Conditions Precedent to Initial Disbursement - GOES

The following Conditions Precedent will be included in the Grant Agreement with the Government of El Salvador:

1. Prior to the disbursement of Project funds under the Grant Agreement with the Government of El Salvador, or the issuance by A.I.D. of documentation pursuant to which disbursement will be made, the Grantee shall, except as A.I.D. may otherwise agree in writing, furnish in form and substance satisfactory to A.I.D.:

(i) An opinion of counsel acceptable to A.I.D. that this Agreement has been duly authorized and/or ratified by and executed on behalf of the Grantee, and that it constitutes a valid and legally binding obligation of the Grantee in accordance with all of its terms; and

(ii) A statement of the name of the person holding or acting in the office of the Grantee specified in Section 4.1, and of any additional representatives, together with a specimen signature of each person in such statement.

(iii) Evidence that the GOES has established a separate colón-denominated bank account to control the receipt and disbursement of Grant funding for other than the Credit Fund.

Conditions Precedent to Subsequent Disbursements - GOES

1. Prior to the disbursement of Project funds under the Grant Agreement with the Government of El Salvador for the Free Zone Development Credit Fund, or the issuance by A.I.D. of documentation pursuant to which disbursement will be made, the Grantee shall, except as A.I.D. may otherwise agree in writing, furnish in form and substance satisfactory to A.I.D.:

(i) Evidence that a separate dollar account has been established in the United States to control the receipt and disbursement of dollar funding for the Credit Fund under the Grant;

(ii) Evidence that the GOES has established a separate colón-denominated bank account to control the receipt and disbursement of Grant funds; and

(iii) Evidence that credit procedures have been established by the Central Reserve Bank which include: the grace periods, repayment periods, and interest rates of both long-term and working capital loans; criteria upon which the selection of commercial banks to participate in the Credit Fund will be based; loan forms and documentation required of loan applicants; the loan approval criteria of the Central Reserve Bank; and assurance of the availability of foreign exchange for subborrowers under the Credit Fund.

B. Prior to the disbursement of Project funds under the Grant Agreement with the Government of El Salvador for assistance to the San Bartolo Free Zone, or the issuance by A.I.D. of documentation pursuant to which disbursement will be made, the Grantee shall, except as A.I.D. may otherwise agree in writing, furnish in form and substance satisfactory to A.I.D.:

(i) A timetable of rental rate increases to be effected to raise rental rates for facilities at the San Bartolo Free Zone to cover operating costs; and

(ii) Evidence that the GOES plans to make the San Bartolo Free Zone a fiscally and operationally autonomous entity.

Covenants - GOES

1. The cooperating country covenants that A.I.D. will be able to brief and debrief consultants, participants and invitational travelers financed under the Agreements and will be furnished copies of reports produced by such persons.

2. The cooperating country covenants to make available foreign exchange, either from this Project's resources or from its own resources, for the foreign exchange needs of private zone developed under this Project or for the public institutions involved in the provision of infrastructure external to said zones.

3. The GOES will make its best efforts to enact measures to improve the administration of the San Bartolo Free Zone.

4. The GOES will make its best efforts to increase rental rates for facilities at the San Bartolo Free Zone for new contracts and contract extensions.

Special Provisions - FUSADES

Prior to the disbursement of Project funds under the Cooperative Agreement with FUSADES, or the issuance by A.I.D. of documentation pursuant to which disbursement will be made, the Grantee shall, except as A.I.D. may otherwise agree in writing, furnish in form and substance satisfactory to A.I.D.:

(i) A statement by the Board of Directors of FUSADES in which it names the person(s) empowered to act on behalf of FUSADES for all purposes relevant to the grant, and of any additional representatives, together with a specimen signature of each person so designated; and

(ii) Evidence that FUSADES has established separate dollar and colón-denominated bank accounts to control the receipt and disbursement of Grant funds.

Covenants - FUSADES

1. FUSADES covenants to maintain, in accordance with GAO Standards for Audit of Governmental Organizations, Programs, Activities, and Functions, consistently applied, books and records related to this Agreement, adequate to show without limitation, the receipt and use of all goods and services acquired under this Agreement. Such books and records will be audited annually, in accordance with generally accepted auditing standards and be maintained for at least three years after the date of the last disbursement by FUSADES under this Agreement.

2. FUSADES covenants that A.I.D. will be able to brief and debrief consultants, participants and invitational travelers financed under the Agreements and will be furnished copies of reports produced by such persons.

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VIII. EVALUATION AND MONITORING ARRANGEMENTS

The evaluation and monitoring arrangements will include continuous monitoring and formal evaluations over the life of the project. The semi-annual and formal project evaluations will focus on two elements: 1) providing continuous information on the implementation of the Project, and 2) periodically measuring the performance and adequacy of inputs, the performance of implementing agencies, progress towards outputs and goal attainment, the distributional impact of Project benefits, especially employment and income, and identifying problem areas and possible solutions. The evaluation and monitoring plan for non-credit activities will be a MICE/FUSADES/AID effort to review the progress and impact of the Project. Evaluation and monitoring of credit activity will be a joint AID/BCR effort.

FUSADES, MICE, and USAID/El Salvador will establish a continuous monitoring program, with quarterly reporting to reflect project progress, problem areas and solutions, and overall impact. This reporting will be prepared by FUSADES, MICE, AND BCR personnel respectively, and will constitute the basis for the formal project evaluation. The continuous monitoring will provide information needed to evaluate the operations of the Project, so that any aspect of the Project's operation which detracts from effective implementation is quickly noted, understood, and corrected.

The Project will undergo two formal evaluations, a mid-term evaluation and a final evaluation, both to be carried by Project-funded outside consultants. The mid-term evaluation will take place in June 1990, and will assess the progress and impact of the project components. By this time, the credit activity will have matured sufficiently to allow for a meaningful assessment.

The contractors will use the results and data generated by the semi-annual reporting carried out by the respective implementing entities as baseline information. In doing so, the contractors will develop simple routine forms which the implementing entities will complete for subsequent data collection and analysis during the final evaluation.

The formal evaluations will be carried out by short-term consultants. It is estimated that two consultants will be required for each evaluation effort, in the following areas: financial analysis, credit, business administration, promotion/marketing. The consultants will have backgrounds and experience in exports, foreign investment, banking and credit, and promotion. Both evaluations will be funded under the Project. In addition to the evaluations, annual audit by local affiliates of U.S. CPA firms will be required of the implementing entities. A total of $330,000 has been budgeted for the Project evaluations/audits.

FREE ZONE DEVELOPMENT, PROJECT NO. 519-0323
PROJECT PAPER ANNEXES

A. STATE 122196 (PID Guidance Cable)

B. Logical Framework

C. Requests for A.I.D. Assistance

D. Certification Pursuant to Section 611(e)

E. Project Checklist

F. Initial Environmental Examination

G. Market Assessment and Demand Analysis

H. Financial Analysis and Capital Cost Estimates

I. Economic Analysis of the Free Zone Project

J. Central Reserve Bank and Commercial Banks

K. Sources Consulted

L. Free Zone Regulation

M. Detailed Budgets

N. Summary of Export and Investment Policies, Laws, and Regulations

ACTION AID-15 INFO AMB DCM

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USAID

E.O. 12356: N/A
TAGS:
SUBJECT: DAEC REVIEW - FREE ZONES DEVELOPMENT PIL (519-0325)

1: SUBJECT REVIEW WAS HELD ON MARCH 24, 1988: THE DAEC APPRECIATED THE PARTICIPATION OF R: SCHOUTEN, J: STEPHENSON AND G: BOGAN. THE MISSION IS TO BE CONGRATULATED ON AN EXCELLENT PID WHICH GREATLY FACILITATED THE PID REVIEW: !!

2: THE DAEC APPROVED SUBJECT PID: HOWEVER, FOR THE FOLLOWING REASONS, IT WAS DECIDED THAT LAC WOULD RETAIN ITS AUTHORITY TO APPROVE THE PROJECT PAPER AND AUTHORIZE THE PROJECT: (A) THE ONGOING REVIEW OF FUSADES, AND THE PROPOSED PARTICIPATION OF FUSADES IN THE PROJECT; (B) THE PROPOSED NEGATIVE INTEREST RATES FOR THE PROJECT'S CREDIT FACILITY; (C) CONCERN ABOUT THE CREDIT MECHANISMS; AND (D) THE GENERAL FEASIBILITY OF THE OVERALL IMPLEMENTATION STRUCTURE:

3: FOLLOWING GUIDANCE IS BASED ON DECISIONS THAT WERE REACHED AT THE DAEC:

(A) RELATIONSHIP TO AID GOALS IN EL SALVADOR.

- THE DAEC CONCURRED THAT THE PROJECT IS CONSISTENT WITH THE MISSION'S APPROVED OVERALL STRATEGY FOR EL SALVADOR:

(B) PROJECT STRATEGY:

- THE DAEC AGREED WITH THE MISSION THAT THE A POSITIVE LEGAL/REGULATORY FRAMEWORK IS CRITICAL TO THE SUCCESS OF THIS PROJECT AND THAT THE PROJECT SHOULD NOT GO FORWARD WITHOUT APPROVAL OF THE FREE ZONE SECTOR REGLAMENTOS [illegible] DISCUSSED AT THE DAEC:

THE MISSION SHOULD ANALYZE THE POLICY FRAMEWORK WHICH WILL IMPACT ON THIS PROJECT ESPECIALLY AS IT IS EXPECTED TO AFFECT BOTH FREE ZONE DEVELOPERS AND CLIENTS AND THE DEMAND FOR PROJECT RESOURCES: IT WAS FURTHER NOTED THAT THE MACROECONOMIC SETTING WILL BE DISCUSSED

See PP Section II.c and Annex N.

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(C) PROJECT DESIGN:

- THE MISSION SHOULD INCLUDE IN THE PROJECT PAPER AN ASSESSMENT OF THE POTENTIAL IMPACT OF COMPETITION BETWEEN THE SAN BARTOLO FREE ZONE (SBFZ) AND THE NEW PRIVATE ZONES THAT WILL BE DEVELOPED UNDER THE PROJECT:

See PP Sections II,E; III,B; VI,B; and Annex G.

- THE PROJECT PAPER SHOULD ARTICULATE THE MISSIONS' OBJECTIVES AND INTENTIONS WITH RESPECT TO CURRENT AND FUTURE ASSISTANCE TO THE SBFZ:

See PP Section II,E. III, D.2.

- WITH RESPECT TO FUSADES' PARTICIPATION IN THE PROJECT, IT WAS DECIDED THAT THE PROJECT WILL NOT BE AUTHORIZED UNTIL AID/W AND THE MISSION HAVE THE OPPORTUNITY TO REVIEW THE RESULTS OF THE UPCOMING EVALUATION OF FUSADES:

FUSADES evaluation submitted separately.

- AS REGARDS THE PROVISION OF CREDIT, THE MISSION IS REQUESTED IN PP DEVELOPMENT TO CONSULT WITH THE RLA ON THE APPLICATION OF FAA SECTION 611 (A) (REQUIRING COMPLETION OF FINANCIAL PLANS NECESSARY TO IMPLEMENT THE PROJECT AND A REASONABLY FIRM ESTIMATE OF THE COST TO THE USG OF PROVIDING THE ASSISTANCE):

RLA and GC/LAC have been consulted. See PP Section V,G.

(D) IMPLEMENTATION ARRANGEMENTS:

THE IMPLEMENTATION ARRANGEMENTS SECTION OF THE PP WILL INCLUDE A RATIONALE FOR UTILIZING FUSADES, IF THE MISSION DECIDES TO INCLUDE IT IN THIS PROJECT, AND A DISCUSSION OF THE ALTERNATIVE ARRANGEMENTS THAT WERE CONSIDERED:

See PP Section III, E.2., and Section VI,E.5.

- THE PP SHOULD EXAMINE THE SHORT-TERM IT ACTIVITIES THAT FUSADES WILL UNDERTAKE (AND THAT WILL NOT BE PART OF BUILDING THESE CAPACITIES INTO FUSADES OVER THE LONG RUN) AS WELL AS THE NON-ZONE SPECIFIC INVESTMENT PROMOTION ACTIVITIES PLANNED TO BE UNDERTAKEN BY FEDEX/FUSADES:

See PP Section III, E.2., and Section VI,E.5.

(E) PROJECT FUNDING: SDA/ESF SPLIT:

- THE DAEC CONCURRED WITH THE PLANNED FY 1988 FUNDING LEVEL OF $5:555 MILLION IN SDA FUNDING, AND WITH THE PROPOSED OVERALL LOP FUNDING TOTAL.

- GIVEN THE SCARCITY OF SDA FUNDS, THE DAEC DETERMINED THAT THE PLANNED LOP LEVEL FOR SDA FUNDING OF DOLS 10.0 MILLION WAS TOO HIGH AND SHOULD HAVE TO BE ADJUSTED TO REFLECT MORE ESF FOR THE PROJECT: HOWEVER, UNLESS

Proposed Project funding is $10.0 million SDA and $16.0 million ESF.

MODIFIED DURING THE AP REVIEW, SDA RESOURCES WILL NOT EXCEED THE FY88 BUDGET LEVEL. THIS ISSUE AND ITS BROADER PORTFOLIO IMPLICATIONS IN TERMS OF PROJECTIZED ESF WILL BE DISCUSSED IN THE UPCOMING AID/W REVIEW OF USAID/EL SALVADOR'S FY 1989-1990 ACTION PLAN:

(F) INTEREST RATE AND TERMS OF CREDIT:

- IT WAS NOTED THAT THE PROPOSED INTEREST RATE FOR THE PROJECT'S CREDIT FACILITY IS PREMATURE, AND THAT WHILE THIS MAY BE COMPETITIVE WITH OTHER CREDIT AVAILABLE FOR SIMILAR PURPOSES IN EL SALVADOR, IT IS INCONSISTENT WITH A:I:D: POLICY: — See PP Section IV,D.

- THE POSSIBILITY OF MAKING LOANS WITH A VARIABLE INTEREST RATE OVER THE REPAYMENT PERIOD WAS CONSIDERED BUT DISCARDED AS NOT FEASIBLE IN EL SALVADOR: HOWEVER, THE MISSION SHOULD CONSIDER AN ADJUSTABLE INTEREST RATE FEATURE WHICH WOULD ALLOW SUB-LOAN TRANCHES TO BE MADE AT MARKET INTEREST RATES PREVAILING AT THE TIME THE SUBSEQUENT TRANCHES ARE APPROVED: — See PP Section IV,D.

- CONCERN WAS EXPRESSED AT THE PAEC ABOUT HOW ZONE DEVELOPERS INFORMING UNDER THE PROPOSED LOCAL CURRENCY CREDIT MECHANISM COULD BE ASSURED OF RECEIVING ACCESS TO DOLLARS NEEDED FOR INFRASTRUCTURE ON A PRIORITY BASIS. IT WAS AGREED AT THE PAEC THAT THIS ISSUE IS A KEY DESIGN ISSUE TO BE EXPLORED WITH THE CENTRAL BANK AND DEALT WITH IN THE PROJECT PAPER. — See PP Section IV,D.

- SUBLOAN DISBURSEMENTS SHOULD BE TIED TO PHYSICAL PROGRESS IN ZONE DEVELOPMENT, ENSURING THAT ADVANCES IN EXCESS OF NEED ARE NOT MADE: — See PP Section IV,D.

G: DEMAND:

- IT WAS NOTED THAT DEMAND FOR PROJECT RESOURCES IS CLEARLY A CENTRAL DESIGN ISSUE TO BE DEALT WITH IN THE PP AND THAT THE MISSION EXPECTS THAT EPZ ZONE CONSTRUCTION WILL BE PHASED TO RESPOND TO DEMAND: WHILE IT IS NOT REALISTIC TO EXPECT THE MISSION TO DEMONSTRATE EFFECTIVE DEMAND FOR ALL THE PROJECT RESOURCES AT THIS JUNCTURE, THE PP SHOULD CONTAIN A THOROUGH ANALYSIS AND DISCUSSION OF THE DEMAND FOR THE INITIAL 10LS 5:55 MILLION OF FUNDING PROPOSED FOR FY 88, IN ANTICIPATION TO THE MORE GENERAL DEPTH ANALYSIS THAT WILL BE PRESENTED IN THE PP: — See PP Section VI,B. and Annex G.

H: LAUTENBERG AMENDMENT: IN THE EVENT THAT THE PROJECT MAY BE PROVIDING DIRECT ASSISTANCE FOR EXPORT RELATED ACTIVITIES THE MISSION AND RLA SHOULD CAREFULLY EXAMINE THE POSSIBLE APPLICATION OF THE LAUTENBERG AMENDMENT TO PROJECT ACTIVITIES: — RLA has been consulted. See PP Section V,F.

I: ENVIRONMENTAL CONSIDERATIONS: THE MISSION AND THE USAID CONCURRED THAT THE IEE COULD BE EXPECTED TO REFLECT A POSITIVE DETERMINATION AND TO INCLUDE DOCU — See Nnex F, the IEE.

INFORMATION ON, FOR EXAMPLE, THE TYPES OF FIRMS LIKELY TO BECOME FREE ZONE CLIENTS UNDER THE PROJECT: THE PROJECT AGREEMENT SHOULD INCLUDE LANGUAGE THAT WILL ENABLE ENVIRONMENTAL ASSESSMENTS TO BE PERFORMED ON THE SPECIFIC PRIVATE FREE ZONE SITES AFTER PROJECT AUTHORIZATION BUT BEFORE USAID/EL SALVADOR APPROVES THE INDIVIDUAL SUBLOANS UNDER THE PROJECT:

6: THE FOLLOWING ISSUES WERE DISCUSSED AND RESOLVED AT THE ISSUES MEETING WHICH WAS HELD ON 3/18/86: (A) GRANT VS: LOAN FUNDING. IT WAS DETERMINED THAT THE PROPOSED GRANT FUNDING IS CONSISTENT WITH THE QUOTE TERMS OF AID UNQUOTE: (B) AID INVOLVEMENT IN CREDIT APPROVAL: SUCH INVOLVEMENT SHOULD BE ON TECHNICAL GROUNDS AND SHOULD NOT APPLY TO REFLOWS. (C) IT WAS RECOGNIZED THAT THE PROVISION BY THE GOES OF THE INFRASTRUCTURE (WATER,

ELECTRICITY, ROADS, AND TELECOMMUNICATIONS), KEY TO THE ACHIEVEMENT OF THE PROJECT PURPOSE AND TO ITS SMOOTH IMPLEMENTATION, WILL BE EXAMINED AND PROVIDED FOR IN THE THE FINAL PROJECT DESIGN: SHULTZ
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Annex B: Logical Framework

NARRAVTIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATOR	MEANS OF VERIFICATION	ASSUMPTIONS
Goal			
To increase productive employment opportunities and foreign exchange earnings in the export sector, thereby assisting the country's economic growth and recovery efforts.	1. Increased participation of nontraditional sectors in total GDP. 2. Increased nontraditional exports to extra-regional markets. 3. Increased employment in export-oriented, nontraditional sectors assisted by Project.	Macroeconomic data and statistics.	1. The legal and policy framework for exports and investment will not change significantly. 2. The military and political situation will not deteriorate over the short-term and will improve over the medium-term. 3. The 1989 Salvadoran election will take place in a democratic fashion. 4. GOES economic stabilization efforts will continue to bear fruit. 5. Exporters from El Salvador will continue to find reasonably profitable marketing opportunities.
Purpose			
To develop private free zones in El Salvador through the establishment of a revolving credit facility for private free zones, and to improve the administration and services offered by the San Bartolo Free Zone.	1(a). Establishment of, at a minimum, an autonomous corporation to manage the SBFZ. 1(b). Establishment of rental rates which cover costs at the SBFZ, and a reduction in delinquent rent payments. 1(c). Rental contracts for non-exporting firms not renewed at end of term.	1. MICE and SBFZ records.	1. The GOES will remain interested in improving the administrative and financial operations of the SBFZ.

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NARRAVTIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATOR	MEANS OF VERIFICATION	ASSUMPTIONS
	2. Free Zone Credit facility operational.	2. BCR and commercial bank records.	2(a). The BCR will remain interested in assisting in channeling credit 2(b). Training will enable NBS employees to operate the facility.
Outputs			
1. Credit facility disbursements for private free zone development.	1.End of year projections- (U.S. $000's): 88: -- 89: 10.0 90: 10.0 91: -- 92: --	1. BCR records.	1. Demand for free zone financing will occur due to CBI opportunities and unmet demand.
2. Technical Assistance to Private zone developers.	2. Pre-investment studies/ analysis financed.	2. Project records and reports.	2. Sufficient interest in developing private zones in El Salvador exists.
3. Training for private zones.	3. Training courses/programs for private zone managers completed.	3. Project records and reports.	3. Unmet demand for zone managerial training exists.
4. Technical assistance and support for PRIDEX' promotional efforts.	4(a). Free Zone Officer designated by PRIDEX and trainees. 4(b). FZ promotional materials prepared. 4(c). FZ Promotional program up and running.	4. Project records and reports.	4. PRIDEX will have the institutional capability to administer a free zone program.

NARRAVTIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATOR	MEANS OF VERIFICATION	ASSUMPTIONS
5. Training for GOES officials involved in the FZ designation/ approval process.	6. FZ designation/ approval process operational.	6. Project records and reports.	6. The GOES will continue to support the development of private free zones.
Inputs			
1. A.I.D. financed	Life of Project ($000's)	1. A.I.D., BCR and FUSADES records.	1. Incremental A.I.D. funds will be available in FY's 89 and 90.
Credit	20,000		
Technical Assistance Training	4,970		
Operational Support	1,030		
subtotal	26,000		
2. Counterpart		2. A.I.D., BCR and FUSADES records.	
GOES	6,132		
Private developers	7,307		
subtotal	13,439		
T O T A L	39,439		

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ANNEX D

CERTIFICATION PURSUANT TO SECTION 611(e) OF THE FOREIGN ASSISTANCE ACT OF 1961, AS AMENDED

I, Henry H. Bassford, as Director of the Agency for International Development Mission to El Salvador, having taken into account, among other things, the maintenance and utilization of projects previously financed by USAID/El Salvador, do hereby certify that in my judgement the implementing agencies have the financial capacity to efffectively utilize and maintain the proposed Free Zone Development Project Grant.

Henry H. Bassford
Director
USAID/El Salvador

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5C(2) - PROJECT CHECKLIST

Listed below are statutory criteria applicable to projects. This section is divided into two parts. Part A includes criteria applicable to all projects. Part B applies to projects funded from specific sources only: B(1) applies to all projects funded with Development Assistance; B(2) applies to projects funded with Development Assistance loans; and B(3) applies to projects funded from ESF.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? HAS STANDARD ITEM CHECKLIST BEEN REVIEWED FOR THIS PROJECT?

5c(1), the Country Checklist, was submitted with the FY 1988 PAAD and with Project 519-0349

A. GENERAL CRITERIA FOR PROJECT

1. FY 1988 Continuing Resolution Sec. 523; FAA Sec. 634A. If money is sought to obligated for an activity not previously justified to Congress, or for an amount in excess of amount previously justified to Congress, has Congress been properly notified?

   Yes

2. FAA Sec. 611(a)(1). Prior to an obligation in excess of $500,000, will there be (a) engineering, financial or other plans necessary to carry out the assistance, and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?

   Yes

3. FAA Sec. 611(a)(2). If legislative action is required within recipient country, what is the basis for a reasonable expectation that such action will be completed in time to permit orderly accomplishment of the purpose of the assistance?

   USAID experience is that the Agreement will be ratified by the Legislative Assembly within 4-6 weeks of signing.

4. FAA Sec. 611(b); FY 1988 Continuing Resolution Sec. 501. If project is for water or water-related land resource construction, have benefits and costs been computed to the extent practicable in accordance with the principles, standards, and procedures established pursuant to the Water Resources Planning Act (42 U.S.C. 1962, et seq.)? (See A.I.D. Handbook 3 for guidelines.)	N/A
5. FAA Sec. 611(e). If project is capital assistance (e.g., construction), and total U.S. assistance for it will exceed $1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability to maintain and utilize the project effectively?	Yes. Certification is attached as Annex D to this Project Paper.
6. FAA Sec. 209. Is project susceptible to execution as part of regional or multilateral project? If so, why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.	NO
7. FAA Sec. 601(a). Information and conclusions on whether projects 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.	The Project is specifically designed to support a,b,c, d and e.
8. FAA Sec. 601(b). Information and conclusions on how project 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).	The construction/developme of Free Zones will greatly increase the availability industrial space in the country, both direct and indirect U.S. investment a participation will be encouraged. Credit will involve buying machinery f U.S.; U.S. firms to provide some TA and training, and private firms eligible for loans.
9. FAA Secs. 612(b), 636(h). Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars.	Borrowers will pay part of TA, training and provide equity for productive ventures.

10. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release? NO

11. FY 1988 Continuing Resolution Sec. 521. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity? No direct assistance will provided for the productic of such commodities.

12. FY 1988 Continuing Resolution Sec. 553. Will the assistance (except for programs in Caribbean Basin Initiative countries under U.S. Tariff Schedule "Section 807," which allows reduced tariffs on articles assembled abroad from U.S.-made components) be used directly to procure feasibility studies, prefeasibility studies, or project profiles of potential investment in, or to assist the establishment of facilities specifically designed for, the manufacture for export to the United States or to third country markets in direct competition with U.S. exports, of textiles, apparel, footwear, handbags, flat goods (such as wallets or coin purses worn on the person), work gloves or leather wearing apparel? NO

13. FAA Sec. 119(g)(4)-(6). Will the assistance (a) support training and education efforts which improve the capacity of recipient countries to prevent loss of biological diversity; (b) be provided under a long-term agreement in which the recipient country agrees to protect ecosystems or other wildlife habitats; (c) support efforts to identify and survey ecosystems in recipient countries worthy of protection; or (d) by any direct or indirect means significantly degrade national parks or similar protected areas or introduce exotic plants or animals into such areas? N/A

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14. FAA 121(d). If a Sahel project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (either dollars or local currency generated therefrom)? N/A

15. FY 1988 Continuing Resolution. If assistance is to be made to a United States PVO (other than a cooperative development organization), does it obtain at least 20 percent of its total annual funding for international activities from sources other than the United States Government? N/A

16. FY Continuing Resolution Sec. 541. If assistance is being made available to a PVO, has that organization provided upon timely request any document, file, or record necessary to the auditing requirements of A.I.D., and is the PVO registered with A.I.D.? Yes

17. FY 1988 Continuing Resolution Sec. 514. If funds are being obligated under an appropriation account to which they were not appropriated, has prior approval of the Appropriations Committees of Congress been obtained? N/A

18. FY Continuing Resolution Sec. 515. If deob/reob authority is sought to be exercised in the provision of assistance, are the funds being obligated for the same general purpose, and for countries within the same general region as originally obligated, and have the Appropriations Committees of both Houses of Congress been properly notified? N/A

19. State Authorization Sec. 139 (as interpreted by conference report). Has confirmation of the date of signing of the project agreement, including the amount involved, been cabled to State L/T and A.I.D. LEG within 60 days of the agreement's entry into force with respect to the United States, and has the full text of the agreement been pouched to those same offices? (See Handbook 3, Appendix 6G for agreements covered by this provision). N/A

B. FUNDING CRITERIA FOR PROJECT

1. Development Assistance Project Criteria

a. FY 1988 Continuing Resolution Sec. 552 (as interpreted by conference report). If assistance is for agricultural development activities (specifically, any testing or breeding feasibility study, variety improvement or introduction, consultancy, publication, conference, or training), are such activities (a) specifically and principally designed to increase agricultural exports by the host country to a country other than the United States, where the export would lead to direct competition in that third country with exports of a similar commodity grown or produced in the United States, and can the activities reasonably be expected to cause substantial injury to U.S. exporters of a similar agricultural commodity; or (b) in support of research that is intended primarily to benefit U.S. producers?

N/A

b. FAA Secs. 102(b), 111, 113, 281(a). Describe extent to which activity will (a) effectively involve the poor in development by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, dispersing investment from cities to small towns and rural areas, and

a) high impact.
b) N/A.
c) To assist the private sector and to facilitat investment in the expo sector.
d) Positive impact. The majority of jobs created will be women.
e) N/A.

insuring wide participation of the poor in the benefits of development on a sustained basis, using appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward a better life, and otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries.

c. FAA Secs. 103, 103A, 104, 105, 106, 120-21. Does the project fit the criteria for the source of funds (functional account) being used? Yes.

d. FAA Sec. 107. Is emphasis placed on use of appropriate technology (relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)? Yes.

e. FAA Secs. 110, 124(d). Will the recipient country provide at least 25 percent of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)? Yes.

f. FAA Sec. 128(b). If the activity attempts to increase the institutional capabilities of private organizations or the government of the country, or if it attempts to stimulate scientific and technological research, has it been designed and will it be monitored to ensure that the ultimate beneficiaries are the poor majority? Yes.

g. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civil education and training in skills required for effective participation in governmental processes essential to self-government.

The Project supports the efforts of a local PVO to promote investm and exports, responds tothe critical need to increase industrial spa suitable for export production in El Salvad

h. FY 1988 Continuing Resolution Sec. 538. Are any of the funds to be used for the performance of abortions as a method of family planning or to motivate or coerce any person to practice abortions? NO

Are any of the funds to be used to pay for the performance of involuntary sterilization as a method of family planning or to coerce or provide any financial incentive to any person to undergo sterilizations? NO

Are any of the funds to be used 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

i. FY 1988 Continuing Resolution. Is the assistance being made available to any organization or program which has been determined to support or participate in the management of a program of coercive abortion or involuntary sterilization? N/A

If assistance is from the population functional account, are any of the funds to be made available to voluntary family planning projects which do not offer, either directly or through referral to or information about access to, a broad range of family planning methods and services? N/A

j. FAA Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise?

Yes.

k. FY 1988 Continuing Resolution. What portion of the funds will be available only for activities of economically and socially disadvantaged enterprises, historically black colleges and universities, colleges and universities having a student body in which more than 20 percent of the students are Hispanic Americans, and private and voluntary organizations which are controlled by individuals who are black Americans, Hispanic Americans, or Native Americans, or who are economically or socially disadvantaged (including women)?

Such organizations will be encouraged to participate in the provision of technical assistance and training activities. However, it is impossible to estimat the amount which might g to them.

l. FAA Sec. 118(c). Does the assistance comply with the environmental procedures set forth in A.I.D. Regulation 16? Does the assistance place a high priority on conservation and sustainable management of tropical forests? Specifically, does the assistance, to the fullest extent feasible: (a) stress the importance of conserving and sustainably managing forest resources; (b) support activities which offer employment and income alternatives to those who otherwise would cause destruction and loss of forests, and help countries identify and implement alternatives to colonizing forested areas; (c) support training programs, educational efforts, and the establishment or strengthening of institutions to improve forest management; (d) help end destructive slash-and-burn agriculture by supporting stable and productive farming practices; (e) help conserve forests which have not yet been degraded by helping to increase production on lands already cleared

Yes.

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or degraded; (f) conserve forested watersheds and rehabilitate those which have been deforested; (g) support training, research, and other actions which lead to sustainable and more environmentally sound practices for timber harvesting, removal, and processing; (h) support research to expand knowledge of tropical forests and identify alternatives which will prevent forest destruction, loss, or degradation; (i) conserve biological diversity in forest areas by supporting efforts to identify, establish, and maintain a representative network of protected tropical forest ecosystems on a worldwide basis, by making the establishment of protected areas a condition of support for activities involving forest clearance or degradation, and by helping to identify tropical forest ecosystems and species in need of protection and establish and maintain appropriate protected areas; (j) seek to increase the awareness of U.S. government agencies and other donors of the immediate and long-term value of tropical forests; and (k)/utilize the resources and abilities of all relevant U.S. government agencies?

m. FAA Sec. 118(c)(13). If the assistance will support a program or project significantly affecting tropical forests (including projects involving the planting of exotic plant species), will the program or project (a) be based upon careful analysis of the alternatives available to achieve the best sustainable use of the land, and (b)/take full account of the environmental impacts of the proposed activities on biological diversity? N/A

n. FAA Sec. 118(c)(14). Will assistance be used for (a) the procurement or use of logging equipment, unless an environmental assessment indicates that all timber harvesting operations involved will be conducted in an environmentally sound manner and that the proposed activity will produce positive economic benefits and sustainable forest management systems; or (b) actions which will significantly degrade national parks or similar protected areas which contain tropical forests, or introduce exotic plants or animals into such areas? NO

o. FAA Sec. 118(c)(15). Will assistance be used for (a) activities which would result in the conversion of forest lands to the rearing of livestock; (b) the construction, upgrading, or maintenance of roads (including temporary haul roads for logging or other extractive industries) which pass through relatively undegraded forest lands; (c) the colonization of forest lands; or (d) the construction of dams or other water control structures which flood relatively undegraded forest lands, unless with respect to each such activity an environmental assessment indicates that the activity will contribute significantly and directly to improving the livelihood of the rural poor and will be conducted in an environmentally sound manner which supports sustainable development? NO

p. FY 1988 Continuing Resolution If assistance will come from the Sub-Saharan Africa DA account, is it (a) to be used to help the poor majority in Sub-Saharan Africa through a process of long-term development and economic growth that is equitable, participatory, environmentally sustainable, and self-reliant; (b) being provided in N/A

accordance with the policies contained in section 102 of the FAA; (c) being provided, when conistent with the objectives of such assistance, through African, United States and other PVOs that have demonstrated effectiveness in the promotion of local grassroots activities on behalf of long-term development in Sub-Saharan Africa; (d) being used to help overcome shorter-term constraints to long-term development, to promote reform of sectoral economic policies, to support the critical sector priorities of agricultural production and natural resources, health, voluntary family planning services, education, and income generating opportunities, to bring about appropriate sectoral restructuring of the Sub-Saharan African economies, to support reform in public administration and finances and to establish a favorable environment for individual enterprise and self-sustaining development, and to take into account, in assisted policy reforms, the need to protect vulnerable groups; (e) being used to increase agricultural production in ways that protect and restore the natural resource base, especially food production, to maintain and improve basic transportation and communication networks, to maintain and restore the natural resource base in ways that increase agricultural production, to improve health conditions with special emphasis on meeting the health needs of mothers and children, including the establishment of self-sustaining primary health care systems that give priority to preventive care, to provide increased access to voluntary family planning services, to improve basic literacy and mathematics especially to those outside the formal educational system and to improve primary education, and to develop income-generating opportunities for the unemployed and underemployed in urban and rural areas?

2. Development Assistance Project Criteria (Loans Only)

a. FAA Sec. 122(b). Information and conclusion on capacity of the country to repay the loan at a reasonable rate of interest. N/A

b. FAA Sec. 620(d). If assistance is for any productive enterprise which will compete with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S. of more than 20 percent of the enterprise's annual production during the life of the loan, or has the requirement to enter into such an agreement been waived by the President because of a national security interest? N/A

c. FY 1988 Continuing Resolution. If for a loan to a private sector institution from funds made available to carry out the provisions of FAA Sections 103 through 106, will loan be provided, to the maximum extent practicable, at or near the prevailing interest rate paid on Treasury obligations of similar maturity at the time of obligating such funds? N/A

d. FAA Sec. 122(b). Does the activity give reasonable promise of assisting long-range plans and programs designed to develop economic resources and increase productive capacities? N/A

3. Economic Support Fund Project Criteria

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

b. FAA Sec. 531(e). Will this assistance be used for military or paramilitary purposes? — NO

c. 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

Annex F: INITIAL ENVIRONMENTAL EXAMINATION

I. BASIC PROJECT DATA

PROJECT LOCATION	:	El Salvador
PROJECT TITLE	:	Free Zone Development
PROJECT NUMBER:	:	519-0323
FUNDING	:	$26.0 million LOP
LIFE OF PROJECT	:	5 years (FY 88 thru FY 93)
PROJECT ASSISTANCE COMPLETION DATE	:	August, 1993
IEE PREPARED BY	:	C. Roberto Gavidia USAID/El Salvador Environmental Officer

RECOMMENDATION FOR THRESHOLD DECISION

USAID/El Salvador recommends a Positive Threshold Determination for this Project, thus requiring further environmental analysis on a sub-project by sub-project basis to be performed locally. This recommendation is based upon an analysis of the range of industries which may be established in the newly developed free zones and the potential for adverse environmental effects.

Henry H. Bassford
Director
USAID/El Salvador

8/30/88
Date

II. DESCRIPTION OF THE PROJECT

A. Goal and Purpose

The proposed five-year Project will consist of $26.0 million in SDA grant funds to provide credit, technical assistance, and training to foment the development and improvement of free zones in El Salvador. The goal of the proposed Project is to increase productive employment opportunities and foreign exchange earnings in the export sector, thereby assisting the country's economic stabilization and growth efforts. The purpose of the Project is to improve the administration and services offered by the GOES free zone at San Bartolo, and to develop private free zones in El Salvador through the creation of a revolving credit fund for private zone development.

Free zones have proven to be an effective mechanism for catalyzing the development of nontraditional industry and promoting economic growth and diversification in countries throughout the Caribbean/Central American region. While El Salvador was one of the first countries in the region to establish a free zone, the public sector zone at San Bartolo has been plagued by bureaucratic and managerial problems, and has been unable to keep pace with demand for industrial space. This Project is intended to address the need to expand the national industrial capacity by providing financial and technical assistance to stimulate and support private sector development of free zones in El Salvador and to improve the performance of the existing GOES San Bartolo Free Zone (SBFZ). The San Bartolo Free Zone does not have sufficient facilities to meet the demand for space, nor the operational freedom to rapidly construct new buildings in response to demand.

B. Project Components

Under the Private Zone Development component, $20.0 million in long-term financing will be made available to private free zone developers for permanent working capital, construction, and basic infrastructure within the zones. In addition, technical assistance and training for pre-design and feasibility, as well as zone management, administration, and planning will be provided to zone developers by PRIDEX, the Investment and Export Promotion Program at FUSADES. Grant financing will also be provided for environmental examinations once potential free zones sites have been indentified to assure that there is no significant adverse environmental impact resulting from the Project.

Under the Promotion/Marketing component, technical assistance, training, and operational support to PRIDEX will be provided. Private zone developers will benefit from PRIDEX's promotional efforts, and will be able to borrow funds for zone-specific promotion under the Project. In addition, public sector employees will receive training in general investment promotion and free zone promotion.

The Infrastructure and Institutional Support component will enable the GOES to improve its support of its free zone as well as of new private free zones. The San Bartolo Free Zone (SBFZ) will receive assistance to improve its administration, management, and planning capabilities. Public sector training under this component will focus on training personnel from the GOES institutions involved in free zone designation and regulation and in zone management, administration, and planning. In addition, this component will utilize counterpart funds to finance the required public infrastructure (water, electricity, telephone lines, etc.) up to the gate of the new private zone(s). These physical works will be coordinated by the Ministry of Planning.

The last component consists of support for the Capital Expenditures of FUSADES (Office Building). FUSADES currently rents office space in four different buildings in San Salvador. The cost of the building and furnishings is estimated at 14.5 million colones ($2.9 million). The building makes sense from both the financial and organizational standpoint, as commercial rents are high in El Salvador, and FUSADES has been unable to locate sufficient space to house all its staff in one building, both results of the devastating 1986 earthquake in the capital city. Furthermore, the building is viewed by FUSADES as critical to the institution's permanence. (The land for the building was purchased with FUSADES' own funds.) The Mission has reviewed the cost estimates and plans for the building, consistent with Section 611 of the FAA, as amended, and finds them reasonable.

III. IMPACT IDENTIFICATION AND EVALUATION

Impact Areas and Sub-Areas	Impact Identification and Evaluation 1/
A. Land Use	
1. Changing the character of the land through:	
a. Increasing the population	L+
b. Extracting natural resources	M+
c. Land Cleaning	M+
d. Changing soil character	N
2. Altering natural defenses	N
3. Foreclosing important uses	N
4. Jeopardizing man or his works	N
5. Other factors	N
B. Water Quality	
1. Physical state of water	M+
2. Chemical and biological status	N
3. Ecological balance	N
4. Other factors	N

C.	**Atmospheric**	
	1. Air additives	N
	2. Air pollution	N
	3. Noise pollution	N
	4. Other factors	N
D.	**Natural Resources**	
	1. Diversion, altered use of water	M+
	2. Irreversible, inefficient commitments	N
	3. Other factors	N
E.	**Cultural**	
	1. Altering physical symbols	N
	2. Dilution of cultural traditions	N
	3. Other factors	N
F.	**Socioeconomic**	
	1. Changes in economic/employment patterns	H+
	2. Changes in population	M+
	3. Changes in cultural patterns	N
	4. Other factors	N
G.	**Health**	
	1. Changing a natural environment	H+
	2. Eliminating an ecosystem	N
	3. Other factors	N
H.	**General**	
	1. International impacts	H+
	2. Controversial impacts	N
	3. Larger program impacts	N
	4. Other factors	
I.	**Other Possible Impacts**	
	1. Urban services	H+
	2. Health services	H+

1/ The following symbols have been used:

N	No environmental impact	U	Unkown environmental impact
L	Little environmental impact	+	Beneficial impact.
M	Moderate environmental impact	-	Negative impact
H	High environmental impact		

IV. SUMMARY OF BENEFITS AND CONCERNS

1. Benefits

The principal Project outputs of the new free zones will be increased employment opportunites and foreign exhange earnings in the export sector, thereby assisting the country's economic stabilization and growth efforts. The following positive impacts will be produced by the Project:

- Improved health and safety in the new facilities such as working areas, water, sewerage, drainage, street lighting, and communications.

- Well-laid out facilities that provide improved access and adequate space.

2. Concerns

The construction of the physical facilities and basic infrastructure in itself are activities which do not inherently not cause adverse effects upon the natural environment. However, these activities require a high-evaluative process.

Sub-project activities center on the construction of light industrial and commercial floorspace. Sound environmental planning in this Project can be achieved by careful site selection, sub-project selection and development using fundamentals of environmental planning.

Since the sites have been identified at this time, a meanizeful environmental assessment is not possible. However, the Project will make grant financing available to potential free zone developers for the preparation of studies to determine the potential environmental impact of the respective zone developments.

Appropriate language will be included in the Project Authorization and Agreement(s) to ensure that credit for sub-projects is not approved prior to competion of environmental analysis. The LAC Bureau Chief Environmental Officer has approved this procedure and provided tguidance on the scope of the environmental analysis which will be performed locally.

) Sites selected for free zone development under this Project will be environmentally acceptable. Forested land, wetlands or other undergraded wildland sites, or sites that would require new access through such lands, will not be eligible for credit financing under the Project. Access to solid sanitary waste disposal facilities, or adequate on-site capacity of the land on which a free zone is to be developed to properly handle waste disposal will also be required.

3. Discussion of Key Environmental Issues

Designs for construction to be carried out under sub-projects will take in consideration the construction code of El Salvador which includes the new methods for scismic design. Design criteria will include appropriate site selection and development of the area to be done in a sound environmetal manner. Zone developments which would result in unacceptable environmental actions will not be financed under the Project.

4. Technical Assistance

Technical assistance to enhance the institutional capabilities of PRIDEX and MICE will be also provided. PRIDEX will review and assess the status of development planning and provide the technical assistance required for pre-investment studies, including locational analysis and site selection; prefeasibility studies (with market supply and demand assessment, project strategy development capital cost estimates, preliminary physical planning including environmental concerns, financial planning); and feasibility studies, encompassing the above and comprehensive market analysis and detailed A/E design work.

5. Conclusion

The net environmental result will be an increase of industrial and commercial floorspace which will provide El Salvador with more employement opportunities in the export sector and foreign exchange to help with the economic stabilization and growth efforts. The range of industries which may be established in the new developed free zone are uncertain at this time. Since sites have not been identified at this time, further analysis after authorization of the Project is needed. Each sub-project will be further analyzed to determine the potential adverse environmental effects of the proposed zone(s). Therefore, a positive determination is recommended. Further environmental analysis on the specific proposed sites will be performed locally; such analysis will be a prerequisite for accessing the Project's credit facility.

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ANNEX G: MARKET ASSESSMENT AND DEMAND ANALYSIS

I. SUMMARY OF APPROACH

II. MARKET ASSESSMENT

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B. Identification of Target Sectors
1. Competitive Position of El Salvador
a. Internal Factors
i. Investment Climate
ii. Market Access
iii. Basic Factors of Production
b. External Factors
2. High-Potential Sectors
a. Apparel Manufacturing
i. Market Structure
ii. Locational and Facilities Requirements
b. Electronics
i. Market Structure
ii. Locational and Facilities Requirements

C. Implications for Project Development

III. DEMAND ANALYSIS

A. Methodology

B. Extrapolations of Regional Demand Trends for Free Zone Space
1. Historic Growth in Effective Demand
2. Current Potential Demand
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C. Direct Market Survey
1. Methodology
2. Survey Results
a. U.S. and Far East Market Survey
i. Responses to Investment Issues
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D. Demand Projections
1. Combined Results of the Demand Analysis
2. Impact of the San Bartolo Free Zone and Recinto Fiscal
3. Implications for Project Development

I. SUMMARY OF APPROACH

The Central American and Caribbean region is host to the most dynamic free zone programs in the world today. The recent successes of regional zone projects; the ambitious construction programs presently underway in countries such as Costa Rica, Jamaica, and the Dominican Republic; the rising levels of investment by U.S. and Asian manufacturers seeking new production locations; and the increasing diversity of zone economic activity are all reflections of growing demand for regional zone facilities. The purpose of this analysis is to determine what portion of this market the facilities developed under this Project can reasonably expect to attract. Specifically, the two objectives are:

- to identify and evaluate the nature and extent of demand for space in new private free zones in El Salvador from target industrial sectors; and
- to develop realistic demand projections for Project resources based upon the results of a direct market survey of target sectors, comparative advantages and disadvantages of El Salvador, and the overall effect of competing zones.

One of the primary considerations in undertaking the development of any free zone project is the assessment of the market and the determination of the demand for zone space. Given the unique circumstances that influence the investment climate in El Salvador, a carefully configured market and demand analysis is especially crucial to arriving at a reasoned judgement on the Project's potential for success.

The following analysis is comprised of two sections: a market assessment, assessing the competitive position of the private free zones to be developed under the Project and identifying target industrial sectors; the demand analysis itself, consisting of demand trend extrapolation and direct market sampling.

The final demand projections are thus based on an analysis of the combined results of the two analytical elements of the demand analysis and, therefore, provide a sounder basis for reasoned decision making than either method in isolation. Finally, conclusions about the Project's viability, taking into consideration the potential impact of the San Bartolo Free Zone expansion and the <u>recinto fiscal</u> program on the projected demand, are made.

II. MARKET ASSESSMENT

A. METHODOLOGY

The identification of "target" sectors for private Salvadoran free zones must take into consideration many factors. Although the rigorous selection of high-potential industrial activities is not within the scope of this analysis, the following process allowed for a determination on feasible operations for the new free zones.

Assess the Comparative Advantages and Disadvantages of the Location. Given the absence of a specific new zone (that is, a development group with a selected location and pre-investment studies underway), this analysis is necessarily general. A realistic assessment of the overall strengths and weaknesses of El Salvador as a location for free zone investment was undertaken to identify its competitive position relative to regional zone projects. These characteristics were then used to define the types of industries that would appear to benefit from locating in a private Salvadoran free zone.

Identify Target Sector Requirements. Potentially viable industries were evaluated to determine their specific locational, operational, facilities and service requirements.

Match Industry Requirements with Locational Attributes. Finally, the various requirements of target industries were compared to locational characteristics to identify those sectors which would be most likely to be attracted to private Salvadoran free zones. The resulting analysis provides a preliminary assessment of the market position of the zones to be developed under the Project and was the basis for determining which firms to contact directly through the market survey.

B. IDENTIFICATION OF TARGET SECTORS

1. Competitive Position of El Salvador

Firms are typically attracted to geographic regions on the basis of proximity to end-user markets, labor cost differentials, and preferential market access, among other factors. Particular countries, in turn, are selected based on their comparative economic, locational, and policy advantages. Furthermore, specific free zone locations are chosen because of the facilities and services offered, rental rates, capability of the management team, availability of space, and so on. Demand is thus affected by two groups of factors: internal variables particular to specific free zones and the national investment climate, and external variables which have a much broader application.

a. Internal Factors

In El Salvador, as in any country, internal variables affecting demand are closely examined by potential investors, and play a decisive role in determining the prospects for successful private free zone development and the realization of the goal and purpose of this Project. Since the onset of the guerilla insurgency in the late 1970s, the Salvadoran economy has suffered from declining foreign investment, capital flight, and reductions in export earnings. When coupled with unfavorable terms of trade for traditional Salvadoran exports and generally stagnant rates of economic growth brought on by the global recession early in the decade, El Salvador's once preeminent position as a regional industrial leader has been eroded. Specific internal components that influence the competitive position of El Salvador as a location for private free zone development within the Central American and Caribbean region include the investment climate, the legal/regulatory framework, and basic production factors.

i. Investment Climate

The ongoing civil conflict in El Salvador contributes to the perception throughout the international business community of the country as a "high risk" location. Although foreign investment levels have risen slowly over the past three years, the continued outbreaks of violence, heavy tolls on public infrastructure, and overall lack of progress toward a peaceful resolution of the conflict have done little to boost investor confidence. Moreover, with the controversy surrounding the March 1988 municipal and legislative elections and related policital party crises did not help to improve the country's image problem as unstable. Progress has been made, however, on improving the legal and regulatory framework for investment and exporting.

In recent years, the Government of El Salvador (GOES) has taken steps to improve the institutional environment for foreign and domestic investment and export expansion. The Export Promotion Law passed in 1986 provided the legal basis for actions required to support the export sector and to promote investment. The regulatory framework needed to support this critical sector has been passed. The benefits offered to foreign and domestic investors under the law, which would apply to free zone firms, are competitive with free zone incentives offered by other countries within the region. They include: 10-year tax holiday for firms exporting more than 25% of their production; a tax holiday in perpetuity for 100% export firms; exemption from duties on imports of raw materials, capital goods and equipment for 10 years and longer; and other attractive incentives.

The 1986 law also established a "one-stop shop" for processing of export documentation. CENTREX, housed within the Ministry of Foreign Trade (MICE), is designed to expedite the application procedures and operational control measures associated with export production. Many bureaucratic requirements have been centralized within its sphere of activities; for example, licensing of imports and exports, issuing certificates of origin, revalidation of import and export licensing and various regulatory functions related to animal and vegetable products are all

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done at CENTREX. However, the absence of two key insitutions -- Customs and the Central Bank (BCR) has inhibited its effectiveness. There are still lengthy waits at the BCR for both foreign and domestic investors alike. Customs, however, appears to be functioning efficiently by comparison; few businesses have voiced dissatisfaction with its procedural requirements. In sum, the broad goal of expediting the processing of all export-related documentation has yet to be realized, although considerable improvement has been made.

Another important element of the Export Promotion Law is that it provides for the establishment of new private free zones. The implementing reglamento, which sets forth the procedures through which such zones can be established, as well as the framework under which they will operate, was signed by the Acting President.

It should also be noted that in April 1988, the Salvadoran Legislative Assembly passed a Foreign Investment Promotion and Guarantee Law, the first in the country's history. The law allows foreign investment in all but small-scale businesses and guarantees full repatriation of profits for most ventures, with the exception of the commercial and services sectors where repatriation is limited to 50%. The law is an important effort by the GOES to clarify the rights of foreign investors in El Salvador and to unify the various regulations regarding their activities in one document.

ii. Market Access

The decline of the Central American Common Market (CACM) has placed a premium on the development of extra-regional exports for all the member countries. As a beneficiary of the Caribbean Basin Initiative (CBI), the U.S. Generalized System of Preferences (U.S. GSP), and Items 806.3/807 of the U.S. Tariff Schedule, El Salvador is well positioned to develop export activities for the U.S. market. A major advantage of El Salvador is that it is one of the few quota-free locations for apparel remaining in the region. Currently, the major garment exporters in the Caribbean Basin -- the Dominican Republic, Haiti, Costa Rica, Panama, Jamaica, and Guatemala -- are restricted by U.S. apparel quotas. This is significant given the recent passage of the "807A" program (allowing for guaranteed access to the U.S. market for assemblies of U.S.-sourced garment components) on the one hand, and the large-scale, across-the-board reductions in the quotas of the apparel exporting countries of the Far East, where access levels were cut by overall 30-35%, on the other hand. El Salvador is thus an exceptionally attractive location for U.S. apparel manufacturers with offshore production sites as well as for the growing numbers of manufacturers from the "newly industrialized countries". (Taiwan, Korea, Singapore, Hong Kong) from a U.S. market access perspective.

iii. Basic Factors of Production

Basic Production factors such as land and buildings, labor, capital, transportation facilities, infrastructure, utilities and services, also form a part of the competitive positioning of El Salvador versus regional competitors.

Land and Buildings. While undeveloped land is plentiful in El Salvador, the 1986 earthquake severely affected the availability of industrial and commercial space. The GOES and donor-funded reconstruction programs have made progress toward rebuilding the inventory of "under-roof" space in the capital. However, many business are still operating out of inadequate temporary quarters or are utilizing buildings that are structurally damaged. Many still have been unable to find suitable space for expansion.

The lack of available space has particularly affected export-oriented firms with large-scale production. Although several industrial parks and warehouse complexes are scattered throughout San Salvador, none offer adequately serviced space suitable for significant production volume. The majority of export firms are located in recintos fiscales (bonded warehouses). While the government-owned and managed San Bartolo Free Zone (SBFZ) has traditionally offered suitable industrial facilities, it is presently fully occupied (although its tenants include the Salvadoran army and several firms producing for the domestic market), and has received additional requests for space in excess of 12,600 m^2.

Minimal relief for the pent-up demand for space will come from the expected expansion of the SBFZ, where construction underway will provide an additional 4,000 m^2 of space in 1988. P.L. 480 counterpart funds have also been made available for the development of an additional 20,000 m^2 of under-roof space. This seemingly positive factor is offset by the fact that the Ministry of Foreign Trade, which operates the facility, has been historically slow to respond to issues relating to the zone, and it is unlikely that the second phase of construction will be completed at San Bartolo before late 1989.

The shortage of available industrial space is a powerful disincentive to both local firms who postpone their expansion plans, and foreign firms, who are drawn to competing locations where buildings are ready for occupancy. In addition, despite the heavily subsidized rental rate for factory space of US$1.40/$m^2$/month offered by the SBFZ, the presence of the army in the facility is regarded as a security problem by many of the local exporters presently operating out of recintos fiscales. The development of a private free zone project with well-appointed industrial facilities could clearly enhance both El Salvador's competitiveness in attracting foreign investment and the growth of the domestic export sector.

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Labor. An important comparative advantage for El Salvador is the large supply of productive, trained labor available throughout the country. El Salvador is widely known for its productive labor force, which is generally regarded to be the best in Central America. Moreover, with the significant underutilitization of labor evident in the country, there is an ample supply of unskilled workers; supplies of trained technicians and managers are adequate. The standard unskilled wage of US$0.64/hour, including fringes, compares favorably with competing locations in the region such as Honduras (US$0.72/hour), Jamaica (US$0.90/hour), and the Dominican Republic (US$0.78/hour). The experiences of existing firms engaged in sophisticated production activities in the country, such as AVX Ceramics, which produces electronic components, have proven the high quality and trainability of the labor force. AVX, a U.S. firm, has found that productivity in its SBFZ plant exceeds that of its 13 facilities around the world. Morever, workers in Salvadoran export operations have remarkably low levels of absenteeism, despite the deficiencies in public transportation and other obstacles.

Capital. As is true in most developing countries, access to long-term capital financing at interest rates, terms, and conditions appropriate for industrial construction or expansion is difficult to obtain in El Salvador. Not only are the commercial banks reluctant to engage in term lending, but the procedural requirements of the BCR have resulted in lengthy delays even for conventional loans. Loans for working capital are specially problematic. In order to address this problem, A.I.D. has established several different local currency credit lines for Salvadoran businesses and has recently launched an offshore dollar-lending facility for exporters through FUSADES. In a related area, the BCR and the Salvadoran insurance industry, through financing provided by AID, have recently launched a unique insurance program available to foreign and domestic firms. PROINVER provides indemnities to replace or repair plants and equipment damaged or destroyed due to terrorism or political violence. Any firm operating under the Export Promotion Law is eligible for coverage; such a program could provide the additional security needed to attract foreign firms that might otherwise be reluctant to establish production facilities in El Salvador.

Transportation Network and Services. El Salvador maintains a well-developed road network by regional standards, although damage resulting from guerilla attacks and the recent earthquake has occured. One area in need of improvement is the lack of adequate transportation service in El Salvador. The privately operated buses which service the major cities and countrysides are generally extremely crowded and often do not offer service at night.

One of the difficulties inherent in the Salvadoran location is the lack of adequate overland and sea-transport routes. Given the absence of a Caribbean port, goods destined for Miami, New York, New Orleans and other locations in the southern and eastern United States are generally trucked to the Guatemalan port of Santo Tomás de Castilla, a facility that is beginning to show signs of heavy use. Many exporters also complain of the

high freight charges levied on their cargo shipped from Guatemala. El Salvador's Pacific port at Acajutla is a full-service container facility, but is underutilized, serving primarily Salvadoran firms exporting to Los Angeles. Moreover, the port is avoided by many carriers because of flaws in its design that make it particularly vulnerable to turbulent waters. On the other hand, adequate air service connections are established and discussions with local exporters indicate that air cargo rates are generally competitive. TACA Airlines and Eastern Airlines provide daily service to the United States from the international airport located outside San Salvador, and cargo flights are also regularly scheduled.

Utilities and Basic Services. Deficiencies in basic services delivery in El Salvador presently hamper industrial expansion. Telecommunications in El Salvador is provided by ANTEL, an autonomous public corporation. Although international direct dialing is available in most parts of the country, the domestic telephone network is currently overloaded and placing calls can be difficult. Delays of several months or more are encountered by firms or individuals wishing to obtain new phone lines. Offshore information services industries will be essentially impossible unless improvements are made.

The Salvadoran power supply has been severely damaged by both the earthquake and guerilla attacks on the system. Power interruptions, brownouts and blackouts are frequent; most companies maintain back-up power generators. Moreover, the rates charged to high energy consuming industries by CEL, the Salvadoran electric utility, are higher than those charged to residences and other businesses to discourage heavy consumption. The domestic water supply is also insufficent to meet the national demand, and during periods of drought, water rationing is employed throughout the country. Consequently, many industries have installed their own cisterns to meet their basic requirements.

b. External Factors

External factors also affect the attractiveness of El Salvador as an investment location and the potential demand for private free zone facilities. Clearly, the overall "health" of the global economy, and especially the U.S. economy, will have an impact on the demand for private free zone space in El Salvador, the flow of foreign investment into the country and the market for zone-produced goods.

Another important external consideration is the evolution of production technology that often displaces labor-intensive processes. The impact of such advances on apparel assembly has been minimal, but for other more sophisticated operations such as electronic component production and offshore information services activity, they are changing the character of workplace and the demands for both the quantity and quality of labor.

Finally, the regional supply of zone facilities and the actions of competitors are an important external influence on demand. As mentioned above, the proliferation of free zones in Central American and the Caribbean has a very direct impact on the potential share of the overall market that a private free zone in El Salvador can expect to attract. The characteristics, services, and facilities of these competing locations must be taken into consideration in the design and configuration of the free zone project and the targetting of priority sectors for promotion and marketing efforts. In the absence of competition, even the most basic industrial estate or free zone can expect to attract a sizeable market of firms simply in search of low-cost production locations. In the region today, however, El Salvador will have to position itself carefully to compete with its neighbors.

c. Summary

Based upon the inventory of comparative advantages and disadvantages as discussed above as well as the external factors which affect El Salvador's competitive position, a set of criteria can be defined to identify industrial activities that would benefit from a Salvadoran free zone location. "Target" industries would share some or all of the following characteristics:

- products with high labor cost-to-weight ratios, especially those suited for air transport;
- sub-assemblies and intermediate goods;
- products with high dutiable value from non-CBI locations;
- products subject to U.S. quota restrictions when exported from competing locations;
- non-technologically complex products; and
- industry sectors with strong growth rates.

The specific industries identified are briefly described below.

2. High-Potential Sectors

a. Apparel Manufacturing

i. Market Structure

The United States is by far the world's largest market for apparel products and textiles. Increasingly, imports are being used to satisfy demand in the United States. Since 1980, apparel imports have increased by an average of 19% annually, accounting for over half the total apparel imports. As imported apparel and fabrics have risen in the United States, the USG has taken steps to tighten restrictions on foreign-produced apparel products. Today, the U.S. has 21 bilateral agreements covering over 90% of its annual textile and apparel inputs. Moreover, a 1% ceiling has been placed on the annual growth of apparel and textile imports originating from its major Far East suppliers. At the same time, U.S. apparel manufacturers have sought to import, source and manufacture both sub-products and finished

goods from offshore locations to remain competitive. Likewise, Far Eastern firms are finding new ways to avoid quota restrictions and access the U.S. and other markets by setting up production facilities in quota-free locations. As a result, the Caribbean Basin has become an increasingly important part of both U.S. and Far East manufacturers product sourcing and manufacturing strategy.

Not all apparel products are suited to manufacture in a developing country location. In general, those items with a high labor cost to weight ratio will be most successfully produced offshore. If an item's labor content is relatively high and its shipping weight low the advantage to be gained by setting up production in an offshore low-cost labor location will more than offset the resulting incremental expenses.

ii. Locational and Facilities Requirements

Textiles and apparel manufacturing are generally the first industries to take hold in a country developing non-traditional exports. The apparel industry continues to dominate free zone industrial activity throughout the region and the world. The capital requirements are limited, the industry utilizes almost 100% imported raw material, is highly labor intensive and has few specialized requirements for facilities.

The Caribbean and Central American region has become an important new supplier of U.S. apparel imports, now accounting for 7 percent of the total imports. Exporting under the TSUS 806.3/807 and 807A which assesses duty on a product's foreign value-added, regional manufacturers import, cut, assemble and re-export U.S.-sourced components. As mentioned above, labor costs are extremely important, as is the cost, frequency, and reliability of ocean cargo services. Less than 10% of apparel inputs are shipped by air. In an increasingly crowded and competitive environment, telecommunications service is also rising in importance for some types of apparel products.

b. Electronics

i. Market Structure

The electronics industry is composed of two major sub-sectors: electronic equipment and instruments, consumer, industrial and military products; and electronic components, both passive components such as resistors, switches and capacitors and active components such as semiconductors. The U.S. remains the world's largest producer of electronic goods in a number of product areas, despite the inroads made by the countries of the Far East, which now produces 25% of U.S. electronics imports. The Caribbean and Central American region presently produces less than one percent of the U.S. market, but the volume is growing.

ii. Locational and Facilities Requirements

The main reason electronics firms locate offshore is to lower production costs, generally through reductions in the wages paid. Highly capital-intensive or technology-intensive electronics products are not generally suited for offshore production. Electronics firms look for locations with low-cost labor, high productivity and excellent quality control for their sub-assembly operations. As a rule, smaller firms seek to sub-contract production to relatively close locations, a plus for the Central American region and Mexico.

C. IMPLICATIONS FOR PROJECT DEVELOPMENT

To summarize, El Salvador is confronted with a difficult task in altering the pervasive perception that it is a risky location for investment; a perception that has obscured the numerous attractions that the country has to offer foreign investors. The productive and competitive labor force, attractive investment incentives, well-developed international transport infrastructure and services, and geographic location are all valuable assets that can help to attract new investment to a private free zone project in El Salvador. The availability of trained managers and technicians is another important factor in a region where most firms are forced to fill such positions with costly expatriates.

Based upon the investment identification criteria developed and the analysis of industry requirements, the firms that appear best suited to locating in a private free zone in El Salvador are those engaged in apparel manufacturing and electronics production. On a broader level, because of the negative perceptions of El Salvador's political stability, initial demand for zone facilities will most likely come from local exporters. These preliminary conclusions were tested through a direct market survey, as discussed below.

III. DEMAND ANALYSIS

A. Methodology

The determinants of investment patterns and subsequent demand for free zone space are complex and interrelated. No one method of demand analysis, by itself, can be considered to be an accurate forecasting tool. To arrive at an accurate preliminary estimate of demand for free zone space, the methodology utilized herein employs two distinct approaches:

- projections of demand for private free zone space in El Salvador based on trend extrapolations of past investment patterns and the historic growth of free zone utilization in the CBI region;

- direct market survey of space requirements and expansion plans of a sampling of targeted firms in high-potential sectors (the electronics and apparel industries) including a canvassing of local firms.

Taken by themselves, extrapolations of trends applied to the situation in El Salvador may not be accurate predictors of future demand; however, past trends do indicate the magnitude of the overall market and provide a baseline for examination and comparison. Moreover, the accuracy of a market survey is inhibited by the size of the sampling and, more importantly in this case, by the lack of concrete information available about the Project. At this stage of project development, accurate assessments of potential demand are difficult to achieve through a direct market survey alone. The firms surveyed are required to respond to the possibility of a private free zone in El Salvador, rather than to attributes of a specific zone. In the absence of basic information regarding location, facilities, services, and management, many companies are understandably unable and sometimes reluctant to express an opinion. In general, experience has shown that at the conceptual stage of zone development, direct survey results often understate the true demand that would be manifested for a zone once operational or under construction.

In this light, the results achieved through both approaches have been analyzed and compared in the following analysis to calculate the extent of corroboration. The resulting corroboration factor is then compared with those that have resulted from other demand analyses in similar studies. Finally, the conclusions regarding projected demand are formulated drawing from the implications of each of the methods employed.

B. Extrapolations of Regional Demand Trends for Free Zone Space

Projections of demand for regional free zone space via trend extrapolation are based on actual data of historical free zone demand and investment patterns for the CBI region. Effective demand is defined as the total amount of free zone space rented/occupied at any given point. Unmet demand is the surplus demand for space that exists in addition to total effective demand (the stock of space rented) at a given moment. Potential demand is, therefore, the sum of effective demand and unmet demand. Effective demand can be easily measured; unmet demand and potential demand are based on reasoned estimations arrived at through careful analysis, as discussed below.

1. Historic Growth in Effective Demand

The growth in effective demand for space in the region's free zones has been impressive, with the number of zones in the Caribbean/Central American area increasing eightfold to 41 facilities from 1975 to 1987. Total direct employment exceeded 193,000 and total leased under-roof space (effective demand) increased by more than 1.5 million m^2 during the period.

The growth in effective demand (the increase in the amount of free zone space actually rented) for the region's zones averaged 20% per annum over the 12 year period, equivalent to an annual increment of 112,000 m^2 rented and occupied. Since 1984, the growth in effective demand has accelerated to 30%. This effective demand figure, however, is indicative only of the average increase in the amount of free zone space rented in a given year. An estimate of potential demand existing during that period (effective demand plus unmet demand) should additionally take into account two factors:

- demand for space in many free zones has historically gone unmet due to bottlenecks in the supply of factory and office space; and

demand for regional free zone space has greatly accelerated in recent years, exceeding a 30 percent annual growth rate.

In this light, straight extrapolation of effective demand trends is likely to substantially understate the current and future potential demand for free zone space in the region and specifically El Salvador.

TABLE G-1
GROWTH IN EFFECTIVE DEMAND IN VARIOUS CBI FREE ZONE LOCATIONS

COUNTRY	COMPOUND AVERAGE ANNUAL RATE OF GROWTH IN EFFECTIVE DEMAND (%)	ANNUAL AVERAGE INCREASE IN RENTED SPACE (sq.m.)
COSTA RICA	64	14,000
DOMINICAN REPUBLIC	90	20,500
JAMAICA	30	8,500
EL SALVADOR	8	3,000
REGION	20	115,000

Note: Average growth rate in effective demand for each free zone is calculated for different periods; i.e., Costa Rica (1985-87); Dominican Republic (1970-87); Jamaica (1980-87); El Salvador (1974-87).

Effective demand for free zone space has varied greatly by location. As shown in Table G-1, effective annual demand rates in the region's major free zones has ranged from a low of 8% (El Salvador) to a high of 90% (Costa Rica).

The demand for El Salvador is technically overstated, since currently over half of the tenants in the San Bartolo Free Zone are either military personnel or manufacturers for the local market. From 1974-1980, San Bartolo's effective demand growth rate exceeded 16%, but the growth rate has plummetted since the onset of the guerrilla insurgency. Moreover, the lack of financial and managerial autonomy and perpetual changes in supervisory responsibility and administrative structure on the ministerial level have severely affected the SBFZ's performance. Excluding non-exporting tenants, effective demand growth from 1982-1988 has been significantly negative.

2. Current Potential Demand

Current potential demand for free zone space is composed of two components: effective demand and the demand for space currently unmet. As shown in Table G-2, reasoned estimates indicate that while occupied under-roof space in regional free zones exceeds 1.5 million m^2, unmet demand for free zone space is over 430,000 m^2 (all "current" figures are as of year-end 1987).

TABLE G-2
EFFECTIVE AND UNMET DEMAND FOR SPACE IN CBI FREE ZONES
(as of December 1987)

COUNTRY	EFFECTIVE DEMAND (SPACE OCCUPIED) (m^2)	UNMET DEMAND FOR SPACE (m^2)
COSTA RICA	139,500	57,000
DOMINICAN REPUBLIC	350,000	139,500
JAMAICA	69,500	130,000
EL SALVADOR	40,000	90,000
OTHER CBI	953,000	37,000
T O T A L	1,552,000	453,500

Source: Data from The Services Group.

Despite the rapid proliferation of free zone facilities over the past five years, unmet demand for zone space is growing. At present, potential demand (consisting of the sum of effective and unmet demand) has exceeded 2 million m^2. As indicated in Table G-2, immediate excess demand for zone space is estimated at over 453,000 m^2.

While the unmet demand figure of 90,000 m^2 for El Salvador may appear high, El Salvador presents a unique case. While effective demand for free zone space has decreased in recent years, this has not been caused by a decrease in potential demand but by a restricted supply of facilities. The combined impact of the destruction of under-roof space brought on by the 1986 earthquake and the constricted supply of free zone space at San Bartolo has resulted in exceedingly high levels of pent-up demand for industrial facilities.

Moreover, requests for space and information on investment have continued over the past five years even with intense regional competition. The overall level of foreign investment in El Salvador is increasing, as Table G-3 indicates, by slightly less than 7% per annum. Given the current political climate and the absence of available facilities, such increases are significant as an indicator of the willingness to invest in the country in general (although not necessarily for export). An examination of the records of PRIDEX/FUSADES indicates that between September 1985 and the first quarter of 1988, US$5,816,000 in new investment and US$19,949,000 in export earnings have been generated by projects it has assisted. The majority of recent investment aided by PRIDEX has been in apparel and other light manufacturing activity, operations especially relevant to free zones.

Moreover, the numerous requests for space at the SBFZ, even without any promotional effort by the zone, is another positive indicator of demand. Current requests exceed 12,600 m^2 in additional facilities. Given these positive indicators, 90,000 m^2 is a reasonable estimate of current potential demand.

TABLE G-3
REGISTERED FOREIGN INVESTMENT IN EL SALVADOR
(US$ 000's)

Investment	1985	1986	1987 (9 months)	1987 (Annualized)
New direct investment	647	1,092	390	590
Reinvestment	2,410	3,956	3,676	4,901
T O T A L	3,057	5,047	4,066	5,421

3. Projected Potential Demand

TABLE G-4
PROJECTED INCREASE IN SUPPLY OF REGIONAL FREE ZONE SPACE BY YEAR END 1988

COUNTRY	ADDITIONAL UNDER-ROOF SPACE (s^2)
COSTA RICA	34,500
DOMINICAN REPUBLIC	251,000
JAMAICA	91,000
EL SALVADOR	4,000
OTHER CBI	9,500
T O T A L	390,000

Source: The Services Group estimates of space currently under construction or realistically planned to be developed by year-end 1988.

In response to growing waiting lists and increasing demand estimates, regional free zone leaders such as the Dominican Republic and Costa Rica are planning to construct an additional 285,000 m^2 of under-roof space by the end of 1988. Based upon past trends and current development patterns, the region as a whole is likely to develop over 2,919,000 m^2 of under-roof space by 1992 (Table G-5). This is equivalent to approximately 273,400 m^2 of space constructed annually in the CBI region, roughly double the historical average.

TABLE G-5
FORECASTED SUPPLY OF SPACE IN CBI FREE ZONES (1988-1992)
(in m^2, by year-end)

COUNTRY	1988	1989	1990	1991	1992
COSTA RICA	174,000	219,500	266,000	312,500	359,000
DOMINICAN REP.	601,000	647,000	693,000	739,500	786,000
JAMAICA	160,500	197,500	234,500	272,000	309,000
EL SALVADOR	44,000	54,000	64,000	68,000	72,000
OTHER CBI	962,500	1,078,000	1,193,000	1,288,000	1,393,000
T O T A L	1,942,000	2,196,000	2,450,500	2,680,000	2,919,000

Note: The Services Group estimates based on extrapolations of past development data and present construction schedules.
1/ SBFZ only, does not include estimates of additional space that would be constructed under this Project.

Near-term supply of free zone space at the San Bartolo Free Zone should increase by September 1988. Two new buildings, each 2,000 m^2, are to be constructed this year; 20,000 m^2 of additional expansion are expected to be completed optimistically by late 1989.

Table G-6 projects the likely performance of regional free zones over the next five years. It represents a generally conservative assessment of the future absorption of space in CBI zones, but deviates from historical trend. From 1975-87, about 111,000 m^2 of space was occupied annually in regional free zones; equivalent to an effective annual demand rate of 20 percent. Forecasts for 1988-1992 estimate that potential demand would average 200,000 m^2 of under-roof space annually. In other words, the annual absorption of 200,000 m^2 translates into 110 new firms initiating operations each year, together creating more than 16,000 jobs annually.

TABLE G-6
FORECAST OF POTENTIAL DEMAND FOR SPACE
IN REGIONAL FREE ZONES (1988-1992)
(m^2)

COUNTRY	1988	1989	1990	1991	1992
COSTA RICA	213,500	250,500	288,000	325,000	362,500
DOMINICAN REP.	644,000	713,500	783,000	853,000	922,500
JAMAICA	227,500	255,000	283,000	311,000	339,000
EL SALVADOR	100,000	112,000	124,000	136,000	148,000
OTHER CBI	725,000	786,500	847,500	908,000	969,500
T O T A L	1,910,000	2,128,500	2,327,500	2,536,000	2,745,500

Although this represents a doubling of the historical average overall, it is a realistic and generally conservative assessment of likely performance levels, given the buoyancy of demand levels in recent years and the success of the region in attaining favorable trade agreements. For example, the countries of the CBI have an edge over other regions due to the innovative "936" twin plant program which allows those companies which establish production sharing operations with Puerto Rico access to low-cost financing. The Dominican Republic, the region's leading free zone program, is now attracting twin-plant operations from Fortune 500 companies such as Baxter-Travenol, GTE, Hanes, and others to its new free zones. These sophisticated office/industrial park complexes are now charging US$6.00/sq.ft./year for office space and US$4.00/sq.ft./year for industrial facilities. Other free zones in the country have been able to obtain up to six years advance rental payments from new tenants in search of any available space. In Jamaica, a recent market analysis conducted for the new, private Spanish Fort Free Zone, near Kingston, revealed that the number of workers in Jamaica's zones has increased from 140 in 1980 to over 12,000 at year-end 1987, as zone economic activity has evolved from essentially warehousing and transshipment operations to include manufacturing and now, information services. The free zones of Costa Rica, on the other hand, are experiencing a phenomenal surge of demand, with a 90% annual growth rate in effective demand for facilities, as discussed earlier. In summation, the health of the region's free zones is excellent and should continue to prosper.

TABLE G-7
FORECASTED POTENTIAL DEMAND FOR SALVADORAN FREE ZONES (1988-1992)
(m^2)

COUNTRY	1988	1989	1990	1991	1992
- Total Salvadoran Free Zone Demand	100,000	112,000	124,000	136,000	148,000
- Total Salvadoran Free Zone Supply	44,000	54,000	64,000	68,000	72,000
- Potential Demand for this Project	56,000	58,000	60,000	68,000	76,000

Table G-7 indicates the potential demand for free zones in El Salvador based on the previous extrapolations of free zone supply and demand over the next five years. As shown, the cumulative total demand for new free zone space over the 1988-1992 period is expected to reach 148,000 square meters. Given MICE's limited effectiveness in responding to current San Bartolo expansion plans, and the lag that is likely to arise in subsequent zone construction of the 20,000 m^2 planned for the next phase of expansion, the supply projection is realistic.

As discussed earlier, the demand estimate is based on the requests for free zone space received by San Bartolo, projections of pent-up demand (both local and foreign) that has developed over the years due to the absence of space for new businesses or industrial expansion, and estimations of the capture rate that El Salvador can expect to achieve from general demand within the region.

It should be noted that this demand is composed of several segments that are affected by a variet of factors. "High-end" companies choosing to locate in private free zones charging in excess of US$43/$m^2$/year are engaged in different types of production processes and are motivated by different considerations than those seeking to locate in inexpensive public sector zones far below private sector standards. Therefore, demand for space in the SBFZ will be affected by different factors than demand for a private free zone in El Salvador. Forecasted demand is an aggregate of demand for public and private free zones. Historically, demand for private zones has substantially outperformed demand for public zones. Finally, it should also be borne in mind that with a comprehensive marketing/promotional program, actual demand could exceed baseline forecasts.

C. Direct Market Survey

1. Methodology

To arrive at accurate conclusions regarding demand for a private free zone in El Salvador, the extrapolation of historical demand trends must be complemented and tested by a direct market survey. The survey instrument employed was designed to give a representation of demand for private free zone space in El Salvador within specific manufacturing sectors.

A total sample of 63 firms were interviewed, primarily from the two priority sectors. The firms were identified on the basis of El Salvador's comparative advantages and disadvantages. Thirty-five firms in the apparel sector, twenty electronics firms, and eight firms engaged in various other types of light manufacturing export activities in El Salvador were selected. The foreign companies, located in the U.S. and Hong Kong, were selected on the basis of size, suitability of their products for offshore manufacture or assembly, and the scope of their international operations. The Salvadoran firms were identified based on their present export operations or their capacity to export. Of the 63 firms interviewed, 27 were located in the United States (including Puerto Rico), 21 were Salvadoran firms, and 15 firms were located in the Far East.

Telephone interviews were employed for firms located in the United States and the Far East, while face-to-face interviews were used for Salvadoran firms. Interviews took place between May 9 - 20, 1988. The survey instruments were designed to assess not only interest in the El Salvador free zone project and subsequent spacial needs over the near term, but also to gauge sensitivity to factors such as rental rates and the availability of space in public free zones and <u>recintos fiscales</u>.

2. Survey Results

Table G-8 presents the results garnered from the 63 firms located in the United States, the Far East and El Salvador. A total of 16 firms (25%) expressed "high" levels of interest (equal to or greater than 7 on a scale of 1-10) in further investigating the possibility of investing in a Salvadoran private free zone. Immediate space needs over the next 12 months, for these companies reach nearly 53,000 m^2.

TABLE G-8
MARKET DEMAND SURVEY RESULTS:
IMMEDIATE DEMAND FOR PRIVATE FREE ZONE SPACE IN EL SALVADOR

	Electronics	Apparel	Other	Total
No. of Firms Interviewed	20	35	8	63
No. of Highly Interested Firms with Immediate Space Needs 1/	0	10	6	16
Sq. Meter Requirements of Highly Interested Firms	0	33,300	19,600	52,900 m^2

1/Highly interested firms expressed an interest of 7 or more on a Scale of 1-10.

63% of the demand for zone space is generated from apparel firms, the remaining 37% from other types of industrial operations, including footwear manufacture, pharmaceutical production, packaging, metal/machine parts, etc. More importantly, the vast majority of cross-sectoral demand (fully 87% of the total demand) comes from Salvadoran firms. As seen from Table G-9 below, the results of the local demand survey were overwhelmingly positive. Because of the striking difference in the responses of Salvadoran versus foreign firms, the results of the survey are discussed separately below.

TABLE G-9
Market Survey Results By Location

	U. S.	Far East	El Salvador
Number of firms contacted	27	15	21
Number of highly interested firms with immediate space needs	0	3	13
Sq. meter requirements of highly interested firms	0	7,000	45,900

a. U.S. and Far East Market Survey

i. Responses to Investment Issues

The reactions of electronics and apparel firms to the concept of basing part of their operations or entering into a joint venture in a private Salvadoran free zone offering a comprehensive package of services was generally negative. These negative reactions stem based on the perceived political instability in El Salvador and subsequent riskiness of investment in facilities there. Of the 39 uninterested firms, 74% cited unstable political and economic conditions as the main reason for their disinterest in further investigating offshore manufacturing in a private free zone in El Salvador. The remaining 26% of uninterested firms were all from the Far East and were generally unaware of the political turmoil in El Salvador and the Central American region. However, a number of manufacturers in both the U.S. and Far East were enthusiastic about the development of private free trade zones in general, and were aware of the favorable reputation of Salvadoran workers.

TABLE G-10
FOREIGN MANUFACTURERS SURVEYED

UNITED STATES:

KOA Speer Electronics, Inc. (E)
Allen-Bradley Co. (E)
Kevin Walker (E)
GSI Inc. (E)
Texas Instruments (E)
Modular Computer Systems (E)
Industrial Devices, Inc. (E)
AMP Inc. (E)
Porta Systems Corporation (E)
Burndy, Inc. (E)
The Gap, Inc. (A)
Utica Dubax (A)
Leadtec, California, Inc. (A)
Chauvin International (A)
Korry Electronics (E)
Union Carbide Electronics Division (E)
Microelectronic Packaging, Inc. (E)
Transitor Electronics (E)
RTE Corporation (E)
LH Research (E)
Miniscribe Corporation (E)
Sawtek, Inc. (E)
GTE Products Corporation (E)
Jantzen, Inc. (A)
Capital Mercury Shirt Corporation (A)
Rhoads and Company (A)
The Kessler Company (A)

E = Electronics A = Apparel

FAR EAST:

Yanjtnekianj Garment Mfg. (A)
Fooh Wah Kun Uee Knitting Ltd. (A)
Sam Sajm (33) Company (A)
Reaco Trading Company (A)
Kuay Wai Tai Sportswear Factory, Ltd. (A)
Borneo Sumatra Trading Company (A)
Capita Fashion Manufacturing (A)
Jackie Edwin Fashions Int'l, Ltd. (A)
Odyssey International, Ltd. (A)
Tanjoo Fashion (A)
Alliance Hip Shinj Sportswear (A)
Lenoble, Loch Ltd. (A)
Cambesley Enterprises Ltd. (A)
Boo Gie Garment Factory (A)
VF Asta, Ltd. (A)

E = Electronics A = Apparel

Over 70 percent of the foreign firms interviewed preferred to engage in direct investment when considering offshore manufacturing. Firms prefer greater control over the quality and execution of production than is normally possible through subcontracting. Several firms had previously entered into subcontracting arrangements in the CBI region and expressed disappointment in product quality and production process control. Firms preferring subcontracting agreements liked the flexibility in investment commitment over the long term. Electronics firms were less receptive to subcontracting than were apparel firms due to the nature of their operations (electronic manufacturing and assembly operations are relatively capital intensive, requiring factory atmosphere control, quality control, and careful packaging, and therefore require higher levels of capital investment).

The primary factors discouraging firms from considering offshore investment in a private free zone in El Salvador, as cited, were: highly volatile political and social climate leading to loss of control over investment; fear of inconsistent policy application regarding foreign investment and exporting/importing processes; and unreliable transportation and communication links.

Over half of the foreign firms interviewed have engaged in or are presently engaging in offshore manufacturing ventures and were knowledgeable of the complexities surrounding offshore investment. Of these firms, almost all of the apparel firms employed subcontracting arrangements in their offshore operations, while electronics firms preferred direct investment. The exceptions to this trend were Far Eastern manufacturers who, due to different perceptions of management and production control, expressed a preference to engage in direct investment. All of the three apparel firms expressing a "high level" of interest in Salvadoran private free zones preferred subcontracting work to Salvadoran firms and therefore did not consider rental rates in the $30 to $35 range to weigh heavily in their decision to invest offshore. Furthermore, uninterested firms showed little sensitivity to rental rates in the initial formulation of their offshore investment decision in a Salvadoran free zone.

ii. Response by Sector

Foreign apparel firms were generally more inclined to express some level of interest in further investigating the possibility of investing in a Salvadoran free zone, largely due to the fact that apparel operations require less of a capital investment than do other industry sectors such as electronics. It is for precisely this reason that apparel manufacturers are well suited for offshore production in free zones.

Electronic manufacturers and assemblers, due to the nature of their operations and need for stable production conditions, were overwhelmingly negative in their reactions due to the perceived deterioration of the political and business climate in El Salvador. Although many interviewees were impressed with the degree of development within the electronics industry in El Salvador, they could not justify investment in a high risk climate.

The Far Eastern companies contacted during the course of the survey were all apparel manufacturers. The entirety of the demand discovered in the overseas market survey (7,000 m^2) originated from Far East apparel manufacturers. Based on similar investment surveys conducted in the past by the consultants and on the investment patterns of Far Eastern companies in the Caribbean/Central American region, and due to the limited size of the survey, the consultants decided to target the industry sector most likely to consider operations in a Central American country.

Response by Location. In general, firms of U.S. origin were disinclined to further investigate offshore manufacturing in El Salvador as a result of the perceived instability in the U.S. regarding El Salvador and the Central American region. Past trends and surveys performed by the consultants for other CBI countries in the same sectors has shown that in most cases U.S. firms are more interested in investigating offshore manufacturing in specific zones. However, U.S. firms are more sensitive to political instability and business climate volatility. Eighteen of the U.S. firms surveyed currently have direct investment or subcontracting agreements offshore, and ten firms are engaged in offshore production in the CBI region.

A total of 15 apparel manufacturers were contacted in the Far East, all located in or near Hong Kong; however, most of the companies surveyed have assembly operations in other Far Eastern countries such as Singapore, Thailand, Korea, the Philippines, and Taiwan. None of the companies currently has operations in the CBI region.

The majority of Far Eastern firms were not interested in setting up operations in El Salvador because they were unfamiliar with the region. The awareness of political unrest and instability in El Salvador among Far Easterners was generally far lower than their U.S. counterparts. However, political stability, favorable investment climate, and attractive government regulations were expressed as extremely important in deciding the location of an offshore operation by three of the companies that actually had considered an expansion somewhere outside the Far Eastern region and are considering Central America. These three firms expressed an interest level of "7" on a scale of 1 to 10, in investing in a private Salvadoran free zone within the next 12 months, with total space requirements totalling 7,000 m^2

b. Salvadoran Market Survey

A total of 21 firms presently operating in El Salvador were interviewed during the market survey. The breakdown by sector was as follows:

Apparel	-	12 firms
Footwear	-	2 firms
Pharmaceuticals	-	2 firms
Machine parts	-	2 firms
Other	-	3 firms
Total		21 firms

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Of the firms surveyed, 14 were Salvadoran-owned operations, 3 were U.S.-owned, 2 German-owned, 1 Korean-owned, and one a joint venture of Salvadoran, Costa Rican and Nicaraguan partners. Eleven of the firms surveyed employed more than two hundred persons, and the average space occupied was 3,500 m^2. Most of the firms contacted were looking for space to expand and were extremely interested in investigating the possibility of establishing operations in a private free zone in El Salvador.

i. Responses to Investment Issues

Clearly, firms presently operating in El Salvador have a vastly different perspective than their foreign-based counterparts regarding political stability in the country. The general attitude exhibited by these manufacturers is positive, their businesses are growing and they are planning to expand their operations rather than discouraged by the investment climate. This holds true for foreign-owned businesses in El Salvador as well as Salvadoran operations.

By far the biggest problem cited by the firms interviewed was the lack of a dependable electricity supply. Several of the larger companies had installed back-up power generators at their plants; others had simply altered work schedules to accommodate scheduled blackouts. Few complaints were voiced regarding transportation service, although several firms indicated that the shortage of reliable transportation for workers was a problem. Also cited as an obstacle was the high cost of ocean cargo via Santo Tomas de Castilla.

The diligence and high-quality of local labor was generally agreed to be the most important contribution to productivity. Training periods for unskilled labor were placed at two months by most businesses. More complicated production processes, such as electronics assembly at AVX Ceramics, employed a variety of training techniques and quality control specialists to achieve productivity and quality standards that rival similar operations worldwide.

Market access to the U.S. under the TSUS 806.3/807 program was a crucial element of the market strategy of the apparel exporters. Other firms using locally sourced goods were exporting under the CBI. Ten of the surveyed firms were exporting 100 percent of their production to the United States, while seven were exporting more than 25 percent of their production, thus qualifying for benefits under El Salvador's Export Promotion Law.

ii. Response by Sector

Fifty-eight percent of the Salvadoran apparel firms were highly interested, with total square meter requirements reaching 26,300 m^2. It should be noted that 16,000 m^2 of this demand comes from one firm, a women's clothing manufacturer exporting under the CBI. The firm currently occupies 5,000 m^2 of space but has sufficient demand to triple its production activities. With an interest ranking of 10 on the 1 to 10 scale, this company is very interested in centralizing facilities in a private free zone as described. The average space requirement of the other apparel firms was 1,500 m^2.

The other firms surveyed were engaged in a broad spectrum of production activities. One footwear manufacturer expressed an interest in both moving his present operations into the zone (3,200 m^2) and in starting up a new line of leather footwear with a space requirement of 4,000 m^2. A U.S. pharmaceutical firm presently exporting to other countries in Central America was also interested in launching a new over-the-counter drug maquila operation with space needs of 5,000 m^2.

In summary, of the 21 firms surveyed, the average level of interest expressed in locating in a private free zone within the next 12 months was 6.5 on a scale of 1-10. Of the interested firms (13 of the 21 surveyed) the weighted average level of interest was a stunning 9.50.

As shown in Table G-11, of the total space requirements of these firms, 33,600 m^2 would be used for expansion of their operations and 12,300 m^2 would be taken up by moving their present operations to a new location, for the total of 45,900 m^2 of expressed demand. The average rental rate now being paid by the surveyed firms is C9.75/m^2/month (US$2.17/sq.ft./year). Of the thirteen firms interested in moving into the free zone the average "optimum" rental rate they suggested for the fully serviced facilities was placed at C12.36/m^2/month (US$2.76/sq.ft./year).

It is important to note here in regard to the viability of private zones developed under this Project that the majority of the firms surveyed were either operating out of recintos fiscales or in the San Bartolo Free Zone. Eight of the "highly interested" firms, or sixty-two percent, surveyed were operating out of recinto fiscales. (See Table G-12.) Present users of the San Bartolo Free Zone had little interest in the Project due, in large part, to the phenomenally low rental rates they are presently paying, although two SBFZ firms did indicate an interest to expand into the zone.

However, the occupants of the recintos fiscales were very much attracted to the proposed private zones even though they already enjoy many of the benefits that apply to free zone users. For the most part, they are interested in: (i) consolidating their operations in one location for centralized control, which is difficult in the present shortage of industrial space and resulting tight market for facilities; and (ii) achieving economies of scale through the shared services such as day care centers, worker transport, energy generation, telecommunications, that would be possible in a free zone. They view the free zone as a means to enhance their production environment at a cost shared by users.

TABLE G-11
SPACE REQUIREMENTS OF HIGHLY INTERESTED SALVADORAN-BASED FIRMS

SECTOR	LEVEL OF INTEREST 1/	SQ. METER RELOCATION	SPACE REQUESTS 2/	TOTAL EXPANSION
1. Apparel	8.5	1,000	1,000	2,000
2. Apparel	7.0	600	1,400	2,000
3. Apparel	10.0	5,000	11,000	16,000
4. Apparel	10.0	1,500	---	1,500
5. Apparel	7.0	---	1,500	1,500
6. Apparel	10.0	---	1,200	1,200
7. Apparel	8.0	---	2,100	2,100
8. Metal-Mech	8.5	---	1,200	1,200
9. Metal-Mech	10.0	---	1,200	1,200
10. Footwear	9.0	1,000	1,000	2,000
11. Footwear	10.0	3,200	4,000	7,200
12. Pharmaceut	7.5	---	5,000	5,000
13. Other	10.0	---	3,000	3,000
		12,300	33,600	45,900

1/ Firms were asked to quantify level of interest in locating in a private free zone within next 12 months.
2/ Free Zone space requirements of surveyed firms within the next 12 months.

TABLE G-12
LISTING OF SALVADORAN-BASED FIRMS SURVEYED

INTEREST	NAME OF FIRM	SECTOR	OWNERSHIP	RECINTO FISCAL/SBFZ
+	Presto de El Salvador	F	Joint Ven.	No
-	Bayer de El Salvador	P	German	No
-	Specialty Products	O	Salvadoran	Yes
+	Corp. Bonima (McKesson)	P	U.S.	No
-	AVX Ceramics	E	U.S.	Yes
+	Cajas y Bolsas	O	Salvadoran	No
+	Suelas de El Salvador	F	Salvadoran	Yes
+	Envasadora Diversificada	M	ES	Yes
+	Universal de Negocios	M	ES	Yes
+	Creaciones Roxana	A	ES	No
+	Maquitex Enterprises	A	ES	Yes
+	Jeesan	A	Korean	Yes
-	Intecu	A	Salvadoran	Yes
+	Hermosa Manufacturing	A	Salvadoran	Yes
+	Pineda Hermanos	A	Salvadoran	Yes
+	Industrias Viktor	A	Salvadoran	No
-	Form-O-Uth	A	U.S.	Yes
-	Industrias Topaz	A	ES	No
-	Mininas	A	ES	No
-	Texport	A	German	No
+	Matex	A	ES	Yes

3. Summary

The major conclusions to be drawn from the direct market survey are as follows:

- Salvadoran-based firms are the primary source of demand for free zone space. Over 87% of the space requirements revealed in the survey come from Salvadoran firms, totalling 45,900 m^2.
- Of the foreign (U.S. and Far Eastern) firms contacted only the apparel manufacturers expressed high levels of interest in Salvadoran private free zones. Responses from electronics firms were disappointing. Total foreign demand for free zone space uncovered in the market survey was 7,000 m^2, all from the apparel sector.
- 73% of the local demand evidenced is for expansion of existing production operations. Only 27% of the square meter requirements represents relocations of existing operations.
- 62% of the Salvadoran firms expressing interest in the Project are presently operating in a recinto fiscal. The effect of recintos fiscales on the demand for free zone space appears limited.
- Most firms surveyed that are presently operating in the San Bartolo Free Zone have little interest in relocating or expanding outside the zone, primarily because of the rental rate which is far below market levels (for some firms as low as C3.50/m^2/month).
- The demand for free zone space evidenced in El Salvador is cross-sectoral, encompassing apparel, footwear, pharmaceuticals, packaging, and machine parts.

In sum, the immediate demand for private free zone space in El Salvador will come primarily from firms already operating here, based on the results of the survey. Over the medium-term, if the investment climate stabilizes in the eyes of foreign manufacturers, El Salvador could expect to attract new foreign investment in the apparel sector. In any event, immediate demand of 52,900 m^2 uncovered in a survey of this size is remarkable and bodes well for the future of the Project.

D. DEMAND PROJECTIONS

1. Combined Results of the Demand Analysis

The demand forecasts arising from trend extrapolations and estimations of unmet demand for industrial facilities in general and free zone facilities in particular, arrive at a projected potential demand for 100,000 m^2 of free zone space in El Salvador for calendar year 1988. As discussed above, while this figure may appear optimistic, it reflects a unique confluence of events in El Salvador. The destruction of industrial facilities in the 1986 earthquake, the restricted supply of free zone space at San Bartolo, the absence of any market-responsive alternative to the public zone, and the growing spacial needs of firms already established in El Salvador have resulted in significant "pent-up" local demand. At the same time, there is a growing movement of foreign firms to the CBI region, a portion of which will be attracted to El Salvador, primarily because of the cost and quality of local labor. Because of this sizeable backlog and given the current construction plans for San Bartolo, projections indicate that there will be an average of 60,000 m^2 of unmet demand per year in El Salvador between 1988-1992.

The findings of the market survey substantiated the projections made through demand extrapolation. As expected, U.S. firms were not immediately interested in investing in El Salvador due, without exception, to the negative perception of the local investment climate. The Asian apparel firms surveyed were more responsive, with expressed demand for 7,000 m^2 of space. However, it was the firms already operating in El Salvador which accounted for 45,900 m^2 of immediate demand for facilities developed under the Project. The total square meter space requirements of the 63 firms surveyed thus reaches nearly 53,000 m^2 in the next 12 months.

Such positive results in a survey this size are remarkable. Despite the limited sampling of firms, an immediate demand greater than the total installed free zone space in El Salvador was found. The market survey uncovered demand equivalent to over 52% of the projected potential demand figure for 1988. The finding of such a high level of corroboration between survey results and demand projections is unusual. For example, a recent market analysis for a private free zone in Jamaica resulted in a corroboration ratio of 25%, while a private free zone project in Honduras was found to have a 20% corroboration rate. Other successful free zone projects have been initiated in Jamaica, the Dominican Reupblic and elsewhere in the region with less than a 15% corroboration rate.

In summary, there appears to be significant immediate demand for private free zone facilities in El Salvador. Moreover, given the current and planned expansion program at the San Bartolo Free Zone, and the delays that have been encountered in meeting construction schedules in the past, there is little reason to believe that this demand will begin to be met by that facility. This Project thus appears well-positioned to capitalize on the backlog that has developed over the past years in demand for industrial space in El Salvador.

2. Impact of the San Bartolo Free Zone and Recinto Fiscal Option

The results of the market survey support the conclusion that the impact of the Salvadoran recinto fiscal program on the demand for space in a new private free zone in El Salvador is limited. 62% of the local firms interested in the private zones to be built under the Project are presently operating in a recinto fiscal and are nevertheless highly interested in either relocating or expanding into a private free zone facility. Several firms cited a desire to keep their operations centralized as one of their primary reasons for being attracted to a free zone facility, since, given the present shortage of industrial space, the likelihood of obtaining facilities or land adjacent to their present building(s) was limited.

However, the reason for interest in a free zone location cited most often by the interested firms was a desire to have access to shared facilities and services that would be available at a cost shared by multiple users. Back-up power generators, day care facilities for workers, worker transportation services, and shared security forces, were all frequently mentioned as attractive elements to be offered by a private free zone. This finding is especially important not only because of the implications it holds for the potential impact of recintos fiscales on demand, but for its implications regarding the potential impact of the SBFZ.

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The types of services desired by these firms are not offered at San Bartolo, nor are they likely to be initiated or installed any time in the near future. The average rental rate paid by the firms interested in the project was C9.75/m^2/month (US$2.17/sq.ft./year). For additional services such as those described above, the firms would be willing to pay an average of C12/m^2/month (US$2.68/sq.ft./year). This is more than twice the rental rate currently being charged to some users at San Bartolo. New firms obtaining space at SBFZ are now paying C7.00/m^2/month ($1.56.sq.ft./year). Both of these figures are far below what the interested local firms estimated as a "reasonable" rent for private free zone facilities. It can be assumed that an element of negotiation is involved in such an estimate and that were such facilities available they would be willing to pay even more for space.

However, the continued provision of subsidized space at San Bartolo will be an important factor for more cost-sensitive foreign and domestic firms. The lure of low rental rates is powerful for small companies engaged in light manufacturing such as apparel or assembly operations. Larger, more established firms with dependable production outlets are less driven by the objective of minimizing costs and more interested in maximizing output. If the Project is to be given the optimal conditions to realize its potential, the subsidization of industrial space at the SBFZ should be stopped and rental rates that cover costs should be charged.

3. Implications for Project Development

The results of the market assessment and demand analysis demonstrate that there is, significant immediate demand for high-quality, private free zone space in El Salvador. The results of the market survey were highly positive, demonstrating both considerable demand from Asian manufacturers and extremely high levels of demand from a cross-sectoral spectrum of Salvadoran firms. The implications of the analysis findings for project development are that there is clearly an immediate need for a free zone project of this type. The key question is whether or not such levels of demand are sustainable. Based upon the trend extrapolation, and as corroborated by the exceedingly high level of demand uncovered in such a small survey of firms, it can be expected that the growth in demand for free zone facilities has basically "peaked," and that over the next five years the increase in demand will be incremental. However, based upon projections herein, the unmet demand will still be more than sufficient to support the construction of industrial space comprehended under this Project. Moreover, should the investment climate improve, El Salvador can expect to experience rising levels of demand from U.S. investors, as well as Asian firms in the years ahead.

ANNEX H: FINANCIAL ANALYSIS AND CAPITAL COST ESTIMATES

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I. SUMMARY OF APPROACH

This Annex presents preliminary estimates of capital costs for the development of one 20 hectare free zone in El Salvador. In the absence of identified sites, only average operating and capital costs can be developed. While it is estimated that this Project's resources will finance two 20 hectacre free zones, the cost analysis presented herein is for a single zone only, for simplification. Since the capital costs are developed on a unit (i.e., per square meter) basis, the estimates can simply be doubled for the two zones developed under the Project. The final three tables included herein show a second slightly larger zone, (40,000 m^2 as opposed to 35,000 m^2), which is initiated two years after the first zone.

This Annex begins with he development of the overall suggested zone development schedule based on conservative assumptions of demand. Capital costs of building construction and land development are derived based upon verifiable costs of several comparable industrial real estate development projects recently undertaken in the San Salvador metropolitan area.

The second part of the discussion present the preliminary financial analysis of the free zone. Based upon the capital cost assumptions developed herein and current factor cost data collected, total free zone development and operating costs have been estimated. Similarly, revenue projections have been developed utilizing data derived from market survey results. The free zone's internal rate of return has been calculated based upon projected financial performance. Sensitivity analysis incorporating varying pricing, demand and financial cost assumptions has been performed to indicate the possible variance in anticipated financial performance.

II. PROPOSED FREE ZONE DEVELOPMENT PLAN

A. Zone Design Basis

One of the leading causes of the poor financial performance of free zones in the developing world is inadequate attention to overall zone design and layout. In order to adequately position a new Salvadoran free zone relative to competing facilities, close attention must be given to designing a zone with an ample industrial plot size, space between buildings, and adequate green areas, reflecting international design standards.

Generally, the total area considered the minimum necessary to achieve economies of scale in free zone development and management is 18-20 hectares. A free zone of 40-60 hectares is common in many countries; larger zones may result in congestion and excessive demands on social infrastructure of the surrounding area.

Regardless of size, land use efficiency is important in order to optimize (rather than maximize) revenue generation. This is measured in ratios involving three variables -- under-roof space, industrial plots and total land area. Table H-1 shows the ratios commonly used by most well-planned free zones worldwide, as well as those suggested for the new private free zones in El Salvador.

Generally, of the total land area of a free zone, at least 20% and an average of 25% must be reserved for roads, easements, green areas and common services such as canteens, water pumping and storage, transformer substations, and the like. Given the hilly terrain in El Salvador outside of the costal plains, a figure of 30% has been used for terracing. Of the remaining 70% available for industrial plots, a maximum of 60% of the land area should be planned for under-roof space for standard factory building (SFB) construction; a figure of 50% is a common estimating factor. This ratio indicates the fully developed capacity of the zone. On a 20 hectare site, this equates to a maximum building or under-roof capacity of 70,000 m^2.

The "average" ratios in Table H-1 are derived from typical configurations of well-planned free zones in developing countries. The ratios vary significantly by the type of activities undertaken. Zones oriented towards simple storage and trans-shipment activities tend to have a higher under-roof space to total land area ratio; "office park" style zones oriented toward information services and similar activities will have a lower ratio, with greater emphasis on landscaping and common areas.

The application of these estimating ratios are to optimize rather than maximize revenues. In the latter case (higher ratios), the zone can easily become too congested and unattractive to potential users -- especially large multinationals -- and can have a serious adverse affect on worker productivity and morale. The application of these ratios leads to the proposed zone development plan shown in Table H-2.

B. Zone Development Schedule

In formulating a realistic zone construction schedule, it is important that the pace of land development and factory construction be kept in line with effective demand. In many countries, free zones have failed because market considerations have been not taken into account. Zones have been built too rapidly, far outpacing market demand, and become financial failures. The full area of the free zone will not be developed and occupied at once. Rather, there should be a reasonable expectation that over the course of 8 to 12 years, increases in effective demand will justify a phased construction schedule culminating in the full development and occupancy of the site.

TABLE H-1
PROPOSED LAND USE RATIOS

	Average	Proposed
Under-roof Area/Industrial Plots	45%	50%
Industrial Plots/Total Land Area	60%	70%
Under-roof Area/Total Land Area	30%	30%

TABLE H-2
PLANNED FREE ZONE DEVELOPMENT

		Hectares	m2	S.F.
(i)	Total Land Area:	20.0	200,000	2,152,000
(ii)	Total Area Urbanized (50% of site)	10.0	100,000	1,076,000
(iii)	Industrial Plots (70% of urbanized area)	7.0	70,000	753,200
(iv)	Under-Roof Space (50% of industrial plots)	3.5	35,000	376,600

TABLE H-3
PHASED CONSTRUCTION SCHEDULE

Construction Phase	Year	Industrial Plots (hectares)	Buildings (m2)	Number of Buildings Erected
I	1	1.80	9,000	4 1/
	2	2.00	10,000	5
II	3	1.60	8,000	4
	4	1.60	8,000	4
Total		7.00	35,000	17

1/ Includes development of 3,000 m^2 administration building; SFB's are assumed to be 2,000 m^2 each.

The proposed four-year, two phase construction plan will develop one half the 20 hectare site. Assuming adequate demand, the site will eventually be fully developed, providing a total of 70,000 m^2 of under-roof space on 140,000 m^2 of developed land.

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The most effective use of A.I.D. funding is to provide seed finance for the first -- and most critical -- stage of zone development. Development after the initial period can be self-sustained; once the zone has reached a bankable level of occupancy, it can attract debt finance at requisite terms and conditions from the Salvadoran financial system. Reflows of the credit facility funding will also be available for finaning ongoing construction beyond the initial period, as well as finance the development of other zones. Accordingly, the construction schedule, capital cost estimates and financial projections herein are based on a four-year rather than on a eight or ten-year project. This conforms with normal financial forecasting techniques, given the difficulty in predicting events over the next 10 or more years. It also presents a more realistic indication of financial viability to the private developer who, in many cases, seeks to recoup his investment in 3-5 years. In that light, a 8-12 year continuous construction schedule would be regarded as unrealistic and risky.

The proposed zone development schedule shown in Table H-3 is conservative given the existence of more than 47,000 m^2 of strong immediate demand for industrial space documented by the May 1988 market survey. Depending on future economic and political trends in El Salvador and the region, the demand forecast may well be exceeded. However, given the uncertainties of demand forecasting, the four year forecast represents a viable plan of phased construction (i.e., the rate of capital investment) linked to and kept in line with effective demand.

The Phase I two-year construction plan would provide 3.8 hectares of industrial plots and 19,000 m^2 of under-roof space. This first construction phase would include the erection of 8 SFB's providing a total of 16,000 m^2 and an administration building, providing 3,000 m^2 which would house enterprises providing specialized services, the administration offices and the customs offices.

Execution of the Phase II program over the following three years is contingent, of course, on absorption of the Phase I facilities. Assuming the facilities are occupied as forecast, completion of Phase II in the fourth year of construction would add 3.2 more hectares of industrial plots for a total of 7.0 hectares and 35,000 m^2 of SFB space. By implementing the construction schedule in step effective demand, a reasonable surplus of unallocated space would be available at all times. This approach is in line with the long-established practices of successful zones in other countries (e.g. Ireland, Malaysia, Mexico) where advance construction of SFBs has proven to be one of the strongest, if not <u>the</u> strongest, promotion tools. A strategy of phased construction requires maximum flexibility in the terms and conditions of the construction and close coordination between the zone owners and the supervising architect/engineering firm. If demand exceeds expectations, civil works should be accelerated; conversely, if demand falters, civil works should be stretched out or, in the worst case, interrupted.

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III. CAPITAL COST ESTIMATES

A. Unit Cost Analysis

The costs of developing a free zone include the acquisition cost of new land, land improvements including basic infrastructure within the zone, construction costs of SFBs, and the cost of administrative and other specialized facilities. The costs of both land acquisition and development vary widely within any country depending on the specific locational characteristics and nature of the terrain. At this stage of analysis, the land acquisition and development costs utilized herein are average costs based upon the recent development of similar projects in El Salvador.

1. Land Acquisition Costs

Land purchase costs in the country vary from $2,000/hectare (₡10,000) for agricultural land, to $7,000/hectare (C35,000) for unimproved land with dual uses such as residential and industrial development, to over $35,000/hectare (₡175,000) for improved land in the industrial zone outside of San Salvador. Assuming that an attractive free zone site is more likely to be located in a populated area than on purely agricultural land, a figure of $30,000/hectare (₡15/m^2) is an appropriate figure. This is equivalent to $3/m^2 or $0.28/sq.ft.

In reality, land acquisition costs seldom figure directly into the financing requirements of a zone, as most zones are developed by parties that already own the land. However, land value is part of the total project cost, and is most often the major component of the developer's equity investment. For purposes of analysis, previously owned land can be assigned an imputed value, equivalent to the cost of comparably priced land in the surrounding area. As development proceeds, the value of this land and adjacent undeveloped land owned by the zone will increase as demand for a zone location drives up property values. This imputed land value is useful in looking at overall project value and can be an important element in a financing package.

2. Land Development Costs

Land development costs include the preparation of industrial plots and site preparation (grading, leveling, filling, removal of topsoil, etc.); the construction of internal infrastructure (interior roads, electrical, telecommunications and water and waste treatment facilities); and other items such as perimeter fencing, street lighting, firefighting equipment, access gates, etc. These costs vary depending on the degree of land preparation required. On a unit cost basis relative to total land area, these costs can be as low as $6/m^2 (₡30/m^2 or $0.56/sq.ft.) or can reach over $29/m^2 (₡145/m^2 or $2.70/sq.ft.) for projects on swampy ground requiring substantial fill. Current projections for terracing alone at the SBFZ are $5/m^2 (₡25 m^2 or $0.46/sq.ft.); estimates for a similar project in Honduras were $8/m^2 (₡40/m^2 or $0.74/sq.ft.) without substantial land preparation. For the purposes of this analysis, a figure of $9/m^2 (₡45/m^2 or $0.84/sq.ft.) is utilized.

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3. Building Construction Costs

SFB's appropriate for most light manufacturing applications are normally constructed in modules that can easily be converted and subdivided. Per unit construction costs include the basic factory shell with bathrooms and provision water, electrical and sewerage services to the building. Interior electrical plumbing, HVAC (heating, ventilation, and air conditioning) systems and other leasehold improvements are undertaken by the tenant or are provided by the zone at additional cost.

TABLE H-4
COMPARATIVE SFB CONSTRUCTION COSTS
(1988 Prices)

Country	$/m^2	$/sq.ft.	₡/m^2
Honduras	$190	$17.66	₡ 950
Costa Rica	$125	$11.62	₡ 625
Dominican Republic	$182	$16.91	₡ 910
Jamaica	$238	$22.12	₡1,190

Note: The above are actual unit construction costs of selected zones. The figure for Jamaica is high because the zone was being built on reclaimed land. The figure for Costa Rica is very low because construction was undertaken on substantially developed land.

TABLE H-5
COMPARATIVE SFB CONSTRUCTION COST ESTIMATES/EL SALVADOR
(1988 Prices)

Project	$/m^2	$/sq.ft.	C/m^2
SBFZ	$220	$20.45	₡1,100
AVX Building Expansion	$165	$15.40	₡ 829
Parque Industrial Desarrollo	$125	$11.62	₡ 625

Note: These figures are based upon reported base construction costs of traditional concrete SFBs. They do not include physical contingency factors or architectural or engineering fees. The 1988 figures for the AVX building and the Parque Industrial Desarrollo in Soyapango are derived by increasing them by a 25% inflation rate in 1987.

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The SBFZ is currently estimating construction costs for new buildings in 1988 at $220/m^2 (₡1,100/m^2 or $20.45/sq.ft.) which is high for the region (see Table H-4). The contract awarded in 1987 for the expansion of AVX building (2,112 m^2) was for ₡1.4 million, or $132/m^2 (₡663/m^2. or $12.32/sq.ft.) In estimating costs for SFB construction at Soyapango in January 1987, Parque Industrial y Comercio de Desarrollo (PICD) estimated ₡500,000 per 1,000 m^2 building, or a unit cost of $125/m^2 allowing for 25% inflation rate in 1987. These estimates are substantially below the $220/m^2 unit cost of SBFZ, even allowing for additional inflation and contingencies (see Table H-5).

The estimation of a conservative figure for SFB construction cost is based on the consideration of these figures. The SBFZ estimate is widely regarded as inflated, and should therefore be discounted. The PICD estimate of $125/m^2 should be treated with caution because the estimates are dated and possible understated. Given that contracting by private developers is normally more efficient than similar public sector efforts, the $132/m^2 figure for the AVX expansion is a better estimator for a private free zone. Allowing for a 25% inflation rate in 1987, the AVX estimate in 1988 prices would be $165/m^2. (₡825/m^2. or $15.33/sq.ft.) However, the AVX building has a number of special features and amenities that are not normally part of basic SFB design; the cost should accordingly be scaled down. Based on these considerations, the base SFB construction cost utilized in this analysis is $145/m^2 (₡725/m^2 or $13.47/sq.ft.) as shown in Table H-6.

TABLE H-6
UNIT CONSTRUCTION COSTS
(1988 Prices)

Item	$/m^2	₡/m^2	$/sq.ft
Land	3.00	15.00	0.28
Land Development (includes fill, grading, roads and all infrastructure)	9.00	45.00	0.84
Standard Factory Buildings (SFBs)	145.00	725.00	13.47

Note: Base unit costs exclusive of contingency or design factors.

Adding an Architectural & Engineering fee of 2%, 1/ and a physical contingency factor of 10%, a figure of $162.69/m^2 (C813.45 or $15.12/sq.ft.) is used for estimating "fully loaded" project SFB construction costs at 1988 levels.

The capital cost of the three phase project over a five-year construction period is tabulated in Table H-7, on the following page. Capital cost estimates in this table have been prepared only for buildings without air conditioning, the norm for industrial development in El Salvador.

In real terms, the total development cost is C38,288,250 ($7,651,750). When converted to current terms, based on a effective annual (over 20 years) inflation factor of 10.7 percent per annum, the actual fixed asset cash requirement is ₡50,098,110 ($9,947,622). Table H-8 shows the capital requirement on an annual expenditure basis in current terms.

The Free Zone Project will also have a significant direct and indirect foreign exchange component. As shown in Table H-9, the indirect foreign exchange component is estimated at 60%; direct foreign exchange costs are usually about 20-25% of total Project costs.

1/ An A&E factor of 6-7% is normally attached to cover the design work required for zone development. In the present case, however, the majority (75%) of the detailed engineering and design work as well as pre-investment analyses is included in the technical assistance funded under this Project. As such, a 2% A&E factor should be more than sufficient to cover ongoing construction supervision and other costs.

TABLE H-7
CAPITAL COST ESTIMATES
(Constant 1988 Colones)

	Unit Cost (C/m^2)	Area m^2	Total Cost (Colones)
Year 1			
Land Cost	15	200,000	3,000,000
Land Development	45	25,714	1,157,130
Buildings	725	9,000	6,525,000
Base Line Total			7,682,130
A&E Fee (2%)			153,643
Physical Contingency (10%)			665,550
Total			11,501,000
Year 2			
Land Development	45	28,571	1,285,695
Buildings	725	10,000	7,250,000
Base Line Total			8,535,695
A&E Fee (2%)			170,714
Physical Contingency (10%)			591,600
Total			7,557,000
Year 3			
Land Development	45	22,857	1,028,565
Buildings	725	8,000	5,800,000
Base Line Total			6,828,565
A&E Fee (2%)			136,571
Physical Contingency (10%)			739,500
Total			9,446,000
Year 4			
Land Development	45	22,857	1,028,565
Buildings	725	8,000	5,800,000
Base Line Total			6,828,565
A&E Fee (2%)			136,571
Physical Contingency (10%)			591,600
Total			7,557,000

TOTAL PROJECT DEVELOPMENT COSTS (C): 36,061,000

TOTAL PROJECT DEVELOPMENT COSTS ($): 7,212,000

Note: A&E fees are 2% of the "Land Development" and "Buildings" costs. Physical contingency is 10% of the "Buildings" costs including A&E fees. Assumes non-air conditioned SFBs. Based on construction of 16 standard factory buildings and 1 administration building, and land development of one-half of the 20 hectare site under construction phases I and II. Figures in this table are rounded. All currency conversions are at the current official exchange rate of ₡5 = US$1.

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TABLE H-8
CAPITAL COST ESTIMATES ADJUSTED FOR INFLATION

Year	Capital Financing Requirement (1988 Colones)	Capital Financing Requirement (Current Colones)	Capital Financing Requirement (Current $)
1	11,501,000	11,501,000	2,230,000
2	9,446,000	11,335,000	2,267,000
3	7,557,000	10,882,000	2,176,000
4	7,557,000	12,514,000	2,503,000
Total	36,061,000	46,232,000	9,246,000

Notes: Amounts are rounded, assuming a 20% inflation rate in years 1-3; 15% years 4-6; 10% years 7-10; 8% thereafter. All currency conversions are at the current official exchange rate of ₡5 = US$1.

TABLE H-9
ESTIMATED FOREIGN AND LOCAL COSTS
(Constant 1988 Prices)

	Total	Foreign	Local
STRUCTURES			
Factory Shells	25,900	10,360	15,540
Physical Contingency	2,590	1,036	1,554
Price Contingency	2,770	1,108	1,662
Subtotal	31,260	12,504	18,756
LAND DEVELOPMENT AND INFRASTRUCTURE			
Civil Works	4,590	1,148	3,442
Physical Contingency	459	115	344
Price Contingency	491	123	368
Subtotal	5,540	1,386	4,154
TOTAL	36,800	13,890	22,910

Note: Estimates based on "normal" ratios. Price contingency is derived utilizing a 10.7 percent effective annual inflation rate. Figures are rounded.

IV. FINANCIAL ANALYSIS

A. Overview

In order to measure the financial viability of private free zone development in El Salvador, this section projects the likely financial performance of one zone development. A projected set of revenue forecasts, income and cash flow statements, balance sheets and rate of return tables have been prepared, evaluating the prototype zone's performance under various assumptions over a 20 year period. It should be noted that the analyses presented herein represents a conservative estimate of likely performance, given present capital and operating cost structures, revenue projections and financing structures.

B. Base Case Assumptions

The assumptions utilized in the Base Case analysis (Tables H-11 and H-17) are as follows:

1. Project Financing Plan

As indicated in the previous section, total capitalization for the El Salvador free zone project is expected to exceed ₡46 million in current terms over the four-year construction period; total working capital financing should exceed ₡8 million. Together, these requirements amoung to a need for ₡54 million.

The assumed financing plan envisages a debt/equity structure of 75/25, consisting of approximately ₡41 million in debt financing and ₡13 million of equity or risk capital. Depending on the terms and conditions of the debt financing, the zone development could possibly stand a higher debt/equity ratio (80/20) without becoming "over-leveraged".

2. Revenues

Projected revenues are derived directly from the forecasts of market demand for under-roof space and the unit rental rate discussed in Annex G of this Project Paper.

The revenue estimates shown in Table H-12 present a base case income stream from the zone. The revenue stream projected is the result of assumptions made regarding three variables: the amount of new construction of under-roof SFB space built each year; the average occupancy level of the buildings; and the base rental rate for SFB space.

The identification of the optimal base rental rate for SFB space utilized in this analysis is based upon the several considerations:

- the rent charged must be competitive with competing free zones in the region;

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- the rent cannot be so high as to deter "price sensitive" users from establishing operations; and
- the rental rate charged must be sufficient to not only cover operating costs and debt service requirements, but also generate a reasonable financial return within a 5-8 year time frame.

Given the difficulties in attracting foreign investors to El Salvador, pricing of the free zone space will have to be at an initially lower level than could be realistically be achieved elsewhere. As shown in Table H-9 above, the suggested base rental rate is competitive with most free zones, and certainly most private free zones in the region.

TABLE H-10
COMPARATIVE RENTS FOR CARIBBEAN BASIN FREE ZONES

Country	Annual Rent ($/sq.ft.)	Annual Rent ($/m^2)
Barbados	2.50 - 4.00	26.90 - 43.04
Costa Rica	2.00 - 4.50	21.52 - 48.42
Dominican Rep.	2.00 - 4.50	21.52 - 48.42
El Salvador		
- SBFZ	1.56	16.79
- Proposed	2.95	31.74
Guatemala	2.30 - 3.20	24.75 - 34.43
Honduras	3.00	32.28
Jamaica	2.50 - 4.25	26.90 - 45.73
Panama	2.22 - 3.50	21.52 - 37.66

Note: Lower rents are generally public sector zones; higher rates are private free zones. However, comparisons made upon the basis of base rental rates alone are misleading as many zones charge up-front deposits and rental premiums. Some Dominican free zones, for example, are asking (and receiving) 6 years of advance rent; the Kingston Free Zone in Jamaica charges new companies rental premiums averaging 10-20%; the Cartago Free Zone in Costa Rica requires an upfront deposit of 25% for new users.

The revenue forecast shown in Table H-12 additionally assumes the following: (i) only one-half of the construction completed in the first year is leased; (ii) occupancy rates are assumed to rise from 90% over the first two years, to 95% by Year 5, and 100% thereafter; and (iii) that 2,500 m^2. of the Administration Building will be leased to independent operators supplying specialized services to zone tenants, with the remainder reserved for zone administration offices.

Moreover, revenue projections in current terms assume that rental rates rise with inflation, which is set at an effective annual rate of 10.7% over 20 years. In practice, of course, lease terms and conditions may, specify adjustments at other time intervals, e.g. 2, 3 or 5 years. Whatever time interval is chosen, the adjustment should be linked to somme agreed upon index to insure that the rental income keeps pace with general prices levels.

3. Operating Costs

Free zone operating costs include:
- wages and salaries;
- overhead charges;
- ongoing marketing and promotion expenses;
- maintenance charges;
- depreciation and interest.

One of the fundamental errors made in zone development is assuming that free zones require a large management and administrative structure. While most public free zones have organizational structures with 50-100 people or more, efficient private zones have lean staffing structures.

Operations are expected to commence in the first year of construction. An initial staff of three people is suggested for the management and administration of the zone. Initial staffing and salaries are as follows: General Manager (₡200,000), Bilingual Secretary (₡30,000), Maintenance Engineer (₡36,000), and 36 security guards (₡10,000 each); increasing by another secretary, and an administrative officer (₡30,000) in Year 6. Overhead is calculated at 75 percent of the salary bill and includes: insurance, utilities, supplies, and legal/accounting fees.

Promotion is set at ₡375,000 ($75,000) per year, lower than most free zone projects. Typical, annual marketing and promotional expenses of a 20 hectare project would be in the range of $100,000-$175,000; however, the promotional budget here is lower as the project will essentially "piggy-back" on the promotional activities of PRIDEX financed under the A.I.D. Project No. 519-0287, Industrial Stabilization and Recovery. Maintenance is assumed at 1 percent of the installed capital plant in the zone annually for the first 10 years, and 2 percent thereafter. In line with the assumed 5 percent annual rate of inflation, all of the above costs increase accordingly when expressed in current terms.

Depreciation is calculated by the straight-line method over a period of 20 years beginning in the first full operating year for each phase of construction. Interest expense assumes that the loan component is amortized over a 15-year period at 15 percent interest. The working capital loans are amortized, with no grace period, over five years from the date of the last disbursement (i.e., nine years amortization) at 15 percent interest. Interest is applied only to the outstanding principal balance. To approximate the staggered draw down of funds, all funds disbursed each year are assumed to be released in one tranche at mid-year.

C. Base Case Results

1. Financial Summary

The Financial Summary, Table H-11, gives a one page review of the financial performance of the zone. Revenues rise sharply over the four-year construction period for the zone until they hit full capacity of roughly ₡10 million in year 5. Thereafter, they continue to increase at the inflation rate. Net income is negative during the construction period, ranging from ₡2 million to ₡2.5 million annually. On a cash basis (that is, adding back Depreciation, which is a non-cash expense), the zone breaks even in Year 5, only one year after the construction period.

2. Operating Income and Cash Flow Projections

As can be seen from Table H-13, the Income Statement, shows operating surpluses in Year 6 (on a cash basis in Year 5). Debt service begins in Year 1 (on funds borrowed in Year 1) and builds up to a maximum of ₡8 million annual payment of interest plus principal (annuity) in Year 6, declining thereafter until all long-term debt is fully amortized in Year 20. (See Table K-17.) At full capacity, when construction is complete, the zone facilities will be generating annual revenues of ₡10.4 million in Year 5, and exceeding ₡37 million in annual revenues by Year 20.

The annual working capital requirement noted in the Income Statement shows the anticipated cash deficit in each period (i.e., Net Income with Depreciation added back). This figure is used as a base for determining the Working Capital Loan (see Table H-17).

As can be seen from Table H-14, the Cash Flow Statement, the projected cash flow from the zone is sufficient to service the long-term and working capital debt. Overall, projected cash flow is more than adequate to cover ongoing capital investment and loan amortization obligations.

3. Financial Returns to the Project

The expected profitability of the free zone as projected (Table H-16), confirms the zone's ability to generate an appropriate return on investment. Over the 20-year nominal life of a zone development, including 4 years of construction and 16 years of full operation, it produces a significant cumulative expected return. This financial return, as summarized in the Rate of Return Table, is comprised of three elements: net income, the depreciation stream resulting from the physical assets, and the return to

interest to the lenders to the zone. The first two factors represent the return on equity. Based on this measurement of the zone project's potential, capital budgeting evaluations give an estimate of the strength of the zone project.

The Payback Period on equity capital for this project is 9 years. In a real estate development, where properly maintained assets retain their value substantially beyond the 20-year depreciation period, this ratio of payback period to asset life is acceptable.

The Return on Investment (ROI, or Financial Internal Rate of Return) measures the internal rate of return generated by the project on both the debt and equity components of finance. In order to calculate the ROI and the ROE, a residual value of 50 percent of the zone project's current value has been added after a period of ten years and after a period of twenty years. Based on an assumed nominal cost of capital of 15%, the ROI is 13.0% over the first ten-year period and 18.4% over the full twenty-year period. This return is excellent for free zone projects, and is particularly given the low rental rate utilized in the analysis. The Return on Equity (ROE), which measures the return to the owner's capital, is higher than the ROI due to leveraging, namely, 18.9% after ten years and 24.1% for the full twenty-year period.

The Net Present Value of the project is ₡14.7 million considering returns over a 20 year period (i.e., 16 years after construction is complete). This figure presents an estimate of the increase in value of the company as a result of proceeding with this investment, expressed in present value terms. It assumes that the developer's cost of capital is 15 percent, which is equal to the interest rate on the borrowing. If the final average cost of capital to the project is less than this figure (for example due to the equity contribution made by the donation of land or through use of municipal bond funding as a debt source) then this indicator will have an even larger value than that estimated in this analysis.

D. Sensitivity Analysis

The effect on the overall financial viability of the free zone was tested by modifying key assumptions underlying the base case financial projections. The impact of these changes on project profitability is presented in Table H-18 below. As may be seen, overall profitability of the project is not seriously compromised under any of the scenarios utilized. The specific results of the sensitivity runs are presented below.

TABLE H-18
SUMMARY OF PROJECT RETURNS UNDER DIFFERENT SCENARIOS

Scenario	10 Year ROE	Total Financing (millions)
Base Case	18.9%	$10.9
A. Application of a Lower Rental Rate	15.4%	$12.3
B. Application of Higher Interest Rate	17.4%	$11.6
C. Use of Steel Buildings	20.8%	$10.0
D. Accelerating Zone Development Period	21.4%	$ 9.7

1. Scenario A

The lowering of the SFB annual rental rate to ₡147.95/m^2. (equivalent to $2.75/sq.ft. or ₡12.33/month) represents, essentially a 7% drop in the overall revenue stream. In reality, this drop in revenues could also be the result of a drop in demand (causing lower occupancy levels). The impact of this on project performance is not overly significant; the return on equity of 15.4% is still above the cost of capital. Further rental decreases (or shortfalls in demand) should be avoided as project profitability will be adversely affected. (See Tables H-19 to H-25 for full financial projections.)

The working capital required nearly doubles (from C8 million to C15 million) in order to provide the zone with liquidity in the early years before it has established a sufficiently strong revenue stream to be self-financing. Despite this shortfall, the zone is still breaking even on a cash basis in Year 5.

2. Scenario B

The raising of the nominal annual interest rate on the debt financing to 16% has an interesting impact on project profitability, dropping the ORE to 17.4%. Nonetheless, basic zone profitability is not significantly affected by the higher interest rate used in the analysis. (See Tables H-26 to H-32 for full financial projections).

As with Scenario A, additional working capital is required to meet early liquidity needs of the zone. Again, the fundamental strength of the zone remains with the zone easily breaking even on a cash basis in Year 5.

3. Scenario C

The use of steel pre-fabricated buildings greatly enhances project profitability. Based upon actual price quotes, a unit SFB "construction" and installation cost of $135.84/m^2 (calculated from an unit cost of $40.80/m^2 plus installation costs estimated at 3.3 times the CIF price of pre-fabricated steel SFBs imported from the U.S.) or ₡679.19/m^2., is equivalent to lowering project capital costs by approximately 7%. This has the effect of significantly improving expected returns across-the-board. This has the effect of driving up the ROE to 20.8%. (See Tables H-33 to H-39 for full financial projections).

The drop in capital costs means a lower demand for long-term financing which also results in a lower demand for working capital financing. Overall borrowing needs decline from C54 million to C50 million, while the zone comes within C51,000 of breaking even in Year 4.

4. Scenario D

The final sensitivity test was to determine the affect of accelerating project development. Although typically project development is phased over several years to minimize financial risk and keep in pace with demand, in the case of El Salvador, ample demand is clearly documented. As such, it may be feasible to accelerate the construction of under-roof space to capture as much of the demand as possible. By increasing the pace of SFB construction to 12,000 m^2 (Year 1), 20,000 m^2 (Year 2) and 3,000 (Year 3), the impact on project profitability in current terms is strongly positive, raising the ROE to 21.4%. (See Tables H-40 to H-46 for full financial projections).

By concentrating development in the early years, the revenue generating potential of the assets is realized sooner, and the construction occurs before inflation can increase the costs of construction. Accordingly, both the long-term and working capital financing needs are reduced. In this case, total financing requirements fall from ₡54 million to ₡48 million, while the zone breaks even on a cash basis in Year 4.

E. Second Free Zone

Finally, this analysis is extended to include the construction of a second, slightly larger free zone, which is not initiated until Year 3 of the first project (see Tables H-47 through H-49).

The performance of this second zone is basically analagous to the first. Return on Equity is a bit higher due to the effect of having more development early in the Project (see Scenario D) and because there is a greater amount of revenue generating space for an almost identical overhead.

Consolidation of the two free zone projects is shown in Table H-49, where total debt financing reaches $19.3 million.

F. Cash Flow Analysis of Credit Facility

Analysis of the cash flow of the credit facility indicates that there will be sufficient resources to finance an additional free zone(s) or zone expansions after the LOP, as well as working capital throughout the twenty year projections. To maintain flexibility, reflows will be available for expansion of existing private zones as well as for new private free zones, depending upon demand in the out years. To enable sufficient reflows to accumulate to finance increased long-term capital investment in private free zones, a cap on total working capital of 25% of reflows at any given time will be established.

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TABLE H - 11
EL SALVADOR FREE ZONE -- BASE CASE PROJECTIONS

FINANCIAL SUMMARY

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
REVENUES	607	2,358	4,990	7,725	10,473	12,115	13,198	14,562	16,255	18,340
NET INCOME	(1,990)	(2,662)	(2,520)	(2,285)	(664)	350	1,428	2,742	4,387	6,216
ASSETS	11,436	22,328	31,932	42,165	40,827	38,191	36,634	36,390	37,792	41,696
LIABILITIES	7,637	18,328	27,834	38,043	37,369	34,384	31,398	28,413	25,428	23,116
NET WORTH	3,799	4,000	4,098	4,122	3,457	3,807	5,235	7,977	12,364	18,580

YEAR	11	12	13	14	15	16	17	18	19	20
REVENUES	20,609	23,177	26,207	29,772	33,953	38,845	44,557	51,216	58,965	67,973
NET INCOME	7,461	9,737	12,423	15,589	19,311	23,680	28,800	34,790	41,791	49,962
ASSETS	46,846	54,271	64,382	77,660	94,659	116,028	142,516	174,994	214,474	262,124
LIABILITIES	20,804	18,493	16,181	13,870	11,558	9,246	6,935	4,623	2,312	
NET WORTH	26,041	35,778	48,201	63,790	83,101	106,781	135,581	170,371	212,162	262,124

RETURN ON EQUITY (10 YRS) : 18.9%

FINANCING STRUCTURE:

Long Term Financing		C 46,232	-	$ 9,246
	Of Which: Equity	C 11,558	-	$ 2,312
	Debt	C 34,674	-	$ 6,935
Working Capital Financing		C 8,085	-	$ 1,617
	Of Which: Equity	C 2,021	-	$ 404
	Debt	C 6,064	-	$ 1,213
Total Financing		C 54,317	-	$ 10,863
	Of Which: Equity	C 13,579	-	$ 2,716
	Debt	C 40,738	-	$ 8,148

TABLE H - 12
EL SALVADOR FREE ZONE -- BASE CASE PROJECTIONS

CONSTRUCTION SCHEDULE AND REVENUE PROJECTIONS

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
ANNUAL INFLATION RATE	.0%	20.0%	20.0%	15.0%	15.0%	15.0%	10.0%	10.0%	10.0%	10.0%
CUMULATIVE INFLATION FACTOR	1.00	1.20	1.44	1.66	1.90	2.19	2.41	2.65	2.91	3.21
EFFECTIVE ANNUAL INFLATION RATE	10.7%									
DEVELOPMENT COSTS, OF WHICH:										
LAND VALUE /1	3,000									
LAND DEVELOPMENT COSTS /2	1,180	1,574	1,511	1,737						
CONSTRUCTION COST /2	6,656	8,874	8,519	9,797						
CONTINGENCY /3	666	887	852	980						
TOTAL DEVELOPMENT COST	11,501	11,335	10,882	12,514						
DEPRECIATION:										
CUMULATIVE TOTAL INVESTMENT /4	11,501	22,836	33,718	46,232	46,232	53,167	58,484	64,332	70,765	77,842
DEPRECIABLE ASSETS /5	7,321	17,082	26,453	37,230	37,230	37,230	37,230	37,230	37,230	37,230
ANNUAL DEPRECIATION /6	366	854	1,323	1,861	1,861	1,861	1,861	1,861	1,861	1,861
ACCUMULATED DEPRECIATION	366	1,220	2,543	4,404	6,266	8,127	9,989	11,850	13,712	15,573
SPACE AVAILABLE & REVENUE PROJECTION:										
ANNUAL NEW CONSTRUCTION (m2)	9,000	10,000	8,000	8,000	0					
ADMINISTRATION BUILDING	500									
CUMULATIVE SPACE AVAILABLE (m2)	4,250	13,500	22,500	30,500	34,500	34,500	34,500	34,500	34,500	34,500
AVERAGE OCCUPANCY RATE	90.0%	90.0%	95.0%	95.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
RENTAL RATE (C/M2/MONTH) /7	13.22	15.86	19.04	21.89	25.18	28.95	31.85	35.03	38.54	42.39
ANNUAL REVENUE /8	607	2,313	4,883	7,612	10,423	11,986	13,185	14,504	15,954	17,549

NOTES:

1/ 20 Hectares total area @ C15 per m2)
2/ Unit construction costs: C. 739.50 for SFBs & C. 45.90 for land development; inclusive of architectural and engineering charges.
3/ Physical contingency allows 10.0% over SFB construction costs.
4/ Total cumulative investment; after Year 5 adjusted to current value according to inflation.
5/ Total cost of buildings and structures.
6/ Depreciation over 20 years by the straight line method.
7/ Annual rental rate, adjusted for inflation. The exchange rate used is C 5.00/US$ 1.0 for the rental payments, which are denominated in US$.
8/ Assumes an exchange rate of C5.00/US$ 1.0 on rental revenue.

ABLE H- 13
L SALVADOR FREE ZONE -- BASE CASE PROJECTIONS

N C O M E S T A T E M E N T

Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
REVENUES:										
OPERATING INCOME /1	607	2,313	4,883	7,612	10,423	11,986	13,185	14,504	15,954	17,549
INTEREST INCOME /2		45	107	113	51	129	13	59	301	791
TOTAL REVENUES	607	2,358	4,990	7,725	10,473	12,115	13,198	14,562	16,255	18,340
COSTS:										
SALARIES /3	626	751	901	1,037	1,192	1,546	1,701	1,871	2,058	2,264
PAYROLL BURDEN /4	188	225	270	311	358	464	510	561	617	679
OVERHEAD /5	470	563	676	777	894	1,160	1,276	1,403	1,543	1,698
PROMOTION	375	450	540	621	714	821	903	994	1,093	1,202
MAINTENANCE /6		228	337	462	462	532	585	643	708	773
DEPRECIATION	366	854	1,323	1,861	1,861	1,861	1,861	1,861	1,861	1,861
INTEREST	573	1,947	3,462	4,941	5,656	5,381	4,934	4,486	3,988	3,641
TOTAL OPERATING COSTS	2,597	5,020	7,510	10,011	11,138	11,766	11,770	11,820	11,869	12,124
NET INCOME	(1,990)	(2,662)	(2,520)	(2,285)	(664)	350	1,428	2,742	4,387	6,216
ANNUAL WORKING CAPITAL REQUIREMENT /7	1,624	1,808	1,198	424						

NOTES:

1/ Operating Income is the rental revenue from leasing buildings.

2/ Interest Income equals the interest (at 15.0%) on the previous year's cumulative surplus. The Cumulative Surplus is shown in the Balance Sheet as Current Assets. Implicitly this item for Interest Income represents reinvestment of the surplus at the cost of capital.

3/ Assumes Staffing as shown below at the following annual rates, including payroll burden:

Years 1-5:		Years 6-20 add:	
General Manager	200	Administrative Assistant	30
Secretary	30	Second Secretary	10
Maintenance Engineer	36	4 Additional Security	40
Security (8)	360		

4/ Payroll Burden Assumed: 30.0%

5/ Overhead includes insurance, legal/accounting fees, utilities and supplies.
Overhead Factor @ 75.0% of wage bill.

6/ Maintenance is estimated at 1% of total physical assets through year 10, and 2% thereafter.

7/ Working Capital Requirement is the funding needed to cover the cash deficit (i.e., the negative of Net Income with Depreciation removed).

TABLE H - 13 (CONTINUED)
EL SALVADOR FREE ZONE -- BASE CASE PROJECTIONS

INCOME STATEMENT

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	11	12	13	14	15	16	17	18	19	20
REVENUES:										
OPERATING INCOME /1	18,953	20,469	22,107	23,876	25,786	27,848	30,076	32,482	35,081	37,888
INTEREST INCOME /2	1,656	2,707	4,100	5,896	8,167	10,996	14,481	18,733	23,884	30,085
TOTAL REVENUES	20,609	23,177	26,207	29,772	33,953	38,845	44,557	51,216	58,965	67,973
COSTS:										
SALARIES /3	2,445	2,640	2,852	3,080	3,326	3,592	3,880	4,190	4,525	4,887
PAYROLL BURDEN /4	733	792	856	924	998	1,078	1,164	1,257	1,358	1,466
OVERHEAD /5	1,834	1,980	2,139	2,310	2,495	2,694	2,910	3,143	3,394	3,665
PROMOTION	1,299	1,403	1,515	1,636	1,767	1,908	2,061	2,226	2,404	2,596
MAINTENANCE /6	1,681	1,816	1,961	2,118	2,288	2,471	2,668	2,882	3,112	3,361
DEPRECIATION	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861
INTEREST	3,294	2,947	2,601	2,254	1,907	1,560	1,214	867	520	173
TOTAL OPERATING COSTS	13,148	13,440	13,784	14,183	14,642	15,165	15,757	16,425	17,174	18,011
NET INCOME	7,461	9,737	12,423	15,589	19,311	23,680	28,800	34,790	41,791	49,962

NOTES:

1/ Operating Income is the rental revenue from leasing buildings.

2/ Interest Income equals) on the previous year's cumulative surplus.
The Cumulative Surplus is shown in the Balance Sheet as Current Assets. Implicitly this item for Interest Income represents reinvestment of the surplus at the cost of capital.

3/ Assumes Staffing as shown below at the following annual rates, including payroll burden:
Years 1-5: Years 6-20 add:
General Manager
Secretary
Maintenance Engineer
Security (8)

4/ Payroll Burden Assumed:

5/ Overhead includes insurance, legal/accounting fees, utilities and supplies.
Overhead Factor @ of wage bill.

6/ Maintenance is estimated at 1% of total physical assets through year 10, and 2% thereafter.

7/ Working Capital Requirement is the funding needed to cover the cash deficit (i.e., the negative of Net Income with Depreciation removed).

TABLE H - 14
EL SALVADOR FREE ZONE -- BASE CASE PROJECTIONS

C A S H F L O W S T A T E M E N T

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
SOURCES OF FUNDS:										
NET INCOME	(1,990)	(2,662)	(2,520)	(2,285)	(664)	350	1,428	2,742	4,387	6,216
DEPRECIATION	366	854	1,323	1,861	1,861	1,861	1,861	1,861	1,861	1,861
FINANCING FOR PHYSICAL ASSETS:										
EQUITY	5,140	2,140	2,140	2,140						
LONG-TERM LOAN	6,362	9,196	8,742	10,374						
FINANCING FOR WORKING CAPITAL:										
EQUITY	650	723	479	170						
WORKING CAPITAL LOAN	1,949	2,169	1,437	509						
TOTAL SOURCES	12,476	12,420	11,600	12,768	1,197	2,211	3,289	4,604	6,248	8,078
USES OF FUNDS:										
LAND ACQUISITION & DEVELOPMENT	4,180	1,574	1,511	1,737						
CONSTRUCTION	7,321	9,761	9,371	10,777						
LONG-TERM LOAN AMORTIZATION						2,312	2,312	2,312	2,312	2,312
WORKING CAPITAL LOAN AMORTIZATION	674	674	674	674	674	674	674	674	674	
TOTAL USES	12,175	12,009	11,555	13,188	674	2,985	2,985	2,985	2,985	2,312
ANNUAL SURPLUS/DEFICIT	301	411	45	(419)	523	(774)	304	1,618	3,263	5,766
CUMULATIVE SURPLUS/DEFICIT	301	712	756	337	860	86	390	2,009	5,271	11,037

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TABLE H - 14 (CONTINUED)
EL SALVADOR FREE ZONE -- BASE CASE PROJECTIONS

C A S H F L O W S T A T E M E N T

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	11	12	13	14	15	16	17	18	19	20
SOURCES OF FUNDS:										
NET INCOME	7,461	9,737	12,423	15,589	19,311	23,680	28,800	34,790	41,791	49,962
DEPRECIATION	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861
FINANCING FOR PHYSICAL ASSETS:										
EQUITY										
LONG-TERM LOAN										
FINANCING FOR WORKING CAPITAL:										
EQUITY										
WORKING CAPITAL LOAN										
TOTAL SOURCES	9,323	11,598	14,285	17,450	21,173	25,541	30,661	36,652	43,652	51,823
USES OF FUNDS:										
LAND ACQUISITION & DEVELOPMENT										
CONSTRUCTION										
LONG-TERM LOAN AMORTIZATION	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312
WORKING CAPITAL LOAN AMORTIZATION										
TOTAL USES	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312
ANNUAL SURPLUS/DEFICIT	7,011	9,286	11,973	15,139	18,861	23,230	28,350	34,340	41,341	49,512
CUMULATIVE SURPLUS/DEFICIT	18,048	27,335	39,308	54,447	73,308	96,538	124,887	159,228	200,568	250,080

TABLE H - 15
EL SALVADOR FREE ZONE -- BASE CASE PROJECTIONS

B A L A N C E S H E E T

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
ASSETS:										
CURRENT ASSETS	301	712	756	337	860	86	390	2,009	5,271	11,037
FIXED ASSETS:										
LAND AND IMPROVEMENTS	4,180	5,754	7,265	9,002	9,002	9,002	9,002	9,002	9,002	9,002
BUILDINGS	7,321	17,082	26,453	37,230	37,230	37,230	37,230	37,230	37,230	37,230
LESS ACCUMULATED DEPRECIATION	(366)	(1,220)	(2,543)	(4,404)	(6,266)	(8,127)	(9,989)	(11,850)	(13,712)	(15,573)
TOTAL FIXED ASSETS	11,135	21,616	31,175	41,828	39,966	38,105	36,243	34,382	32,520	30,659
TOTAL ASSETS	11,436	22,328	31,932	42,165	40,827	38,191	36,634	36,390	37,792	41,696
LIABILITIES:										
CURRENT LIABILITIES										
WORKING CAPITAL DEBT	1,275	2,771	3,534	3,369	2,695	2,021	1,348	674		
LONG-TERM DEBT	6,362	15,557	24,300	34,674	34,674	32,362	30,051	27,739	25,428	23,116
TOTAL LIABILITIES	7,637	18,328	27,834	38,043	37,369	34,384	31,398	28,413	25,428	23,116
CAPITAL:										
EQUITY	5,789	8,652	11,270	13,579	13,579	13,579	13,579	13,579	13,579	13,579
RETAINED EARNINGS	(1,990)	(4,652)	(7,172)	(9,458)	(10,122)	(9,772)	(8,344)	(5,602)	(1,215)	5,001
TOTAL CAPITAL	3,799	4,000	4,098	4,122	3,457	3,807	5,235	7,977	12,364	18,580
TOTAL LIABILITIES AND CAPITAL	11,436	22,328	31,932	42,165	40,827	38,191	36,634	36,390	37,792	41,696

TABLE M - 15 (CONTINUED)
EL SALVADOR FREE ZONE -- BASE CASE PROJECTIONS

B A L A N C E S H E E T

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Not

YEAR	11	12	13	14	15	16	17	18	19	20
ASSETS:										
CURRENT ASSETS	18,048	27,335	39,308	54,447	73,308	96,538	124,887	159,228	200,568	250,080
FIXED ASSETS:										
LAND AND IMPROVEMENTS	9,002	9,002	9,002	9,002	9,002	9,002	9,002	9,002	9,002	9,002
BUILDINGS	37,230	37,230	37,230	37,230	37,230	37,230	37,230	37,230	37,230	37,230
LESS ACCUMULATED DEPRECIATION	(17,435)	(19,296)	(21,158)	(23,019)	(24,881)	(26,742)	(28,604)	(30,465)	(32,327)	(34,188)
TOTAL FIXED ASSETS	28,797	26,936	25,074	23,213	21,351	19,490	17,628	15,767	13,905	12,044
TOTAL ASSETS	46,846	54,271	64,382	77,660	94,659	116,028	142,516	174,994	214,474	262,124
LIABILITIES:										
CURRENT LIABILITIES										
WORKING CAPITAL DEBT										
LONG-TERM DEBT	20,804	18,493	16,181	13,870	11,558	9,246	6,935	4,623	2,312	
TOTAL LIABILITIES	20,804	18,493	16,181	13,870	11,558	9,246	6,935	4,623	2,312	
CAPITAL:										
EQUITY	13,579	13,579	13,579	13,579	13,579	13,579	13,579	13,579	13,579	13,579
RETAINED EARNINGS	12,462	22,199	34,622	50,211	69,522	93,202	122,001	156,792	198,583	248,545
TOTAL CAPITAL	26,041	35,778	48,201	63,790	83,101	106,781	135,581	170,371	212,162	262,124
TOTAL LIABILITIES AND CAPITAL	46,846	54,271	64,382	77,660	94,659	116,028	142,516	174,994	214,474	262,124

TABLE H - 16
EL SALVADOR FREE ZONE -- BASE CASE PROJECTIONS

R A T E O F R E T U R N A N A L Y S I S

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR		1	2	3	4	5	6	7	8	9	10
ON TOTAL INVESTMENT:											
IRR STREAM	(38,976)	(1,052)	140	2,265	4,517	6,853	7,593	8,223	9,090	10,236	11,718
INTERNAL RATE OF RETURN:	10 YRS	13.0%		NET PRESENT VALUE:		10 YRS		(4,702)			
	20 YRS	18.4%				20 YRS		14,736			
ON EQUITY:											
ROE STREAM /2	(10,241)	(1,624)	(1,808)	(1,198)	(424)	1,197	2,211	3,289	4,604	6,248	8,078
RETURN ON EQUITY:	10 YRS	18.9%		NET PRESENT VALUE:		10 YRS		4,396			
	20 YRS	24.1%				20 YRS		22,161			

NOTES: 1/ The first column contains the total investment discounted to its present value in the first year, while each column contains the Net Income for that year with Depreciation and Interest added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10 or 20).

2/ The first column contains the equity investment discounted to its present value while each column contains the Retained Earnings for that year with depreciation added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10 or 20).

TABLE [redacted] - 16 (CONTINUED)
EL SALVADOR FREE ZONE -- BASE CASE PROJECTIONS

R A T E O F R E T U R N A N A L Y S I S

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Not

YEAR	11	12	13	14	15	16	17	18	19	20
ON TOTAL INVESTMENT:										
IRR STREAM	12,617	14,545	16,885	19,704	23,080	27,102	31,875	37,519	44,173	136,024
ON EQUITY:										
ROE STREAM /2	9,323	11,598	14,285	17,450	21,173	25,541	30,661	36,652	43,652	135,851

NOTES: 1/ The first column contains the total investment discounted to its present value in the first year, while each column contains the Net Income for that year with Depreciation and Interest added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10 or 20).

2/ The first column contains the equity investment discounted to its present value while each column contains the Retained Earnings for that year with depreciation added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10 or 20).

TABLE M - 17
EL SALVADOR FREE ZONE -- BASE CASE PROJECTIONS

F I N A N C I N G S T R U C T U R E

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
LONG-TERM LOAN:										
PRINCIPAL (B.O.Y.)		6,362	15,557	24,300	34,674	34,674	32,362	30,051	27,739	25,428
DRAWDOWN	6,362	9,196	8,742	10,374						
INTEREST	477	1,644	2,989	4,423	5,201	5,028	4,681	4,334	3,988	3,641
AMORTIZATION /1						2,312	2,312	2,312	2,312	2,312
PRINCIPAL (E.O.Y.)	6,362	15,557	24,300	34,674	34,674	32,362	30,051	27,739	25,428	23,116
EQUITY INVESTMENT	5,140	2,140	2,140	2,140						
WORKING CAPITAL LOAN:										
PRINCIPAL (B.O.Y.)		1,275	2,771	3,534	3,369	2,695	2,021	1,348	674	
DRAWDOWN	1,949	2,169	1,437	509						
INTEREST	96	303	473	518	455	354	253	152		
AMORTIZATION /1	674	674	674	674	674	674	674	674	674	
PRINCIPAL (E.O.Y.)	1,275	2,771	3,534	3,369	2,695	2,021	1,348	674		
EQUITY INVESTMENT /2	650	723	479	170						
DEBT SERVICE COVERAGE /3	-.84	.05	.55	.80	1.08	.91	1.04	1.22	1.47	1.97
DEBT/EQUITY RATIO /4	2.01	4.58	6.79	9.23	10.81	9.03	6.00	3.56	2.06	1.24

ASSUMPTIONS:

LONG-TERM FINANCING

TOTAL INVESTMENT	C	46,232
OF WHICH: EQUITY	C	11,558
DEBT	C	34,674
ANNUAL INTEREST RATE		15.0%
TERM: INCLUDING GRACE		20 yrs
GRACE PERIOD		5 yrs

WORKING CAPITAL FINANCING

TOTAL INVESTMENT /5	C	8,085
OF WHICH: EQUITY	C	2,021
DEBT	C	6,064
ANNUAL INTEREST RATE		15.0%
TERM: INCLUDING GRACE		5 yrs
GRACE PERIOD		0 yrs

NOTES:

1/ Equal principal repayments are made with interest paid on the average outstanding balance.
2/ Equity is assumed to be the cost of land in year 1 plus equal annual investments of the balance of the 25% of total investment.
3/ Ratio of Net Income plus Interest and Depreciation to Interest and Amortization
4/ Ratio of Total Liabilities to Total Capital.
5/ Total investment in Working Capital is 160% of the Working Capital Requirement defined in the Income Statement.

TABLE M - 17 (CONTINUED)
EL SALVADOR FREE ZONE -- BASE CASE PROJECTIONS

F I N A N C I N G S T R U C T U R E

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	11	12	13	14	15	16	17	18	19	20
LONG-TERM LOAN:										
PRINCIPAL (B.O.Y.)	23,116	20,804	18,493	16,181	13,870	11,558	9,246	6,935	4,623	2,312
DRAWDOWN										
INTEREST	3,294	2,947	2,601	2,254	1,907	1,560	1,214	867	520	173
AMORTIZATION /1	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312
PRINCIPAL (E.O.Y.)	20,804	18,493	16,181	13,870	11,558	9,246	6,935	4,623	2,312	
EQUITY INVESTMENT										
WORKING CAPITAL LOAN:										
PRINCIPAL (B.O.Y.)										
DRAWDOWN										
INTEREST										
AMORTIZATION /1										
PRINCIPAL (E.O.Y.)										
EQUITY INVESTMENT /2										
DEBT SERVICE COVERAGE /3	2.25	2.77	3.44	4.32	5.47	7.00	9.04	11.80	15.60	20.92
DEBT/EQUITY RATIO /4	.80	.52	.34	.22	.14	.09	.05	.03	.01	

NOTES:
1/ Equal principal repayments are made with interest paid on the average outstanding balance.
2/ Equity is assumed to be the cost of land in year 1 plus equal annual investments of the balance of the 25% of total investment.
3/ Ratio of Net Income plus Interest and Depreciation to Interest and Amortization
4/ Ratio of Total Liabilities to Total Capital.
5/ Total investment in Wor of the Working Capital Requirement defined in the Income Statement.

TABLE H - 18 INSERTED IN TEXT

TABLE N - 19
EL SALVADOR FREE ZONE -- SCENARIO A PROJECTIONS -- LOWER RENT

FINANCIAL SUMMARY

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
REVENUES	566	2,355	5,010	7,701	10,325	11,692	12,497	13,547	14,883	16,568
NET INCOME	(2,083)	(2,841)	(2,805)	(2,710)	(1,207)	(379)	509	1,596	3,015	4,444
ASSETS	12,453	24,657	35,183	45,851	43,387	39,439	36,378	34,406	33,852	35,984
LIABILITIES	8,323	19,987	30,252	40,960	39,703	36,134	32,565	28,997	25,428	23,116
NET WORTH	4,130	4,670	4,931	4,891	3,684	3,304	3,813	5,409	8,424	12,868

YEAR	11	12	13	14	15	16	17	18	19	20
REVENUES	18,476	20,622	23,159	26,147	29,656	33,764	38,565	44,162	50,679	58,255
NET INCOME	5,328	7,182	9,375	11,964	15,014	18,600	22,807	27,737	33,505	40,244
ASSETS	39,001	43,871	50,934	60,587	73,290	89,678	110,073	135,499	166,692	204,625
LIABILITIES	20,804	18,493	16,181	13,870	11,558	9,246	6,935	4,623	2,312	
NET WORTH	18,196	25,378	34,753	46,717	61,731	80,331	103,139	130,876	164,381	204,625

RETURN ON EQUITY (10 YRS) : 15.4%

FINANCING STRUCTURE:

Long Term Financing		C 46,232	-	$ 9,246
	Of Which: Equity	C 11,558	-	$ 2,312
	Debt	C 34,674	-	$ 6,935
Working Capital Financing		C 15,087	-	$ 3,017
	Of Which: Equity	C 3,772	-	$ 754
	Debt	C 11,315	-	$ 2,263
Total Financing		C 61,319	-	$ 12,264
	Of Which: Equity	C 15,330	-	$ 3,066
	Debt	C 45,989	-	$ 9,198

TABLE M - 20
EL SALVADOR FREE ZONE -- SCENARIO A PROJECTIONS -- LOWER RENT

CONSTRUCTION SCHEDULE AND REVENUE PROJECTIONS

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
ANNUAL INFLATION RATE	.0%	20.0%	20.0%	15.0%	15.0%	15.0%	10.0%	10.0%	10.0%	10.0%
CUMULATIVE INFLATION FACTOR	1.00	1.20	1.44	1.66	1.90	2.19	2.41	2.65	2.91	3.21
EFFECTIVE ANNUAL INFLATION RATE	10.7%									
DEVELOPMENT COSTS, OF WHICH:										
LAND VALUE /1	3,000									
LAND DEVELOPMENT COSTS /2	1,180	1,574	1,511	1,737						
CONSTRUCTION COST /2	6,656	8,874	8,519	9,797						
CONTINGENCY /3	666	887	852	980						
TOTAL DEVELOPMENT COST	11,501	11,335	10,882	12,514						
DEPRECIATION:										
CUMULATIVE TOTAL INVESTMENT /4	11,501	22,836	33,718	46,232	46,232	53,167	58,484	64,332	70,765	77,842
DEPRECIABLE ASSETS /5	7,321	17,082	26,453	37,230	37,230	37,230	37,230	37,230	37,230	37,230
ANNUAL DEPRECIATION /6	366	854	1,323	1,861	1,861	1,861	1,861	1,861	1,861	1,861
ACCUMULATED DEPRECIATION	366	1,220	2,543	4,404	6,266	8,127	9,989	11,850	13,712	15,573
SPACE AVAILABLE & REVENUE PROJECTION:										
ANNUAL NEW CONSTRUCTION (m2)	9,000	10,000	8,000	8,000	0					
ADMINISTRATION BUILDING	500									
CUMULATIVE SPACE AVAILABLE (m2)	4,260	13,500	22,500	30,500	34,500	34,500	34,500	34,500	34,500	34,500
AVERAGE OCCUPANCY RATE	90.0%	90.0%	95.0%	95.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
RENTAL RATE (C/M2/MONTH) /7	12.33	14.80	17.76	20.42	23.48	27.00	29.70	32.67	35.94	39.54
ANNUAL REVENUE /8	566	2,157	4,554	7,100	9,721	11,179	12,297	13,527	14,880	16,368

NOTES:

1/ 20 Hectares total area @ C15 per m2)
2/ Unit construction costs: C. 739.50 for SFBs & C. 45.90 for land development; inclusive of architectural and engineering charges.
3/ Physical contingency allows 10.0% over SFB construction costs.
4/ Total cumulative investment; after Year 5 adjusted to current value according to inflation.
5/ Total cost of buildings and structures.
6/ Depreciation over 20 years by the straight line method.
7/ Annual rental rate, adjusted for inflation. The exchange rate used is C 5.00/US$ 1.0 for the rental payments, which are denominated in US$.
8/ Assumes an exchange rate of C5.00/US$ 1.0 on rental revenue.

TABLE A - 20 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO A PROJECTIONS -- LOWER RENT

CONSTRUCTION SCHEDULE AND REVENUE PROJECTIONS

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Not

YEAR	11	12	13	14	15	16	17	18	19	20
ANNUAL INFLATION RATE	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
CUMULATIVE INFLATION FACTOR	3.46	3.74	4.04	4.36	4.71	5.09	5.50	5.93	6.41	6.92
EFFECTIVE ANNUAL INFLATION RATE										
DEVELOPMENT COSTS, OF WHICH:										
LAND VALUE /1										
LAND DEVELOPMENT COSTS /2										
CONSTRUCTION COST /2										
CONTINGENCY /3										
TOTAL DEVELOPMENT COST										
DEPRECIATION:										
CUMULATIVE TOTAL INVESTMENT /4	84,069	90,795	98,058	105,903	114,375	123,525	133,407	144,080	155,606	168,054
DEPRECIABLE ASSETS /5	37,230	37,230	37,230	37,230	37,230	37,230	37,230	37,230	37,230	37,230
ANNUAL DEPRECIATION /6	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861
ACCUMULATED DEPRECIATION	17,435	19,296	21,158	23,019	24,881	26,742	28,604	30,465	32,327	34,188
SPACE AVAILABLE & REVENUE PROJECTION:										
ANNUAL NEW CONSTRUCTION (m2)										
ADMINISTRATION BUILDING										
CUMULATIVE SPACE AVAILABLE (m2)	34,500	34,500	34,500	34,500	34,500	34,500	34,500	34,500	34,500	34,500
AVERAGE OCCUPANCY RATE	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
RENTAL RATE (C/M2/MONTH) /7	42.70	46.11	49.80	53.79	58.09	62.74	67.76	73.18	79.03	85.35
ANNUAL REVENUE /8	17,677	19,091	20,619	22,268	24,050	25,974	28,052	30,296	32,719	35,337

NOTES:
1/ 20 Hectares total area @ C15 per m2)
2/ Unit construction co for land development; inclusive of architectural and engineering charges.
3/ Physical contingency over SFB construction costs.
4/ Total cumulative investment; after Year 5 adjusted to current value according to inflation.
5/ Total cost of buildings and structures.
6/ Depreciation over 20 years by the straight line method.
7/ Annual rental rate, adjusted for inflation. The exchange rate used is C 5.00/US$ 1.0 for the rental payments, which are denominated in US$.
8/ Assumes an exchange rate of C5.00/US$ 1.0 on rental revenue.

TABLE [illegible]- 21
EL SALVADOR FREE ZONE -- SCENARIO A PROJECTIONS -- LOWER RENT

INCOME STATEMENT

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
REVENUES:										
OPERATING INCOME /1	566	2,157	4,554	7,100	9,721	11,179	12,297	13,527	14,880	16,368
INTEREST INCOME /2		198	456	601	603	513	200	20	4	200
TOTAL REVENUES	566	2,355	5,010	7,701	10,325	11,692	12,497	13,547	14,883	16,568
COSTS:										
SALARIES /3	626	751	901	1,037	1,192	1,546	1,701	1,871	2,058	2,264
PAYROLL BURDEN /4	188	225	270	311	358	464	510	561	617	679
OVERHEAD /5	470	563	676	777	894	1,160	1,276	1,403	1,543	1,698
PROMOTION	375	450	540	621	714	821	903	994	1,093	1,202
MAINTENANCE /6		228	337	462	462	532	585	643	708	778
DEPRECIATION	366	854	1,323	1,861	1,861	1,861	1,861	1,861	1,861	1,861
INTEREST	624	2,123	3,768	5,341	6,050	5,688	5,152	4,617	3,988	3,641
TOTAL OPERATING COSTS	2,649	5,196	7,816	10,411	11,532	12,072	11,989	11,951	11,869	12,124
NET INCOME	(2,083)	(2,841)	(2,805)	(2,710)	(1,207)	(379)	509	1,596	3,015	4,444
ANNUAL WORKING CAPITAL REQUIREMENT /7	1,717	1,987	1,483	849						

NOTES:

1/ Operating Income is the rental revenue from leasing buildings.

2/ Interest Income equals the interest (at 15.0%) on the previous year's cumulative surplus. The Cumulative Surplus is shown in the Balance Sheet as Current Assets. Implicitly this item for Interest Income represents reinvestment of the surplus at the cost of capital.

3/ Assumes Staffing as shown below at the following annual rates, including payroll burden:

Years 1-5:		Years 6-20 add:	
General Manager	200	Administrative Assistant	30
Secretary	30	Second Secretary	10
Maintenance Engineer	36	4 Additional Security	40
Security (8)	360		

4/ Payroll Burden Assumed: 30.0%

5/ Overhead includes insurance, legal/accounting fees, utilities and supplies. Overhead Factor = 75.0% of wage bill.

6/ Maintenance is estimated at 1% of total physical assets through year 10, and 2% thereafter.

7/ Working Capital Requirement is the funding needed to cover the cash deficit (i.e., the negative of Net Income with Depreciation removed).

TABLE N - 21 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO A PROJECTIONS -- LOWER RENT

INCOME STATEMENT

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	11	12	13	14	15	16	17	18	19	20
REVENUES:										
OPERATING INCOME /1	17,677	19,091	20,619	22,268	24,050	25,974	28,052	30,296	32,719	35,337
INTEREST INCOME /2	799	1,531	2,540	3,879	5,606	7,791	10,513	13,867	17,960	22,918
TOTAL REVENUES	18,476	20,622	23,159	26,147	29,656	33,764	38,565	44,162	50,679	58,255
COSTS:										
SALARIES /3	2,445	2,640	2,852	3,080	3,326	3,592	3,880	4,190	4,525	4,887
PAYROLL BURDEN /4	733	792	856	924	998	1,078	1,164	1,257	1,358	1,466
OVERHEAD /5	1,834	1,980	2,139	2,310	2,495	2,694	2,910	3,143	3,394	3,665
PROMOTION	1,299	1,403	1,515	1,636	1,767	1,908	2,061	2,226	2,404	2,596
MAINTENANCE /6	1,681	1,816	1,961	2,118	2,288	2,471	2,668	2,882	3,112	3,361
DEPRECIATION	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861
INTEREST	3,294	2,947	2,601	2,254	1,907	1,560	1,214	867	520	173
TOTAL OPERATING COSTS	13,148	13,440	13,784	14,183	14,642	15,165	15,757	16,425	17,174	18,011
NET INCOME	5,328	7,182	9,375	11,964	15,014	18,600	22,807	27,737	33,505	40,244
ANNUAL WORKING CAPITAL REQUIREMENT /7										

NOTES:

1/ Operating Income is the rental revenue from leasing buildings.

2/ Interest Income equals) on the previous year's cumulative surplus. The Cumulative Surplus is shown in the Balance Sheet as Current Assets. Implicitly this item for Interest Income represents reinvestment of the surplus at the cost of capital.

3/ Assumes Staffing as shown below at the following annual rates, including payroll burden:

Years 1-5:	Years 6-20 add:
General Manager	
Secretary	
Maintenance Engineer	
Security (8)	

4/ Payroll Burden Assumed:

5/ Overhead includes insurance, legal/accounting fees, utilities and supplies. Overhead Factor @ of wage bill.

6/ Maintenance is estimated at 1% of total physical assets through year 10, and 2% thereafter.

7/ Working Capital Requirement is the funding needed to cover the cash deficit (i.e., the negative of Net Income with Depreciation removed).

TABLE N - 22
EL SALVADOR FREE ZONE -- SCENARIO A PROJECTIONS -- LOWER RENT

C A S H F L O W S T A T E M E N T

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
SOURCES OF FUNDS:										
NET INCOME	(2,083)	(2,841)	(2,805)	(2,710)	(1,207)	(379)	509	1,596	3,015	4,444
DEPRECIATION	366	854	1,323	1,861	1,861	1,861	1,861	1,861	1,861	1,861
FINANCING FOR PHYSICAL ASSETS:										
EQUITY	5,140	2,140	2,140	2,140						
LONG-TERM LOAN	6,362	9,196	8,742	10,374						
FINANCING FOR WORKING CAPITAL:										
EQUITY	1,073	1,242	927	530						
WORKING CAPITAL LOAN	3,219	3,725	2,780	1,591						
TOTAL SOURCES	14,076	14,315	13,106	13,787	655	1,482	2,370	3,458	4,876	6,305
USES OF FUNDS:										
LAND ACQUISITION & DEVELOPMENT	4,180	1,574	1,511	1,737						
CONSTRUCTION	7,321	9,761	9,371	10,777						
LONG-TERM LOAN AMORTIZATION						2,312	2,312	2,312	2,312	2,312
WORKING CAPITAL LOAN AMORTIZATION	1,257	1,257	1,257	1,257	1,257	1,257	1,257	1,257	1,257	
TOTAL USES	12,759	12,592	12,139	13,771	1,257	3,569	3,569	3,569	3,569	2,312
ANNUAL SURPLUS/DEFICIT	1,318	1,723	967	16	(603)	(2,087)	(1,199)	(111)	1,307	3,994
CUMULATIVE SURPLUS/DEFICIT	1,318	3,040	4,007	4,023	3,420	1,334	135	24	1,331	5,325

TABLE M - 22 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO A PROJECTIONS -- LOWER RENT

C A S H F L O W S T A T E M E N T

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	11	12	13	14	15	16	17	18	19	20
SOURCES OF FUNDS:										
NET INCOME	5,328	7,182	9,375	11,964	15,014	18,600	22,807	27,737	33,505	40,244
DEPRECIATION	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861
FINANCING FOR PHYSICAL ASSETS:										
EQUITY										
LONG-TERM LOAN										
FINANCING FOR WORKING CAPITAL:										
EQUITY										
WORKING CAPITAL LOAN										
TOTAL SOURCES	7,190	9,043	11,237	13,826	16,876	20,461	24,669	29,599	35,366	42,106
USES OF FUNDS:										
LAND ACQUISITION & DEVELOPMENT										
CONSTRUCTION										
LONG-TERM LOAN AMORTIZATION	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312
WORKING CAPITAL LOAN AMORTIZATION										
TOTAL USES	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312
ANNUAL SURPLUS/DEFICIT	4,878	6,732	8,925	11,514	14,564	18,150	22,357	27,287	33,055	39,794
CUMULATIVE SURPLUS/DEFICIT	10,203	16,935	25,860	37,374	51,938	70,088	92,445	119,732	152,787	192,581

TABLE N - 23
EL SALVADOR FREE ZONE -- SCENARIO A PROJECTIONS -- LOWER RENT

B A L A N C E S H E E T

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
ASSETS:										
CURRENT ASSETS	1,318	3,040	4,007	4,023	3,420	1,334	135	24	1,331	5,325
FIXED ASSETS:										
LAND AND IMPROVEMENTS	4,180	5,754	7,265	9,002	9,002	9,002	9,002	9,002	9,002	9,002
BUILDINGS	7,321	17,082	26,453	37,230	37,230	37,230	37,230	37,230	37,230	37,230
LESS ACCUMULATED DEPRECIATION	(366)	(1,220)	(2,543)	(4,404)	(6,266)	(8,127)	(9,989)	(11,850)	(13,712)	(15,573)
TOTAL FIXED ASSETS	11,135	21,616	31,175	41,828	39,966	38,105	36,243	34,382	32,520	30,659
TOTAL ASSETS	12,453	24,657	35,183	45,851	43,387	39,439	36,378	34,406	33,852	35,984
LIABILITIES:										
CURRENT LIABILITIES										
WORKING CAPITAL DEBT	1,961	4,429	5,952	6,286	5,029	3,772	2,514	1,257		
LONG-TERM DEBT	6,362	15,557	24,300	34,674	34,674	32,362	30,051	27,739	25,428	23,116
TOTAL LIABILITIES	8,323	19,987	30,252	40,960	39,703	36,134	32,565	28,997	25,428	23,116
CAPITAL:										
EQUITY	6,212	9,594	12,660	15,330	15,330	15,330	15,330	15,330	15,330	15,330
RETAINED EARNINGS	(2,083)	(4,923)	(7,729)	(10,439)	(11,646)	(12,025)	(11,517)	(9,920)	(6,906)	(2,462)
TOTAL CAPITAL	4,130	4,670	4,931	4,891	3,684	3,304	3,813	5,409	8,424	12,868
TOTAL LIABILITIES AND CAPITAL	12,453	24,657	35,183	45,851	43,387	39,439	36,378	34,406	33,852	35,984

TABLE H - 23 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO A PROJECTIONS -- LOWER RENT

B A L A N C E S H E E T

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Not

YEAR	11	12	13	14	15	16	17	18	19	20
ASSETS:										
CURRENT ASSETS	10,203	16,935	25,860	37,374	51,938	70,088	92,445	119,732	152,787	192,581
FIXED ASSETS:										
LAND AND IMPROVEMENTS	9,002	9,002	9,002	9,002	9,002	9,002	9,002	9,002	9,002	9,002
BUILDINGS	37,230	37,230	37,230	37,230	37,230	37,230	37,230	37,230	37,230	37,230
LESS ACCUMULATED DEPRECIATION	(17,435)	(19,296)	(21,158)	(23,019)	(24,881)	(26,742)	(28,604)	(30,465)	(32,327)	(34,188)
TOTAL FIXED ASSETS	28,797	26,936	25,074	23,213	21,351	19,490	17,628	15,767	13,905	12,044
TOTAL ASSETS	39,001	43,871	50,934	60,587	73,290	89,578	110,073	135,499	166,692	204,625
LIABILITIES:										
CURRENT LIABILITIES										
WORKING CAPITAL DEBT										
LONG-TERM DEBT	20,804	18,493	16,181	13,870	11,558	9,246	6,935	4,623	2,312	
TOTAL LIABILITIES	20,804	18,493	16,181	13,870	11,558	9,246	6,935	4,623	2,312	
CAPITAL:										
EQUITY	15,330	15,330	15,330	15,330	15,330	15,330	15,330	15,330	15,330	15,330
RETAINED EARNINGS	2,866	10,048	19,423	31,388	46,402	65,001	87,809	115,546	149,051	189,295
TOTAL CAPITAL	18,196	25,378	34,753	46,717	61,731	80,331	103,139	130,876	164,381	204,625
TOTAL LIABILITIES AND CAPITAL	39,001	43,871	50,934	60,587	73,290	89,578	110,073	135,499	166,692	204,625

TABLE M - 24
EL SALVADOR FREE ZONE -- SCENARIO A PROJECTIONS -- LOWER RENT

R A T E O F R E T U R N A N A L Y S I S

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR		1	2	3	4	5	6	7	8	9	10
ON TOTAL INVESTMENT:											
IRR STREAM	(44,020)	(1,092)	137	2,285	4,492	6,704	7,170	7,523	8,075	8,864	9,946
INTERNAL RATE OF RETURN:	10 YRS	10.5%	NET PRESENT VALUE:			10 YRS		(10,981)			
	20 YRS	16.0%				20 YRS		4,232			
ON EQUITY:											
ROE STREAM /2	(11,501)	(1,717)	(1,987)	(1,483)	(849)	655	1,482	2,370	3,458	4,876	6,305
RETURN ON EQUITY:	10 YRS	15.4%	NET PRESENT VALUE:			10 YRS		484			
	20 YRS	20.8%				20 YRS		14,024			

NOTES: 1/ The first column contains the total investment discounted to its present value in the first year, while each column contains the Net Income for that year with Depreciation and Interest added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10 or 20).

2/ The first column contains the equity investment discounted to its present value while each column contains the Retained Earnings for that year with depreciation added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10 or 20).

TABLE N - 24 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO A PROJECTIONS -- LOWER REN

R A T E O F R E T U R N A N A L Y S I S

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Not

YEAR	11	12	13	14	15	16	17	18	19	20
ON TOTAL INVESTMENT:										
IRR STREAM	10,484	11,991	13,837	16,080	18,783	22,022	25,882	30,466	35,887	126,306
ON EQUITY:										
ROE STREAM /2	7,190	9,043	11,237	13,826	16,876	20,461	24,669	29,599	35,366	126,133

NOTES: 1/ The first column contains the total investment discounted to its present value in the first year, while each column contains the Net Income for that year with Depreciation and Interest added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10 or 20).

2/ The first column contains the equity investment discounted to its present value while each column contains the Retained Earnings for that year with depreciation added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10 or 20).

TABLE M - 25
EL SALVADOR FREE ZONE -- SCENARIO A PROJECTIONS -- LOWER RENT

F I N A N C I N G S T R U C T U R E

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
LONG-TERM LOAN:										
PRINCIPAL (B.O.Y.)		6,362	15,557	24,300	34,674	34,674	32,362	30,051	27,739	25,428
DRAWDOWN	6,362	9,196	8,742	10,374						
INTEREST	477	1,644	2,989	4,423	5,201	5,028	4,681	4,334	3,988	3,641
AMORTIZATION /1						2,312	2,312	2,312	2,312	2,312
PRINCIPAL (E.O.Y.)	6,362	15,557	24,300	34,674	34,674	32,362	30,051	27,739	25,428	23,116
EQUITY INVESTMENT	5,140	2,140	2,140	2,140						
WORKING CAPITAL LOAN:										
PRINCIPAL (B.O.Y.)		1,961	4,429	5,952	6,286	5,029	3,772	2,514	1,257	
DRAWDOWN	3,219	3,725	2,780	1,591						
INTEREST	147	479	779	918	849	660	471	283		
AMORTIZATION /1	1,257	1,257	1,257	1,257	1,257	1,257	1,257	1,257	1,257	
PRINCIPAL (E.O.Y.)	1,961	4,429	5,952	6,286	5,029	3,772	2,514	1,257		
EQUITY INVESTMENT /2	1,073	1,242	927	530						
DEBT SERVICE COVERAGE /3	-.58	.04	.45	.68	.92	.77	.86	.99	1.17	1.67
DEBT/EQUITY RATIO /4	2.02	4.28	6.14	8.36	10.78	10.94	8.54	5.36	3.02	1.80

ASSUMPTIONS:

LONG-TERM FINANCING

TOTAL INVESTMENT	C	46,232
OF WHICH: EQUITY	C	11,558
DEBT	C	34,674
ANNUAL INTEREST RATE		15.0%
TERM: INCLUDING GRACE		20 yrs
GRACE PERIOD		5 yrs

WORKING CAPITAL FINANCING

TOTAL INVESTMENT /5	C	15,087
OF WHICH: EQUITY	C	3,772
DEBT	C	11,315
ANNUAL INTEREST RATE		15.0%
TERM: INCLUDING GRACE		6 yrs
GRACE PERIOD		0 yrs

NOTES:

1/ Equal principal repayments are made with interest paid on the average outstanding balance.
2/ Equity is assumed to be the cost of land in year 1 plus equal annual investments of the balance of the 25% of total investment.
3/ Ratio of Net Income plus Interest and Depreciation to Interest and Amortization
4/ Ratio of Total Liabilities to Total Capital.
5/ Total investment in Working Capital is 250% of the Working Capital Requirement defined in the Income Statement.

TABLE [illegible] - 25 (CONTINUED)
EL SALVADOR FREE ZONE - SCENARIO A PROJECTIONS -- LOWER RENT

F I N A N C I N G S T R U C T U R E

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	11	12	13	14	15	16	17	18	19	20
LONG-TERM LOAN:										
PRINCIPAL (B.O.Y.)	23,116	20,804	18,493	16,181	13,870	11,558	9,246	6,935	4,623	2,312
DRAWDOWN										
INTEREST	3,294	2,947	2,601	2,254	1,907	1,560	1,214	867	520	173
AMORTIZATION /1	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312
PRINCIPAL (E.O.Y.)	20,804	18,493	16,181	13,870	11,558	9,246	6,935	4,623	2,312	
EQUITY INVESTMENT										
WORKING CAPITAL LOAN:										
PRINCIPAL (B.O.Y.)										
DRAWDOWN										
INTEREST										
AMORTIZATION /1										
PRINCIPAL (E.O.Y.)										
EQUITY INVESTMENT /2										
DEBT SERVICE COVERAGE /3	1.87	2.28	2.82	3.52	4.45	5.69	7.34	9.59	12.67	17.01
DEBT/EQUITY RATIO /4	1.14	.73	.47	.30	.19	.12	.07	.04	.01	

NOTES:
1/ Equal principal repayments are made with interest paid on the average outstanding balance.
2/ Equity is assumed to be the cost of land in year 1 plus equal annual investments of the balance of the 25% of total investment.
3/ Ratio of Net Income plus Interest and Depreciation to Interest and Amortization
4/ Ratio of Total Liabilities to Total Capital.
5/ Total investment in Wor of the Working Capital Requirement defined in the Income Statement.

TABLE N - 26
EL SALVADOR FREE ZONE -- SCENARIO B PROJECTIONS -- HIGHER INTEREST

FINANCIAL SUMMARY

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
REVENUES	607	2,429	5,157	7,958	10,731	12,280	13,251	14,509	16,105	18,109
NET INCOME	(2,052)	(2,805)	(2,737)	(2,590)	(992)	(7)	1,036	2,321	3,970	5,743
ASSETS	11,858	23,326	33,336	43,754	41,799	38,517	36,279	35,325	36,020	39,451
LIABILITIES	7,927	19,086	28,986	39,490	38,527	35,252	31,977	28,703	25,428	23,116
NET WORTH	3,931	4,241	4,350	4,264	3,272	3,265	4,301	6,622	10,592	16,335

YEAR	11	12	13	14	15	16	17	18	19	20
REVENUES	20,360	22,923	25,974	29,594	33,873	38,921	44,861	51,839	60,022	69,607
NET INCOME	6,993	9,286	12,017	15,261	19,105	23,652	29,023	35,356	42,814	51,585
ASSETS	44,132	51,107	60,812	73,761	90,554	111,895	138,606	171,651	212,153	261,426
LIABILITIES	20,804	18,493	16,181	13,870	11,558	9,246	6,935	4,623	2,312	
NET WORTH	23,328	32,614	44,631	59,892	78,996	102,649	131,672	167,028	209,841	261,426

RETURN ON EQUITY (10 YRS) : 17.4%

FINANCING STRUCTURE:

Long Term Financing		C 46,232	-	$ 9,246
	Of Which: Equity	C 11,558	-	$ 2,312
	Debt	C 34,674	-	$ 6,935
Working Capital Financing		C 11,559	-	$ 2,312
	Of Which: Equity	C 2,890	-	$ 578
	Debt	C 8,669	-	$ 1,734
Total Financing		C 57,791	-	$ 11,558
	Of Which: Equity	C 14,448	-	$ 2,890
	Debt	C 43,344	-	$ 8,669

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TABLE M - 27
EL SALVADOR FREE ZONE -- SCENARIO B PROJECTIONS -- HIGHER INTEREST

CONSTRUCTION SCHEDULE AND REVENUE PROJECTIONS

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
ANNUAL INFLATION RATE	.0%	20.0%	20.0%	15.0%	15.0%	15.0%	10.0%	10.0%	10.0%	10.0%
CUMULATIVE INFLATION FACTOR	1.00	1.20	1.44	1.66	1.90	2.19	2.41	2.65	2.91	3.21
EFFECTIVE ANNUAL INFLATION RATE	10.7%									
DEVELOPMENT COSTS, OF WHICH:										
LAND VALUE /1	3,000									
LAND DEVELOPMENT COSTS /2	1,180	1,674	1,511	1,737						
CONSTRUCTION COST /2	6,656	8,874	8,519	9,797						
CONTINGENCY /3	666	887	852	980						
TOTAL DEVELOPMENT COST	11,501	11,335	10,882	12,514						
DEPRECIATION:										
CUMULATIVE TOTAL INVESTMENT /4	11,501	22,836	33,718	46,232	46,232	53,167	58,484	64,332	70,765	77,842
DEPRECIABLE ASSETS /5	7,321	17,082	26,453	37,230	37,230	37,230	37,230	37,230	37,230	37,230
ANNUAL DEPRECIATION /6	366	854	1,323	1,861	1,861	1,861	1,861	1,861	1,861	1,861
ACCUMULATED DEPRECIATION	366	1,220	2,543	4,404	6,266	8,127	9,989	11,850	13,712	15,573
SPACE AVAILABLE & REVENUE PROJECTION:										
ANNUAL NEW CONSTRUCTION (m2)	9,000	10,000	8,000	8,000	0					
ADMINISTRATION BUILDING	500									
CUMULATIVE SPACE AVAILABLE (m2)	4,250	13,500	22,500	30,500	34,500	34,500	34,500	34,500	34,500	34,500
AVERAGE OCCUPANCY RATE	90.0%	90.0%	95.0%	95.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
RENTAL RATE (C/M2/MONTH) /7	13.22	15.86	19.04	21.89	25.18	28.95	31.85	35.03	38.54	42.39
ANNUAL REVENUE /8	607	2,313	4,883	7,612	10,423	11,986	13,185	14,504	15,954	17,549

NOTES:

1/ 20 Hectares total area @ C15 per m2)
2/ Unit construction costs: C. 739.50 for SFBs & C. 45.90 for land development; inclusive of architectural and engineering charges.
3/ Physical contingency allows 10.0% over SFB construction costs.
4/ Total cumulative investment; after Year 5 adjusted to current value according to inflation.
5/ Total cost of buildings and structures.
6/ Depreciation over 20 years by the straight line method.
7/ Annual rental rate, adjusted for inflation. The exchange rate used is C 5.00/US$ 1.0 for the rental payments, which are denominated in US$.
8/ Assumes an exchange rate of C5.00/US$ 1.0 on rental revenue.

TABLE [illegible] - 27 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO B PROJECTIONS -- HIGHER INTEREST

CONSTRUCTION SCHEDULE AND REVENUE PROJECTIONS

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Not

YEAR	11	12	13	14	15	16	17	18	19	20
ANNUAL INFLATION RATE	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
CUMULATIVE INFLATION FACTOR	3.46	3.74	4.04	4.36	4.71	5.09	5.50	5.93	6.41	6.92
EFFECTIVE ANNUAL INFLATION RATE										
DEVELOPMENT COSTS, OF WHICH:										
LAND VALUE /1										
LAND DEVELOPMENT COSTS /2										
CONSTRUCTION COST /2										
CONTINGENCY /3										
TOTAL DEVELOPMENT COST										
DEPRECIATION:										
CUMULATIVE TOTAL INVESTMENT /4	84,069	90,795	98,058	105,903	114,375	123,525	133,407	144,080	155,606	168,054
DEPRECIABLE ASSETS /5	37,230	37,230	37,230	37,230	37,230	37,230	37,230	37,230	37,230	37,230
ANNUAL DEPRECIATION /6	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861
ACCUMULATED DEPRECIATION	17,435	19,296	21,158	23,019	24,881	26,742	28,604	30,465	32,327	34,188
SPACE AVAILABLE & REVENUE PROJECTION:										
ANNUAL NEW CONSTRUCTION (m2)										
ADMINISTRATION BUILDING										
CUMULATIVE SPACE AVAILABLE (m2)	34,500	34,500	34,500	34,500	34,500	34,500	34,500	34,500	34,500	34,500
AVERAGE OCCUPANCY RATE	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
RENTAL RATE (C/M2/MONTH) /7	45.78	49.44	53.40	57.67	62.28	67.27	72.65	78.46	84.74	91.52
ANNUAL REVENUE /8	18,953	20,469	22,107	23,876	25,786	27,848	30,076	32,482	35,081	37,888

NOTES:

1/ 20 Hectares total area @ C15 per m2)
2/ Unit construction co for land development; inclusive of architectural and engineering charges.
3/ Physical contingency over SFB construction costs.
4/ Total cumulative investment; after Year 5 adjusted to current value according to inflation.
5/ Total cost of buildings and structures.
6/ Depreciation over 20 years by the straight line method.
7/ Annual rental rate, adjusted for inflation. The exchange rate used is C 5.00/US$ 1.0 for the rental payments, which are denominated in US$.
8/ Assumes an exchange rate of C5.00/US$ 1.0 on rental revenue.

TABLE N- 28
EL SALVADOR FREE ZONE -- SCENARIO B PROJECTIONS -- HIGHER INTEREST

I N C O M E S T A T E M E N T

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
REVENUES:										
OPERATING INCOME /1	607	2,313	4,883	7,612	10,423	11,986	13,185	14,504	15,954	17,549
INTEREST INCOME /2		116	274	346	308	293	66	6	151	560.
TOTAL REVENUES	607	2,429	5,157	7,958	10,731	12,280	13,251	14,509	16,105	18,109
COSTS:										
SALARIES /3	626	751	901	1,037	1,192	1,546	1,701	1,871	2,058	2,264
PAYROLL BURDEN /4	188	225	270	311	358	464	510	561	617	679
OVERHEAD /5	470	563	676	777	894	1,160	1,276	1,403	1,543	1,698
PROMOTION	375	450	540	621	714	821	903	994	1,093	1,202
MAINTENANCE /6		228	337	462	462	532	585	643	708	778
DEPRECIATION	366	854	1,323	1,861	1,861	1,861	1,861	1,861	1,861	1,861
INTEREST	634	2,161	3,846	5,478	6,241	5,902	5,378	4,854	4,253	3,883
TOTAL OPERATING COSTS	2,659	5,233	7,894	10,548	11,723	12,286	12,215	12,188	12,134	12,367
NET INCOME	(2,052)	(2,805)	(2,737)	(2,590)	(992)	(7)	1,036	2,321	3,970	5,743
ANNUAL WORKING CAPITAL REQUIREMENT /7	1,686	1,951	1,414	729						

NOTES:

1/ Operating Income is the rental revenue from leasing buildings.

2/ Interest Income equals the interest (at 16.0%) on the previous year's cumulative surplus. The Cumulative Surplus is shown in the Balance Sheet as Current Assets. Implicitly this item for Interest Income represents reinvestment of the surplus at the cost of capital.

3/ Assumes Staffing as shown below at the following annual rates, including payroll burden:

Years 1-5:		Years 6-20 add:	
General Manager	200	Administrative Assistant	30
Secretary	30	Second Secretary	10
Maintenance Engineer	36	4 Additional Security	40
Security (8)	360		

4/ Payroll Burden Assumed: 30.0%

5/ Overhead includes insurance, legal/accounting fees, utilities and supplies.
Overhead Factor @ 75.0% of wage bill.

6/ Maintenance is estimated at 1% of total physical assets through year 10, and 2% thereafter.

7/ Working Capital Requirement is the funding needed to cover the cash deficit (i.e., the negative of Net Income with Depreciation removed).

TABLE M - 28 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO B PROJECTIONS -- HIGHER INTEREST

INCOME STATEMENT

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	11	12	13	14	15	16	17	18	19	20
REVENUES:										
OPERATING INCOME /1	18,953	20,469	22,107	23,876	25,786	27,848	30,076	32,482	35,081	37,888
INTEREST INCOME /2	1,407	2,454	3,867	5,718	8,088	11,072	14,785	19,358	24,941	31,720
TOTAL REVENUES	20,360	22,923	25,974	29,594	33,873	38,921	44,861	51,839	60,022	69,607
COSTS:										
SALARIES /3	2,445	2,640	2,852	3,080	3,326	3,592	3,880	4,190	4,525	4,887
PAYROLL BURDEN /4	733	792	856	924	998	1,078	1,164	1,257	1,358	1,466
OVERHEAD /5	1,834	1,980	2,139	2,310	2,495	2,694	2,910	3,143	3,394	3,665
PROMOTION	1,299	1,403	1,515	1,636	1,767	1,908	2,061	2,226	2,404	2,596
MAINTENANCE /6	1,681	1,816	1,961	2,118	2,288	2,471	2,668	2,882	3,112	3,361
DEPRECIATION	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861
INTEREST	3,514	3,144	2,774	2,404	2,034	1,664	1,294	925	555	185
TOTAL OPERATING COSTS	13,367	13,637	13,957	14,333	14,769	15,269	15,838	16,483	17,209	18,022
NET INCOME	6,993	9,286	12,017	15,261	19,105	23,652	29,023	35,356	42,814	51,585
ANNUAL WORKING CAPITAL REQUIREMENT /7										

NOTES:

1/ Operating Income is the rental revenue from leasing buildings.

2/ Interest Income equals) on the previous year's cumulative surplus.
The Cumulative Surplus is shown in the Balance Sheet as Current Assets. Implicitly this item for Interest Income represents reinvestment of the surplus at the cost of capital.

3/ Assumes Staffing as shown below at the following annual rates, including payroll burden:
Years 1-5: Years 6-20 add:
General Manager
Secretary
Maintenance Engineer
Security (8)

4/ Payroll Burden Assumed:

5/ Overhead includes insurance, legal/accounting fees, utilities and supplies.
Overhead Factor @ of wage bill.

6/ Maintenance is estimated at 1% of total physical assets through year 10, and 2% thereafter.

7/ Working Capital Requirement is the funding needed to cover the cash deficit (i.e., the negative of Net Income with Depreciation removed).

TABLE M - 29
EL SALVADOR FREE ZONE -- SCENARIO B PROJECTIONS -- HIGHER INTEREST

C A S H F L O W S T A T E M E N T

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
SOURCES OF FUNDS:										
NET INCOME	(2,052)	(2,805)	(2,737)	(2,590)	(992)	(7)	1,036	2,321	3,970	5,743
DEPRECIATION	366	854	1,323	1,861	1,861	1,861	1,861	1,861	1,861	1,861
FINANCING FOR PHYSICAL ASSETS:										
EQUITY	5,140	2,140	2,140	2,140						
LONG-TERM LOAN	6,362	9,196	8,742	10,374						
FINANCING FOR WORKING CAPITAL:										
EQUITY	843	975	707	364						
WORKING CAPITAL LOAN	2,528	2,926	2,122	1,093						
TOTAL SOURCES	13,187	13,286	12,296	13,243	869	1,855	2,898	4,182	5,832	7,604
USES OF FUNDS:										
LAND ACQUISITION & DEVELOPMENT	4,180	1,574	1,511	1,737						
CONSTRUCTION	7,321	9,761	9,371	10,777						
LONG-TERM LOAN AMORTIZATION						2,312	2,312	2,312	2,312	2,312
WORKING CAPITAL LOAN AMORTIZATION	963	963	963	963	963	963	963	963	963	
TOTAL USES	12,465	12,298	11,845	13,477	963	3,275	3,275	3,275	3,275	2,312
ANNUAL SURPLUS/DEFICIT	722	988	451	(234)	(94)	(1,420)	(377)	908	2,557	5,293
CUMULATIVE SURPLUS/DEFICIT	722	1,710	2,161	1,927	1,833	412	35	943	3,500	8,792

TABLE M - 29 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO B PROJECTIONS -- HIGHER INTEREST

CASH FLOW STATEMENT

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	11	12	13	14	15	16	17	18	19	20
SOURCES OF FUNDS:										
NET INCOME	6,993	9,286	12,017	15,261	19,105	23,652	29,023	35,356	42,814	51,585
DEPRECIATION	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861	1,861
FINANCING FOR PHYSICAL ASSETS:										
EQUITY										
LONG-TERM LOAN										
FINANCING FOR WORKING CAPITAL:										
EQUITY										
WORKING CAPITAL LOAN										
TOTAL SOURCES	8,854	11,148	13,879	17,122	20,966	25,514	30,884	37,217	44,675	53,446
USES OF FUNDS:										
LAND ACQUISITION & DEVELOPMENT										
CONSTRUCTION										
LONG-TERM LOAN AMORTIZATION	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312
WORKING CAPITAL LOAN AMORTIZATION										
TOTAL USES	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312
ANNUAL SURPLUS/DEFICIT	6,543	8,836	11,567	14,810	18,655	23,202	28,573	34,906	42,363	51,135
CUMULATIVE SURPLUS/DEFICIT	15,335	24,171	35,738	50,549	69,203	92,405	120,978	155,884	198,247	249,382

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TABLE H - 30
EL SALVADOR FREE ZONE -- SCENARIO B PROJECTIONS -- HIGHER INTEREST

B A L A N C E S H E E T

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
ASSETS:										
CURRENT ASSETS	722	1,710	2,161	1,927	1,833	412	35	943	3,500	8,792
FIXED ASSETS:										
LAND AND IMPROVEMENTS	4,180	5,754	7,265	9,002	9,002	9,002	9,002	9,002	9,002	9,002
BUILDINGS	7,321	17,082	26,453	37,230	37,230	37,230	37,230	37,230	37,230	37,230
LESS ACCUMULATED DEPRECIATION	(366)	(1,220)	(2,543)	(4,404)	(6,266)	(8,127)	(9,989)	(11,850)	(13,712)	(15,573)
TOTAL FIXED ASSETS	11,135	21,616	31,175	41,828	39,966	38,105	36,243	34,382	32,520	30,659
TOTAL ASSETS	11,858	23,326	33,336	43,754	41,799	38,517	36,279	35,325	36,020	39,451
LIABILITIES:										
CURRENT LIABILITIES										
WORKING CAPITAL DEBT	1,565	3,528	4,686	4,816	3,853	2,890	1,927	963		
LONG-TERM DEBT	6,362	15,557	24,300	34,674	34,674	32,362	30,051	27,739	25,428	23,116
TOTAL LIABILITIES	7,927	19,086	28,986	39,490	38,527	35,252	31,977	28,703	25,428	23,116
CAPITAL:										
EQUITY	5,982	9,097	11,944	14,448	14,448	14,448	14,448	14,448	14,448	14,448
RETAINED EARNINGS	(2,052)	(4,857)	(7,594)	(10,184)	(11,176)	(11,183)	(10,147)	(7,826)	(3,856)	1,887
TOTAL CAPITAL	3,931	4,241	4,350	4,264	3,272	3,265	4,301	6,622	10,592	16,335
TOTAL LIABILITIES AND CAPITAL	11,858	23,326	33,336	43,754	41,799	38,517	36,279	35,325	36,020	39,451

TABLE N - 30 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO B PROJECTIONS -- HIGHER INTEREST

B A L A N C E S H E E T

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Not

YEAR	11	12	13	14	15	16	17	18	19	20
ASSETS:										
CURRENT ASSETS	15,335	24,171	35,738	50,549	69,203	92,405	120,978	155,884	198,247	249,382
FIXED ASSETS:										
LAND AND IMPROVEMENTS	9,002	9,002	9,002	9,002	9,002	9,002	9,002	9,002	9,002	9,002
BUILDINGS	37,230	37,230	37,230	37,230	37,230	37,230	37,230	37,230	37,230	37,230
LESS ACCUMULATED DEPRECIATION	(17,435)	(19,296)	(21,158)	(23,019)	(24,881)	(26,742)	(28,604)	(30,465)	(32,327)	(34,188)
TOTAL FIXED ASSETS	28,797	26,936	25,074	23,213	21,351	19,490	17,628	15,767	13,905	12,044
TOTAL ASSETS	44,132	51,107	60,812	73,761	90,554	111,895	138,606	171,651	212,153	261,426
LIABILITIES:										
CURRENT LIABILITIES										
WORKING CAPITAL DEBT										
LONG-TERM DEBT	20,804	18,493	16,181	13,870	11,558	9,246	6,935	4,623	2,312	
TOTAL LIABILITIES	20,804	18,493	16,181	13,870	11,558	9,246	6,935	4,623	2,312	
CAPITAL:										
EQUITY	14,448	14,448	14,448	14,448	14,448	14,448	14,448	14,448	14,448	14,448
RETAINED EARNINGS	8,880	18,166	30,183	45,444	64,549	88,201	117,224	152,580	195,393	246,978
TOTAL CAPITAL	23,328	32,614	44,631	59,892	78,996	102,649	131,672	167,028	209,841	261,426
TOTAL LIABILITIES AND CAPITAL	44,132	51,107	60,812	73,761	90,554	111,895	138,606	171,651	212,153	261,426

TABLE N - 31
EL SALVADOR FREE ZONE -- SCENARIO B PROJECTIONS -- HIGHER INTEREST

RATE OF RETURN ANALYSIS

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR		1	2	3	4	5	6	7	8	9	10
ON TOTAL INVESTMENT:											
IRR STREAM	(40,645)	(1,052)	210	2,431	4,749	7,111	7,757	8,276	9,037	10,085	11,488
INTERNAL RATE OF RETURN:	10 YRS	12.5%		NET PRESENT VALUE:		10 YRS		(7,822)			
	20 YRS	18.1%				20 YRS		8,606			
ON EQUITY:											
ROE STREAM /2	(10,679)	(1,686)	(1,951)	(1,414)	(729)	869	1,855	2,898	4,162	5,832	7,604
RETURN ON EQUITY:	10 YRS	17.4%		NET PRESENT VALUE:		10 YRS		1,541			
	20 YRS	23.2%				20 YRS		16,401			

NOTES: 1/ The first column contains the total investment discounted to its present value in the first year, while each column contains the Net Income for that year with Depreciation and Interest added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10 or 20).

2/ The first column contains the equity investment discounted to its present value while each column contains the Retained Earnings for that year with depreciation added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10 or 20).

TABLE [redacted] - 31 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO B PROJECTIONS -- HIGHER INTEREST

R A T E O F R E T U R N A N A L Y S I S

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Not

YEAR	11	12	13	14	15	16	17	18	19	20
ON TOTAL INVESTMENT:										
IRR STREAM	12,368	14,292	16,653	19,526	23,000	27,178	32,179	38,142	45,230	137,658
ON EQUITY:										
RDE STREAM /2	8,854	11,148	13,879	17,122	20,966	25,514	30,884	37,217	44,675	137,473

NOTES: 1/ The first column contains the total investment discounted to its present value in the first year, while each column contains the Net Income for that year with Depreciation and Interest added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10 or 20).

2/ The first column contains the equity investment discounted to its present value while each column contains the Retained Earnings for that year with depreciation added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10 or 20).

TABLE [illegible] - 32
EL SALVADOR FREE ZONE -- SCENARIO B PROJECTIONS -- HIGHER INTEREST

F I N A N C I N G S T R U C T U R E

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
LONG-TERM LOAN:										
PRINCIPAL (B.O.Y.)		6,362	15,557	24,300	34,674	34,674	32,362	30,051	27,739	25,428
DRAWDOWN	6,362	9,196	8,742	10,374						
INTEREST	509	1,754	3,189	4,718	5,548	5,363	4,993	4,623	4,253	3,883
AMORTIZATION /1						2,312	2,312	2,312	2,312	2,312
PRINCIPAL (E.O.Y.)	6,362	15,557	24,300	34,674	34,674	32,362	30,051	27,739	25,428	23,116
EQUITY INVESTMENT	5,140	2,140	2,140	2,140						
WORKING CAPITAL LOAN:										
PRINCIPAL (B.O.Y.)		1,565	3,526	4,686	4,816	3,853	2,890	1,927	963	
DRAWDOWN	2,528	2,926	2,122	1,093						
INTEREST	125	407	657	760	694	539	385	231		
AMORTIZATION /1	963	963	963	963	963	963	963	963	963	
PRINCIPAL (E.O.Y.)	1,565	3,528	4,686	4,816	3,853	2,890	1,927	963		
EQUITY INVESTMENT /2	843	975	707	364						
DEBT SERVICE COVERAGE /3	-.66	.07	.51	.74	.99	.85	.96	1.11	1.34	1.85
DEBT/EQUITY RATIO /4	2.02	4.50	6.66	9.26	11.78	10.80	7.43	4.33	2.40	1.42

ASSUMPTIONS:

LONG-TERM FINANCING

TOTAL INVESTMENT	C	46,232
OF WHICH: EQUITY	C	11,558
DEBT	C	34,674
ANNUAL INTEREST RATE		16.0%
TERM: INCLUDING GRACE		20 yrs
GRACE PERIOD		5 yrs

WORKING CAPITAL FINANCING

TOTAL INVESTMENT /5	C	11,559
OF WHICH: EQUITY	C	2,890
DEBT	C	8,669
ANNUAL INTEREST RATE		16.0%
TERM: INCLUDING GRACE		5 yrs
GRACE PERIOD		0 yrs

NOTES:

1/ Equal principal repayments are made with interest paid on the average outstanding balance.
2/ Equity is assumed to be the cost of land in year 1 plus equal annual investments of the balance of the 25% of total investment.
3/ Ratio of Net Income plus Interest and Depreciation to Interest and Amortization
4/ Ratio of Total Liabilities to Total Capital.
5/ Total investment in Working Capital is 200% of the Working Capital Requirement defined in the Income Statement.

TABLE M - 32 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO B PROJECTIONS -- HIGHER INTEREST

F I N A N C I N G S T R U C T U R E

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	11	12	13	14	15	16	17	18	19	20
LONG-TERM LOAN:										
PRINCIPAL (B.O.Y.)	23,116	20,804	18,493	16,181	13,870	11,558	9,246	6,935	4,623	2,312
DRAWDOWN										
INTEREST	3,514	3,144	2,774	2,404	2,034	1,664	1,294	925	555	185
AMORTIZATION /1	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312	2,312
PRINCIPAL (E.O.Y.)	20,804	18,493	16,181	13,870	11,558	9,246	6,935	4,623	2,312	
EQUITY INVESTMENT										
WORKING CAPITAL LOAN:										
PRINCIPAL (B.O.Y.)										
DRAWDOWN										
INTEREST										
AMORTIZATION /1										
PRINCIPAL (E.O.Y.)										
EQUITY INVESTMENT /2										
DEBT SERVICE COVERAGE /3	2.12	2.62	3.27	4.14	5.29	6.84	8.92	11.79	15.78	21.48
DEBT/EQUITY RATIO /4	.89	.57	.36	.23	.15	.09	.05	.03	.01	

NOTES:
1/ Equal principal repayments are made with interest paid on the average outstanding balance.
2/ Equity is assumed to be the cost of land in year 1 plus equal annual investments of the balance of the 25% of total investment.
3/ Ratio of Net Income plus Interest and Depreciation to Interest and Amortization
4/ Ratio of Total Liabilities to Total Capital.
5/ Total investment in Wor of the Working Capital Requirement defined in the Income Statement.

TABLE H - 33
EL SALVADOR FREE ZONE -- SCENARIO C PROJECTIONS -- STEEL BUILDINGS

FINANCIAL SUMMARY

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
REVENUES	607	2,371	5,007	7,736	10,466	12,188	13,383	14,871	16,701	18,938
NET INCOME	(1,935)	(2,466)	(2,168)	(1,751)	(78)	994	2,150	3,553	5,293	7,256
ASSETS	10,958	21,151	30,056	39,436	38,787	37,052	36,472	37,295	39,858	44,954
LIABILITIES	7,304	17,341	26,082	35,247	34,677	31,947	29,217	26,487	23,758	21,598
NET WORTH	3,654	3,810	3,974	4,189	4,111	5,105	7,254	10,808	16,101	23,356

YEAR	11	12	13	14	15	16	17	18	19	20
REVENUES	21,362	24,115	27,356	31,161	35,616	40,821	46,893	53,963	62,184	71,733
NET INCOME	8,694	11,140	14,024	17,417	21,402	26,073	31,542	37,936	45,400	54,106
ASSETS	51,488	60,468	72,332	87,589	106,831	130,744	160,127	195,903	239,143	291,090
LIABILITIES	19,438	17,278	15,119	12,959	10,799	8,639	6,479	4,320	2,160	
NET WORTH	32,050	43,190	57,213	74,630	96,032	122,105	153,647	191,583	236,983	291,090

RETURN ON EQUITY (10 YRS) : 20.8%

FINANCING STRUCTURE:

Long Term Financing		C 43,196	-	$ 8,639
	Of Which: Equity	C 10,799	-	$ 2,160
	Debt	C 32,397	-	$ 6,479
Working Capital Financing		C 6,840	-	$ 1,368
	Of Which: Equity	C 1,710	-	$ 342
	Debt	C 5,130	-	$ 1,026
Total Financing		C 50,036	-	$ 10,007
	Of Which: Equity	C 12,509	-	$ 2,502
	Debt	C 37,527	-	$ 7,505

TABLE M - 34
EL SALVADOR FREE ZONE -- SCENARIO C PROJECTIONS -- STEEL BUILDINGS

CONSTRUCTION SCHEDULE AND REVENUE PROJECTIONS

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
ANNUAL INFLATION RATE	.0%	20.0%	20.0%	15.0%	15.0%	15.0%	10.0%	10.0%	10.0%	10.0%
CUMULATIVE INFLATION FACTOR	1.00	1.20	1.44	1.66	1.90	2.19	2.41	2.65	2.91	3.21
EFFECTIVE ANNUAL INFLATION RATE	10.7%									
DEVELOPMENT COSTS, OF WHICH:										
LAND VALUE /1	3,000									
LAND DEVELOPMENT COSTS /2	1,180	1,574	1,511	1,737						
CONSTRUCTION COST /2	6,113	8,150	7,824	8,998						
CONTINGENCY /3	611	815	782	900						
TOTAL DEVELOPMENT COST	10,904	10,539	10,117	11,635						
DEPRECIATION:										
CUMULATIVE TOTAL INVESTMENT /4	10,904	21,443	31,561	43,196	43,196	49,675	54,643	60,107	66,118	72,729
DEPRECIABLE ASSETS /5	6,724	15,689	24,296	34,194	34,194	34,194	34,194	34,194	34,194	34,194
ANNUAL DEPRECIATION /6	336	784	1,215	1,710	1,710	1,710	1,710	1,710	1,710	1,710
ACCUMULATED DEPRECIATION	336	1,121	2,335	4,045	5,755	7,465	9,174	10,884	12,594	14,303
SPACE AVAILABLE & REVENUE PROJECTION:										
ANNUAL NEW CONSTRUCTION (m2)	9,000	10,000	8,000	8,000	0					
ADMINISTRATION BUILDING	500									
CUMULATIVE SPACE AVAILABLE (m2)	4,250	13,500	22,500	30,500	34,500	34,500	34,500	34,500	34,500	34,500
AVERAGE OCCUPANCY RATE	90.0%	90.0%	95.0%	95.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
RENTAL RATE (C/M2/MONTH) /7	13.22	15.86	19.04	21.89	25.18	28.95	31.85	35.03	38.54	42.39
ANNUAL REVENUE /8	607	2,313	4,883	7,612	10,423	11,986	13,185	14,504	15,954	17,549

NOTES:

1/ 20 Hectares total area @ C15 per m2)
2/ Unit construction costs: C. 679.19 for SFBs & C. 45.90 for land development; inclusive of architectural and engineering charges.
3/ Physical contingency allows 10.0% over SFB construction costs.
4/ Total cumulative investment; after Year 5 adjusted to current value according to inflation.
5/ Total cost of buildings and structures.
6/ Depreciation over 20 years by the straight line method.
7/ Annual rental rate, adjusted for inflation. The exchange rate used is C 5.00/US$ 1.0 for the rental payments, which are denominated in US$.
8/ Assumes an exchange rate of C5.00/US$ 1.0 on rental revenue.

TABLE H - 34 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO C PROJECTIONS -- STEEL BUILDINGS

CONSTRUCTION SCHEDULE AND REVENUE PROJECTIONS

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Not

YEAR	11	12	13	14	15	16	17	18	19	20
ANNUAL INFLATION RATE	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
CUMULATIVE INFLATION FACTOR	3.46	3.74	4.04	4.36	4.71	5.09	5.50	5.93	6.41	6.92
EFFECTIVE ANNUAL INFLATION RATE										
DEVELOPMENT COSTS, OF WHICH:										
LAND VALUE /1										
LAND DEVELOPMENT COSTS /2										
CONSTRUCTION COST /2										
CONTINGENCY /3										
TOTAL DEVELOPMENT COST										
DEPRECIATION:										
CUMULATIVE TOTAL INVESTMENT /4	78,548	84,832	91,618	98,948	106,863	115,413	124,646	134,617	145,387	157,017
DEPRECIABLE ASSETS /5	34,194	34,194	34,194	34,194	34,194	34,194	34,194	34,194	34,194	34,194
ANNUAL DEPRECIATION /6	1,710	1,710	1,710	1,710	1,710	1,710	1,710	1,710	1,710	1,710
ACCUMULATED DEPRECIATION	16,013	17,723	19,432	21,142	22,852	24,561	26,271	27,981	29,690	31,400
SPACE AVAILABLE & REVENUE PROJECTION:										
ANNUAL NEW CONSTRUCTION (m2)										
ADMINISTRATION BUILDING										
CUMULATIVE SPACE AVAILABLE (m2)	34,500	34,500	34,500	34,500	34,500	34,500	34,500	34,500	34,500	34,500
AVERAGE OCCUPANCY RATE	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
RENTAL RATE (C/M2/MONTH) /7	45.78	49.44	53.40	57.67	62.28	67.27	72.65	78.46	84.74	91.52
ANNUAL REVENUE /8	18,953	20,469	22,107	23,876	25,786	27,848	30,076	32,482	35,081	37,888

NOTES:

1/ 20 Hectares total area @ C15 per m2)
2/ Unit construction co for land development; inclusive of architectural and engineering charges.
3/ Physical contingency over SFB construction costs.
4/ Total cumulative investment; after Year 5 adjusted to current value according to inflation.
5/ Total cost of buildings and structures.
6/ Depreciation over 20 years by the straight line method.
7/ Annual rental rate, adjusted for inflation. The exchange rate used is C 5.00/US$ 1.0 for the rental payments, which are denominated in US$.
8/ Assumes an exchange rate of C5.00/US$ 1.0 on rental revenue.

TABLE N- 35
EL SALVADOR FREE ZONE -- SCENARIO C PROJECTIONS -- STEEL BUILDINGS

I N C O M E S T A T E M E N T

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
REVENUES:										
OPERATING INCOME /1	607	2,313	4,883	7,612	10,423	11,986	13,185	14,504	15,954	17,549
INTEREST INCOME /2		58	124	125	43	202	198	367	747	1,388
TOTAL REVENUES	607	2,371	5,007	7,736	10,466	12,188	13,383	14,871	16,701	18,938
COSTS:										
SALARIES /3	626	751	901	1,037	1,192	1,546	1,701	1,871	2,058	2,264
PAYROLL BURDEN /4	188	225	270	311	358	464	510	561	617	679
OVERHEAD /5	470	563	676	777	894	1,160	1,276	1,403	1,543	1,698
PROMOTION	370	400	040	621	714	021	903	994	1,093	1,202
MAINTENANCE /6		214	316	432	432	497	546	601	661	727
DEPRECIATION	336	784	1,215	1,710	1,710	1,710	1,710	1,710	1,710	1,710
INTEREST	548	1,848	3,257	4,600	5,244	4,997	4,587	4,178	3,726	3,402
TOTAL OPERATING COSTS	2,542	4,837	7,175	9,487	10,544	11,194	11,233	11,318	11,408	11,682
NET INCOME	(1,935)	(2,466)	(2,168)	(1,751)	(78)	994	2,150	3,553	5,293	7,256
ANNUAL WORKING CAPITAL REQUIREMENT /7	1,599	1,681	953	41						

NOTES:

1/ Operating Income is the rental revenue from leasing buildings.

2/ Interest Income equals the interest (at 15.0%) on the previous year's cumulative surplus. The Cumulative Surplus is shown in the Balance Sheet as Current Assets. Implicitly this item for Interest Income represents reinvestment of the surplus at the cost of capital.

3/ Assumes Staffing as shown below at the following annual rates, including payroll burden:

Years 1-5:		Years 6-20 add:	
General Manager	200	Administrative Assistant	30
Secretary	30	Second Secretary	10
Maintenance Engineer	36	4 Additional Security	40
Security (8)	360		

4/ Payroll Burden Assumed: 30.0%

5/ Overhead includes insurance, legal/accounting fees, utilities and supplies.
Overhead Factor @ 75.0% of wage bill.

6/ Maintenance is estimated at 1% of total physical assets through year 10, and 2% thereafter.

7/ Working Capital Requirement is the funding needed to cover the cash deficit (i.e., the negative of Net Income with Depreciation removed).

TABLE N - 35 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO C PROJECTIONS -- STEEL BUILDINGS

INCOME STATEMENT

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	11	12	13	14	15	16	17	18	19	20
REVENUES:										
OPERATING INCOME /1	18,953	20,469	22,107	23,876	25,786	27,848	30,076	32,482	35,081	37,888
INTEREST INCOME /2	2,409	3,646	5,249	7,285	9,830	12,973	16,816	21,480	27,103	33,846
TOTAL REVENUES	21,362	24,115	27,356	31,161	35,616	40,821	46,893	53,963	62,184	71,733
COSTS:										
SALARIES /3	2,445	2,640	2,852	3,080	3,326	3,592	3,880	4,190	4,525	4,887
PAYROLL BURDEN /4	733	792	856	924	998	1,078	1,164	1,257	1,358	1,466
OVERHEAD /5	1,834	1,980	2,139	2,310	2,495	2,694	2,910	3,143	3,394	3,665
PROMOTION	1,299	1,403	1,515	1,636	1,767	1,908	2,061	2,226	2,404	2,596
MAINTENANCE /6	1,571	1,697	1,832	1,979	2,137	2,308	2,493	2,692	2,908	3,140
DEPRECIATION	1,710	1,710	1,710	1,710	1,710	1,710	1,710	1,710	1,710	1,710
INTEREST	3,078	2,754	2,430	2,106	1,782	1,458	1,134	810	486	162
TOTAL OPERATING COSTS	12,669	12,975	13,332	13,744	14,214	14,748	15,351	16,027	16,784	17,627
NET INCOME	8,694	11,140	14,024	17,417	21,402	26,073	31,542	37,936	45,400	54,106
ANNUAL WORKING CAPITAL REQUIREMENT /7										

NOTES:

1/ Operating Income is the rental revenue from leasing buildings.

2/ Interest Income equals) on the previous year's cumulative surplus. The Cumulative Surplus is shown in the Balance Sheet as Current Assets. Implicitly this item for Interest Income represents reinvestment of the surplus at the cost of capital.

3/ Assumes Staffing as shown below at the following annual rates, including payroll burden:

Years 1-5:
General Manager
Secretary
Maintenance Engineer
Security (8)

Years 6-20 add:

4/ Payroll Burden Assumed:

5/ Overhead includes insurance, legal/accounting fees, utilities and supplies. Overhead Factor @ of wage bill.

6/ Maintenance is estimated at 1% of total physical assets through year 10, and 2% thereafter.

7/ Working Capital Requirement is the funding needed to cover the cash deficit (i.e., the negative of Net Income with Depreciation removed).

TABLE M - 36
EL SALVADOR FREE ZONE -- SCENARIO C PROJECTIONS -- STEEL BUILDINGS

C A S H F L O W S T A T E M E N T

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
SOURCES OF FUNDS:										
NET INCOME	(1,935)	(2,466)	(2,168)	(1,751)	(78)	994	2,150	3,553	5,293	7,256
DEPRECIATION	336	784	1,215	1,710	1,710	1,710	1,710	1,710	1,710	1,710
FINANCING FOR PHYSICAL ASSETS:										
EQUITY	4,950	1,950	1,950	1,950						
LONG-TERM LOAN	5,955	8,589	8,168	9,685						
FINANCING FOR WORKING CAPITAL:										
EQUITY	640	673	381	17						
WORKING CAPITAL LOAN	1,919	2,0[illegible]	1,144	50						
TOTAL SOURCES	11,864	11,548	10,689	11,660	1,631	2,704	3,859	5,263	7,003	8,966
USES OF FUNDS:										
LAND ACQUISITION & DEVELOPMENT	4,180	1,574	1,511	1,737						
CONSTRUCTION	6,724	8,965	8,607	9,898						
LONG-TERM LOAN AMORTIZATION						2,160	2,160	2,160	2,160	2,160
WORKING CAPITAL LOAN AMORTIZATION	570	570	570	570	570	570	570	570	570	
TOTAL USES	11,474	11,109	10,687	12,205	570	2,730	2,730	2,730	2,730	2,160
ANNUAL SURPLUS/DEFICIT	390	439	2	(545)	1,061	(26)	1,130	2,533	4,273	6,806
CUMULATIVE SURPLUS/DEFICIT	390	828	830	285	1,346	1,320	2,450	4,983	9,256	16,062

TABLE N - 36 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO C PROJECTIONS -- STEEL BUILDINGS

C A S H F L O W S T A T E M E N T

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	11	12	13	14	15	16	17	18	19	20
SOURCES OF FUNDS:										
NET INCOME	8,694	11,140	14,024	17,417	21,402	26,073	31,542	37,936	45,400	54,106
DEPRECIATION	1,710	1,710	1,710	1,710	1,710	1,710	1,710	1,710	1,710	1,710
FINANCING FOR PHYSICAL ASSETS:										
EQUITY										
LONG-TERM LOAN										
FINANCING FOR WORKING CAPITAL:										
EQUITY										
WORKING CAPITAL LOAN										
TOTAL SOURCES	10,403	12,849	15,733	19,127	23,111	27,783	33,252	39,645	47,110	55,816
USES OF FUNDS:										
LAND ACQUISITION & DEVELOPMENT										
CONSTRUCTION										
LONG-TERM LOAN AMORTIZATION	2,160	2,160	2,160	2,160	2,160	2,160	2,160	2,160	2,160	2,160
WORKING CAPITAL LOAN AMORTIZATION										
TOTAL USES	2,160	2,160	2,160	2,160	2,160	2,160	2,160	2,160	2,160	2,160
ANNUAL SURPLUS/DEFICIT	8,243	10,690	13,574	16,967	20,952	25,623	31,092	37,485	44,950	53,656
CUMULATIVE SURPLUS/DEFICIT	24,305	34,995	48,568	65,535	86,487	112,110	143,202	180,687	225,638	279,294

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TABLE M - 37
EL SALVADOR FREE ZONE -- SCENARIO C PROJECTIONS -- STEEL BUILDINGS

B A L A N C E S H E E T

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
ASSETS:										
CURRENT ASSETS	390	828	830	285	1,346	1,320	2,450	4,983	9,256	16,062
FIXED ASSETS:										
LAND AND IMPROVEMENTS	4,180	5,754	7,265	9,002	9,002	9,002	9,002	9,002	9,002	9,002
BUILDINGS	6,724	15,689	24,296	34,194	34,194	34,194	34,194	34,194	34,194	34,194
LESS ACCUMULATED DEPRECIATION	(336)	(1,121)	(2,335)	(4,045)	(5,755)	(7,465)	(9,174)	(10,884)	(12,594)	(14,303)
TOTAL FIXED ASSETS	10,568	20,323	29,225	39,151	37,441	35,731	34,022	32,312	30,602	28,893
TOTAL ASSETS	10,958	21,151	30,056	39,436	38,787	37,052	36,472	37,295	39,858	44,954
LIABILITIES:										
CURRENT LIABILITIES										
WORKING CAPITAL DEBT	1,349	2,797	3,370	2,850	2,280	1,710	1,140	570		
LONG-TERM DEBT	5,955	14,544	22,712	32,397	32,397	30,237	28,077	25,917	23,758	21,598
TOTAL LIABILITIES	7,304	17,341	26,082	35,247	34,677	31,947	29,217	26,487	23,758	21,598
CAPITAL:										
EQUITY	5,589	8,212	10,543	12,509	12,509	12,509	12,509	12,509	12,509	12,509
RETAINED EARNINGS	(1,935)	(4,401)	(6,569)	(8,320)	(8,398)	(7,404)	(5,255)	(1,701)	3,592	10,848
TOTAL CAPITAL	3,654	3,810	3,974	4,189	4,111	5,105	7,254	10,808	16,101	23,356
TOTAL LIABILITIES AND CAPITAL	10,958	21,151	30,056	39,436	38,787	37,052	36,472	37,295	39,858	44,954

TABLE H - 37 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO C PROJECTIONS -- STEEL BUILDINGS

B A L A N C E S H E E T

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Not

YEAR	11	12	13	14	15	16	17	18	19	20
ASSETS:										
CURRENT ASSETS	24,305	34,995	48,568	65,535	86,487	112,110	143,202	180,687	225,638	279,294
FIXED ASSETS:										
LAND AND IMPROVEMENTS	9,002	9,002	9,002	9,002	9,002	9,002	9,002	9,002	9,002	9,002
BUILDINGS	34,194	34,194	34,194	34,194	34,194	34,194	34,194	34,194	34,194	34,194
LESS ACCUMULATED DEPRECIATION	(16,013)	(17,723)	(19,432)	(21,142)	(22,852)	(24,561)	(26,271)	(27,981)	(29,690)	(31,400)
TOTAL FIXED ASSETS	27,183	25,473	23,764	22,054	20,344	18,634	16,925	15,215	13,505	11,796
TOTAL ASSETS	51,488	60,468	72,332	87,589	106,831	130,744	160,127	195,903	239,143	291,090
LIABILITIES:										
CURRENT LIABILITIES										
WORKING CAPITAL DEBT										
LONG-TERM DEBT	19,438	17,278	15,119	12,959	10,799	8,639	6,479	4,320	2,160	
TOTAL LIABILITIES	19,438	17,278	15,119	12,959	10,799	8,639	6,479	4,320	2,160	
CAPITAL:										
EQUITY	12,509	12,509	12,509	12,509	12,509	12,509	12,509	12,509	12,509	12,509
RETAINED EARNINGS	19,541	30,681	44,705	62,121	83,523	109,596	141,139	179,074	224,474	278,581
TOTAL CAPITAL	32,050	43,190	57,213	74,630	96,032	122,105	153,647	191,583	236,983	291,090
TOTAL LIABILITIES AND CAPITAL	51,488	60,468	72,332	87,589	106,831	130,744	160,127	195,903	239,143	291,090

TABLE 99 - 38
EL SALVADOR FREE ZONE -- SCENARIO C PROJECTIONS -- STEEL BUILDINGS

RATE OF RETURN ANALYSIS

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR		1	2	3	4	5	6	7	8	9	10
ON TOTAL INVESTMENT:											
IRR STREAM	(36,055)	(1,052)	167	2,304	4,558	6,876	7,701	8,447	9,441	10,728	12,367
INTERNAL RATE OF RETURN:	10 YRS	14.1%		NET PRESENT VALUE:		10 YRS		(1,972)			
	20 YRS	19.7%				20 YRS		19,452			
ON EQUITY:											
ROE STREAM /2	(9,500)	(1,599)	(1,681)	(953)	(41)	1,631	2,704	3,859	5,263	7,003	8,966
RETURN ON EQUITY:	10 YRS	20.8%		NET PRESENT VALUE:		10 YRS		6,281			
	20 YRS	26.0%				20 YRS		26,143			

NOTES: 1/ The first column contains the total investment discounted to its present value in the first year, while each column contains the Net Income for that year with Depreciation and Interest added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10 or 20).

2/ The first column contains the equity investment discounted to its present value while each column contains the Retained Earnings for that year with depreciation added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10 or 20).

TABLE N - 38 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO C PROJECTIONS -- STEEL BUILDINGS

R A T E O F R E T U R N A N A L Y S I S

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Not

YEAR	11	12	13	14	15	16	17	18	19	20
ON TOTAL INVESTMENT:										
IRR STREAM	13,481	15,603	18,163	21,232	24,893	29,241	34,386	40,455	47,596	134,487
ON EQUITY:										
ROE STREAM /2	10,403	12,849	15,733	19,127	23,111	27,783	33,252	39,645	47,110	134,325

NOTES: 1/ The first column contains the total investment discounted to its present value in the first year, while each column contains the Net Income for that year with Depreciation and Interest added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10 or 20).

2/ The first column contains the equity investment discounted to its present value while each column contains the Retained Earnings for that year with depreciation added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10 or 20).

TABLE [redacted] - 39
EL SALVADOR FREE ZONE -- SCENARIO C PROJECTIONS -- STEEL BUILDINGS

F I N A N C I N G S T R U C T U R E

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
LONG-TERM LOAN:										
PRINCIPAL (B.O.Y.)		5,955	14,544	22,712	32,397	32,397	30,237	28,077	25,917	23,758
DRAWDOWN	5,955	8,589	8,168	9,685						
INTEREST	447	1,537	2,794	4,133	4,860	4,698	4,374	4,050	3,726	3,402
AMORTIZATION /1						2,160	2,160	2,160	2,160	2,160
PRINCIPAL (E.O.Y.)	5,955	14,544	22,712	32,397	32,397	30,237	28,077	25,917	23,758	21,598
EQUITY INVESTMENT	4,950	1,950	1,950	1,950						
WORKING CAPITAL LOAN:										
PRINCIPAL (B.O.Y.)		1,349	2,797	3,370	2,850	2,280	1,710	1,140	570	
DRAWDOWN	1,919	2,018	1,144	50						
INTEREST	101	311	463	467	385	299	214	128		
AMORTIZATION /1	570	570	570	570	570	570	570	570	570	
PRINCIPAL (E.O.Y.)	1,349	2,797	3,370	2,850	2,280	1,710	1,140	570		
EQUITY INVESTMENT /2	640.	673	381	17						
DEBT SERVICE COVERAGE /3	-.94	.07	.60	.88	1.18	1.00	1.15	1.37	1.66	2.22
DEBT/EQUITY RATIO /4	2.00	4.55	6.56	8.41	8.44	6.26	4.03	2.45	1.48	.92

ASSUMPTIONS:

LONG-TERM FINANCING

TOTAL INVESTMENT	C	43,196
OF WHICH: EQUITY	C	10,799
DEBT	C	32,397
ANNUAL INTEREST RATE		15.0%
TERM: INCLUDING GRACE		20 yrs
GRACE PERIOD		5 yrs

WORKING CAPITAL FINANCING

TOTAL INVESTMENT /5	C	6,840
OF WHICH: EQUITY	C	1,710
DEBT	C	5,130
ANNUAL INTEREST RATE		15.0%
TERM: INCLUDING GRACE		5 yrs
GRACE PERIOD		0 yrs

NOTES:

1/ Equal principal repayments are made with interest paid on the average outstanding balance.
2/ Equity is assumed to be the cost of land in year 1 plus equal annual investments of the balance of the 25% of total investment.
3/ Ratio of Net Income plus Interest and Depreciation to Interest and Amortization
4/ Ratio of Total Liabilities to Total Capital.
5/ Total investment in Working Capital is 160% of the Working Capital Requirement defined in the Income Statement.

TABLE N - 39 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO C PROJECTIONS -- STEEL BUILDINGS

F I N A N C I N G S T R U C T U R E

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	11	12	13	14	15	16	17	18	19	20
LONG-TERM LOAN:										
PRINCIPAL (B.O.Y.)	21,598	19,438	17,278	15,119	12,959	10,799	8,639	6,479	4,320	2,160
DRAWDOWN										
INTEREST	3,078	2,754	2,430	2,106	1,782	1,458	1,134	810	486	162
AMORTIZATION /1	2,160	2,160	2,160	2,160	2,160	2,160	2,160	2,160	2,160	2,160
PRINCIPAL (E.O.Y.)	19,438	17,278	15,119	12,959	10,799	8,639	6,479	4,320	2,160	
EQUITY INVESTMENT										
WORKING CAPITAL LOAN:										
PRINCIPAL (B.O.Y.)										
DRAWDOWN										
INTEREST										
AMORTIZATION /1										
PRINCIPAL (E.O.Y.)										
EQUITY INVESTMENT /2										
DEBT SERVICE COVERAGE /3	2.57	3.18	3.96	4.98	6.32	8.08	10.44	13.62	17.99	24.11
DEBT/EQUITY RATIO /4	.61	.40	.26	.17	.11	.07	.04	.02	.01	

NOTES:
1/ Equal principal repayments are made with interest paid on the average outstanding balance.
2/ Equity is assumed to be the cost of land in year 1 plus equal annual investments of the balance of the 25% of total investment.
3/ Ratio of Net Income plus Interest and Depreciation to Interest and Amortization
4/ Ratio of Total Liabilities to Total Capital
5/ Total Investment in Wor of the Working Capital Requirement defined in the Income Statement.

TABLE N - 40
EL SALVADOR FREE ZONE -- SCENARIO D PROJECTIONS -- ACCELERATED DEVELOPMENT

FINANCIAL SUMMARY

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
REVENUES	607	3,750	7,302	8,713	10,473	12,222	13,465	15,009	16,904	19,304
NET INCOME	(2,371)	(3,427)	(2,362)	(1,305)	282	1,394	2,601	4,065	5,779	7,894
ASSETS	14,292	35,990	38,179	36,189	35,786	34,440	34,302	35,627	39,352	45,192
LIABILITIES	11,092	33,614	36,058	33,555	32,870	30,131	27,391	24,652	22,597	20,543
NET WORTH	3,200	2,376	2,121	2,634	2,916	4,310	6,911	10,976	16,755	24,649

YEAR	11	12	13	14	15	16	17	18	19	20
REVENUES	21,830	24,703	28,080	32,040	36,673	42,082	48,385	55,722	64,248	74,148
NET INCOME	9,458	12,014	15,026	18,566	22,720	27,587	33,282	39,935	47,700	56,752
ASSETS	52,595	62,555	75,526	92,037	112,703	138,236	169,464	207,345	252,990	307,688
LIABILITIES	18,489	16,434	14,380	12,326	10,271	8,217	6,163	4,109	2,054	
NET WORTH	34,106	46,121	61,146	79,712	102,432	130,019	163,301	203,236	250,936	307,688

RETURN ON EQUITY (10 YRS) : 21.4%

FINANCING STRUCTURE:

Long Term Financing		C 41,086	$ 8,217
	Of Which: Equity	C 10,271	$ 2,054
	Debt	C 30,814	$ 6,163
Working Capital Financing		C 7,309	$ 1,462
	Of Which: Equity	C 1,827	$ 365
	Debt	C 5,482	$ 1,096
Total Financing		C 48,395	$ 9,679
	Of Which: Equity	C 12,099	$ 2,420
	Debt	C 36,296	$ 7,259

TABLE M - 41
EL SALVADOR FREE ZONE -- SCENARIO 0 PROJECTIONS -- ACCELERATED DEVELOPMENT

CONSTRUCTION SCHEDULE AND REVENUE PROJECTIONS

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
ANNUAL INFLATION RATE	.0%	20.0%	20.0%	15.0%	15.0%	15.0%	10.0%	10.0%	10.0%	10.0%
CUMULATIVE INFLATION FACTOR	1.00	1.20	1.44	1.66	1.90	2.19	2.41	2.65	2.91	3.21
EFFECTIVE ANNUAL INFLATION RATE	10.7%									
DEVELOPMENT COSTS, OF WHICH:										
LAND VALUE /1	3,000									
LAND DEVELOPMENT COSTS /2	1,574	3,147	567							
CONSTRUCTION COST /2	8,874	17,748	3,195							
CONTINGENCY /3	887	1,775	319							
TOTAL DEVELOPMENT COST	14,335	22,670	4,081							
DEPRECIATION:										
CUMULATIVE TOTAL INVESTMENT /4	14,335	37,005	41,086	41,086	41,086	47,249	51,974	57,171	62,888	69,177
DEPRECIABLE ASSETS /5	9,761	29,284	32,798	32,798	32,798	32,798	32,798	32,798	32,798	32,798
ANNUAL DEPRECIATION /6	488	1,464	1,640	1,640	1,640	1,640	1,640	1,640	1,640	1,640
ACCUMULATED DEPRECIATION	488	1,952	3,592	5,232	6,872	8,512	10,152	11,792	13,432	15,072
SPACE AVAILABLE & REVENUE PROJECTION:										
ANNUAL NEW CONSTRUCTION (m2)	12,000	20,000	3,000	0	0					
ADMINISTRATION BUILDING	500									
CUMULATIVE SPACE AVAILABLE (m2)	4,250	21,500	33,000	34,500	34,500	34,500	34,500	34,500	34,500	34,500
AVERAGE OCCUPANCY RATE	90.0%	90.0%	95.0%	95.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
RENTAL RATE (C/M2/MONTH) /7	13.22	15.86	19.04	21.89	25.18	28.95	31.85	35.03	38.54	42.39
ANNUAL REVENUE /8	607	3,684	7,162	8,610	10,423	11,986	13,185	14,504	15,954	17,549

NOTES:

1/ 20 Hectares total area @ C15 per m2)
2/ Unit construction costs: C. 739.50 for GFBs & C. 45.90 for land development; inclusive of architectural and engineering charges.
3/ Physical contingency allows 10.0% over GFB construction costs.
4/ Total cumulative investment; after Year 5 adjusted to current value according to inflation.
5/ Total cost of buildings and structures.
6/ Depreciation over 20 years by the straight line method.
7/ Annual rental rate, adjusted for inflation. The exchange rate used is C 5.00/US$ 1.0 for the rental payments, which are denominated in US$.
8/ Assumes an exchange rate of C5.00/US$ 1.0 on rental revenue.

TABLE N - 41 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO D PROJECTIONS -- ACCELERATED DEVELOPMENT

CONSTRUCTION SCHEDULE AND REVENUE PROJECTIONS

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	11	12	13	14	15	16	17	18	19	20
ANNUAL INFLATION RATE	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%	8.0%
CUMULATIVE INFLATION FACTOR	3.46	3.74	4.04	4.36	4.71	5.09	5.50	5.93	6.41	6.92
EFFECTIVE ANNUAL INFLATION RATE										
DEVELOPMENT COSTS, OF WHICH:										
LAND VALUE /1										
LAND DEVELOPMENT COSTS /2										
CONSTRUCTION COST /2										
CONTINGENCY /3										
TOTAL DEVELOPMENT COST										
DEPRECIATION:										
CUMULATIVE TOTAL INVESTMENT /4	74,711	80,688	87,143	94,115	101,644	109,775	118,557	128,042	138,285	149,348
DEPRECIABLE ASSETS /5	32,798	32,798	32,798	32,798	32,798	32,798	32,798	32,798	32,798	32,798
ANNUAL DEPRECIATION /6	1,640	1,640	1,640	1,640	1,640	1,640	1,640	1,640	1,640	1,640
ACCUMULATED DEPRECIATION	16,712	18,351	19,991	21,631	23,271	24,911	26,551	28,191	29,831	31,471
SPACE AVAILABLE & REVENUE PROJECTION:										
ANNUAL NEW CONSTRUCTION (m2)										
ADMINISTRATION BUILDING										
CUMULATIVE SPACE AVAILABLE (m2)	34,500	34,500	34,500	34,500	34,500	34,500	34,500	34,500	34,500	34,500
AVERAGE OCCUPANCY RATE	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%
RENTAL RATE (C/M2/MONTH) /7	45.78	49.44	53.40	57.67	62.28	67.27	72.65	78.46	84.74	91.52
ANNUAL REVENUE /8	18,953	20,469	22,107	23,876	25,786	27,848	30,076	32,482	35,081	37,888

NOTES:

1/ 20 Hectares total area @ C15 per m2)
2/ Unit construction co for land development; inclusive of architectural and engineering charges.
3/ Physical contingency over SFB construction costs.
4/ Total cumulative investment; after Year 5 adjusted to current value according to inflation.
5/ Total cost of buildings and structures.
6/ Depreciation over 20 years by the straight line method.
7/ Annual rental rate, adjusted for inflation. The exchange rate used is C 5.00/US$ 1.0 for the rental payments, which are denominated in US$.
8/ Assumes an exchange rate of C5.00/US$ 1.0 on rental revenue.

TABLE M- 42
EL SALVADOR FREE ZONE -- SCENARIO O PROJECTIONS -- ACCELERATED DEVELOPMENT

INCOME STATEMENT

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
REVENUES:										
OPERATING INCOME /1	607	3,684	7,162	8,610	10,423	11,986	13,185	14,504	15,954	17,549
INTEREST INCOME /2		67	141	103	50	236	280	505	950	1,755
TOTAL REVENUES	607	3,750	7,302	8,713	10,473	12,222	13,465	15,009	16,904	19,304
COSTS:										
SALARIES /3	626	751	901	1,037	1,192	1,546	1,701	1,871	2,058	2,264
PAYROLL BURDEN /4	188	225	270	311	358	464	510	561	617	679
OVERHEAD /5	470	563	676	777	894	1,160	1,276	1,403	1,543	1,698
PROMOTION	375	450	540	621	714	821	903	994	1,093	1,202
MAINTENANCE /6		370	411	411	411	472	520	572	629	692
DEPRECIATION	488	1,464	1,640	1,640	1,640	1,640	1,640	1,640	1,640	1,640
INTEREST	832	3,353	5,225	5,221	4,982	4,725	4,314	3,903	3,544	3,236
TOTAL OPERATING COSTS	2,978	7,177	9,664	10,018	10,191	10,828	10,864	10,944	11,124	11,410
NET INCOME	(2,371)	(3,427)	(2,362)	(1,305)	282	1,394	2,601	4,065	5,779	7,894
ANNUAL WORKING CAPITAL REQUIREMENT /7	1,883	1,963	722							

NOTES:

1/ Operating Income is the rental revenue from leasing buildings.

2/ Interest Income equals the interest (at 15.0%) on the previous year's cumulative surplus. The Cumulative Surplus is shown in the Balance Sheet as Current Assets. Implicitly this item for Interest Income represents reinvestment of the surplus at the cost of capital.

3/ Assumes Staffing as shown below at the following annual rates, including payroll burden:

Years 1-5:		Years 6-20 add:	
General Manager	200	Administrative Assistant	30
Secretary	30	Second Secretary	10
Maintenance Engineer	36	4 Additional Security	40
Security (8)	360		

4/ Payroll Burden Assumed: 30.0%

5/ Overhead includes insurance, legal/accounting fees, utilities and supplies. Overhead Factor @ 75.0% of wage bill.

6/ Maintenance is estimated at 1% of total physical assets through year 10, and 2% thereafter.

7/ Working Capital Requirement is the funding needed to cover the cash deficit (i.e., the negative of Net Income with Depreciation removed).

TABLE [redacted] - 42 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO O PROJECTIONS -- ACCELERATED DEVELOPMENT

INCOME STATEMENT

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	11	12	13	14	15	16	17	18	19	20
REVENUES:										
OPERATING INCOME /1	18,953	20,469	22,107	23,876	25,786	27,848	30,076	32,482	35,081	37,888
INTEREST INCOME /2	2,877	4,233	5,973	8,165	10,887	14,233	18,309	23,239	29,167	36,260
TOTAL REVENUES	21,830	24,703	28,080	32,040	36,673	42,082	48,385	55,722	64,248	74,148
COSTS:										
SALARIES /3	2,445	2,640	2,852	3,080	3,326	3,592	3,880	4,190	4,525	4,887
PAYROLL BURDEN /4	733	792	856	924	998	1,078	1,164	1,257	1,358	1,466
OVERHEAD /5	1,834	1,980	2,139	2,310	2,495	2,694	2,910	3,143	3,394	3,665
PROMOTION	1,299	1,403	1,515	1,636	1,767	1,908	2,061	2,226	2,404	2,596
MAINTENANCE /6	1,494	1,614	1,743	1,882	2,033	2,196	2,371	2,561	2,766	2,987
DEPRECIATION	1,640	1,640	1,640	1,640	1,640	1,640	1,640	1,640	1,640	1,640
INTEREST	2,927	2,619	2,311	2,003	1,695	1,387	1,079	770	462	154
TOTAL OPERATING COSTS	12,372	12,688	13,055	13,475	13,953	14,494	15,104	15,786	16,548	17,396
NET INCOME	9,458	12,014	15,026	18,566	22,720	27,587	33,282	39,935	47,700	56,752
ANNUAL WORKING CAPITAL REQUIREMENT /7										

NOTES:

1/ Operating Income is the rental revenue from leasing buildings.

2/ Interest Income equals) on the previous year's cumulative surplus. The Cumulative Surplus is shown in the Balance Sheet as Current Assets. Implicitly this item for Interest Income represents reinvestment of the surplus at the cost of capital.

3/ Assumes Staffing as shown below at the following annual rates, including payroll burden:

Years 1-5:	Years 6-20 add:
General Manager	
Secretary	
Maintenance Engineer	
Security (8)	

4/ Payroll Burden Assumed:

5/ Overhead includes insurance, legal/accounting fees, utilities and supplies. Overhead Factor @ of wage bill.

6/ Maintenance is estimated at 1% of total physical assets through year 10, and 2% thereafter.

7/ Working Capital Requirement is the funding needed to cover the cash deficit (i.e., the negative of Net Income with Depreciation removed).

TABLE H - 43

EL SALVADOR FREE ZONE -- SCENARIO D PROJECTIONS -- ACCELERATED DEVELOPMENT

CASH FLOW STATEMENT

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
SOURCES OF FUNDS:										
NET INCOME	(2,371)	(3,427)	(2,362)	(1,305)	282	1,394	2,601	4,065	5,779	7,894
DEPRECIATION	488	1,464	1,640	1,640	1,640	1,640	1,640	1,640	1,640	1,640
FINANCING FOR PHYSICAL ASSETS:										
EQUITY	4,818	1,818	1,818	1,818						
LONG-TERM LOAN	9,517	20,852	2,263	(1,818)						
FINANCING FOR WORKING CAPITAL:										
EQUITY	753	785	289							
WORKING CAPITAL LOAN	2,260	2,355	866							
TOTAL SOURCES	15,465	23,848	4,514	335	1,922	3,034	4,241	5,705	7,419	9,534
USES OF FUNDS:										
LAND ACQUISITION & DEVELOPMENT	4,574	3,147	567							
CONSTRUCTION	9,761	19,523	3,514							
LONG-TERM LOAN AMORTIZATION						2,054	2,054	2,054	2,054	2,054
WORKING CAPITAL LOAN AMORTIZATION	685	685	685	685	685	685	685	685		
TOTAL USES	15,020	23,355	4,766	685	685	2,740	2,740	2,740	2,054	2,054
ANNUAL SURPLUS/DEFICIT	445	492	(252)	(350)	1,237	294	1,502	2,965	5,365	7,479
CUMULATIVE SURPLUS/DEFICIT	445	937	685	335	1,572	1,866	3,368	6,333	11,698	19,177

TABLE N - 43 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO O PROJECTIONS -- ACCELERATED DEVELOPMENT

C A S H F L O W S T A T E M E N T

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	11	12	13	14	15	16	17	18	19	20
SOURCES OF FUNDS:										
NET INCOME	9,458	12,014	15,026	18,566	22,720	27,587	33,282	39,935	47,700	56,752
DEPRECIATION	1,640	1,640	1,640	1,640	1,640	1,640	1,640	1,640	1,640	1,640
FINANCING FOR PHYSICAL ASSETS:										
EQUITY										
LONG-TERM LOAN										
FINANCING FOR WORKING CAPITAL:										
EQUITY										
WORKING CAPITAL LOAN										
TOTAL SOURCES	11,098	13,654	16,665	20,206	24,360	29,227	34,922	41,575	49,340	58,392
USES OF FUNDS:										
LAND ACQUISITION & DEVELOPMENT										
CONSTRUCTION										
LONG-TERM LOAN AMORTIZATION	2,054	2,054	2,054	2,054	2,054	2,054	2,054	2,054	2,054	2,054
WORKING CAPITAL LOAN AMORTIZATION										
TOTAL USES	2,054	2,054	2,054	2,054	2,054	2,054	2,054	2,054	2,054	2,054
ANNUAL SURPLUS/DEFICIT	9,043	11,600	14,611	18,151	22,306	27,173	32,867	39,521	47,286	56,338
CUMULATIVE SURPLUS/DEFICIT	28,221	39,820	54,431	72,583	94,886	122,061	154,929	194,450	241,735	298,073

TABLE N - 44
EL SALVADOR FREE ZONE -- SCENARIO 0 PROJECTIONS -- ACCELERATED DEVELOPMENT

BALANCE SHEET

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
ASSETS:										
CURRENT ASSETS	445	937	685	335	1,572	1,866	3,368	6,333	11,698	19,177
FIXED ASSETS:										
LAND AND IMPROVEMENTS	4,574	7,721	8,288	8,288	8,288	8,288	8,288	8,288	8,288	8,288
BUILDINGS	9,761	29,284	32,798	32,798	32,798	32,798	32,798	32,798	32,798	32,798
LESS ACCUMULATED DEPRECIATION	(488)	(1,952)	(3,592)	(5,232)	(6,872)	(8,512)	(10,152)	(11,792)	(13,432)	(15,072)
TOTAL FIXED ASSETS	13,847	35,053	37,494	35,854	34,214	32,574	30,934	29,294	27,654	26,014
TOTAL ASSETS	14,292	35,990	38,179	36,189	35,786	34,440	34,302	35,627	39,352	45,192
LIABILITIES:										
CURRENT LIABILITIES										
WORKING CAPITAL DEBT	1,575	3,245	3,426	2,741	2,056	1,370	685			
LONG-TERM DEBT	9,517	30,370	32,632	30,814	30,814	28,760	26,706	24,652	22,597	20,543
TOTAL LIABILITIES	11,092	33,614	36,058	33,555	32,870	30,131	27,391	24,652	22,597	20,543
CAPITAL:										
EQUITY	5,571	8,174	10,281	12,099	12,099	12,099	12,099	12,099	12,099	12,099
RETAINED EARNINGS	(2,371)	(5,798)	(8,160)	(9,465)	(9,183)	(7,789)	(5,188)	(1,123)	4,656	12,550
TOTAL CAPITAL	3,200	2,376	2,121	2,634	2,916	4,310	6,911	10,976	16,755	24,649
TOTAL LIABILITIES AND CAPITAL	14,292	35,990	38,179	36,189	35,786	34,440	34,302	35,627	39,352	45,192

TABLE M - 44 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO D PROJECTIONS - ACCELERATED DEVELOPMENT

B A L A N C E S H E E T

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	11	12	13	14	15	16	17	18	19	20
ASSETS:										
CURRENT ASSETS	28,221	39,820	54,431	72,583	94,888	122,061	154,929	194,450	241,735	298,073
FIXED ASSETS:										
LAND AND IMPROVEMENTS	8,288	8,288	8,288	8,288	8,288	8,288	8,288	8,288	8,288	8,288
BUILDINGS	32,798	32,798	32,798	32,798	32,798	32,798	32,798	32,798	32,798	32,798
LESS ACCUMULATED DEPRECIATION	(16,712)	(18,351)	(19,991)	(21,631)	(23,271)	(24,911)	(26,551)	(28,191)	(29,831)	(31,471)
TOTAL FIXED ASSETS	24,374	22,735	21,095	19,455	17,815	16,175	14,535	12,895	11,255	9,615
TOTAL ASSETS	52,595	62,555	75,526	92,037	112,703	138,236	169,464	207,345	252,990	307,688
LIABILITIES:										
CURRENT LIABILITIES										
WORKING CAPITAL DEBT										
LONG-TERM DEBT	18,489	16,434	14,380	12,326	10,271	8,217	6,163	4,109	2,054	
TOTAL LIABILITIES	18,489	16,434	14,380	12,326	10,271	8,217	6,163	4,109	2,054	
CAPITAL:										
EQUITY	12,099	12,099	12,099	12,099	12,099	12,099	12,099	12,099	12,099	12,099
RETAINED EARNINGS	22,008	34,022	49,047	67,613	90,333	117,920	151,202	191,137	238,837	295,589
TOTAL CAPITAL	34,106	46,121	61,146	79,712	102,432	130,019	163,301	203,236	250,936	307,688
TOTAL LIABILITIES AND CAPITAL	52,595	62,555	75,526	92,037	112,703	138,236	169,464	207,345	252,990	307,688

TABLE M - 45
EL SALVADOR FREE ZONE -- SCENARIO D PROJECTIONS -- ACCELERATED DEVELOPMENT

R A T E O F R E T U R N A N A L Y S I S

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR			1	2	3	4	5	6	7	8	9	10
ON TOTAL INVESTMENT:												
IRR STREAM		(38,045)	(1,052)	1,390	4,503	5,556	6,904	7,759	8,555	9,608	10,963	12,769
INTERNAL RATE OF RETURN:	10 YRS	14.5%		NET PRESENT VALUE:			10 YRS		(1,139)			
	20 YRS	20.1%					20 YRS		21,570			
ON EQUITY:												
ROE STREAM /2		(9,237)	(1,883)	(1,963)	(722)	335	1,922	3,034	4,241	5,705	7,419	9,534
RETURN ON EQUITY:	10 YRS	21.4%		NET PRESENT VALUE:			10 YRS		6,926			
	20 YRS	26.7%					20 YRS		28,148			

NOTES: 1/ The first column contains the total investment discounted to its present value in the first year, while each column contains the Net Income for that year with Depreciation and Interest added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10 or 20).

2/ The first column contains the equity investment discounted to its present value while each column contains the Retained Earnings for that year with depreciation added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10 or 20).

TABLE N - 45 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO O PROJECTIONS -- ACCELERATED DEVELO

R A T E O F R E T U R N A N A L Y S I S

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise

YEAR	11	12	13	14	15	16	17	18	
ON TOTAL INVESTMENT:									
IRR STREAM	14,025	16,273	18,977	22,208	25,055	30,614	36,000	42,346	49,8
ON EQUITY:									
ROE STREAM /2	11,098	13,654	16,665	20,206	24,360	29,227	34,922	41,575	49,3

NOTES: 1/ The first column contains the total investment discounted to its present value in the first year,. while each column contains the Net Income for that year with Depreciation and Interest added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10

2/ The first column contains the equity investment discounted to its present value while each column contains the Retained Earnings for that year with depreciation added back. A residual project value equal to 50% of the current value is included in the final year (either yr 10

TABLE M - 46
EL SALVADOR FREE ZONE -- SCENARIO O PROJECTIONS -- ACCELERATED DEVELOPMENT

F I N A N C I N G S T R U C T U R E

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
LONG-TERM LOAN:										
PRINCIPAL (B.O.Y.)		9,517	30,370	32,632	30,814	30,814	28,760	26,706	24,652	22,597
DRAWDOWN	9,517	20,852	2,263	(1,818)						
INTEREST	714	2,992	4,725	4,759	4,622	4,468	4,160	3,852	3,544	3,236
AMORTIZATION /1						2,054	2,054	2,054	2,054	2,054
PRINCIPAL (E.O.Y.)	9,517	30,370	32,632	30,814	30,814	28,760	26,706	24,652	22,597	20,543
EQUITY INVESTMENT	4,818	1,818	1,818	1,818						
WORKING CAPITAL LOAN:										
PRINCIPAL (B.O.Y.)		1,575	3,245	3,426	2,741	2,056	1,370	685		
DRAWDOWN	2,260	2,355	866							
INTEREST	118	361	500	463	360	257	154	51		
AMORTIZATION /1	685	685	685	685	685	685	685	685		
PRINCIPAL (E.O.Y.)	1,575	3,245	3,426	2,741	2,056	1,370	685			
EQUITY INVESTMENT /2	753	785	289							
DEBT SERVICE COVERAGE /3	-.69	.34	.76	.94	1.22	1.04	1.21	1.45	1.96	2.41
DEBT/EQUITY RATIO /4	3.47	14.15	17.00	12.74	11.27	6.99	3.96	2.25	1.35	.83

ASSUMPTIONS:

LONG-TERM FINANCING

TOTAL INVESTMENT	C	41,086
OF WHICH: EQUITY	C	10,271
DEBT	C	30,814
ANNUAL INTEREST RATE		15.0%
TERM: INCLUDING GRACE		20 yrs
GRACE PERIOD		5 yrs

WORKING CAPITAL FINANCING

TOTAL INVESTMENT /5	C	7,309
OF WHICH: EQUITY	C	1,827
DEBT	C	5,482
ANNUAL INTEREST RATE		15.0%
TERM: INCLUDING GRACE		5 yrs
GRACE PERIOD		0 yrs

NOTES:

1/ Equal principal repayments are made with interest paid on the average outstanding balance.
2/ Equity is assumed to be the cost of land in year 1 plus equal annual investments of the balance of the 25% of total investment.
3/ Ratio of Net Income plus Interest and Depreciation to Interest and Amortization
4/ Ratio of Total Liabilities to Total Capital.
5/ Total investment in Working Capital is 160% of the Working Capital Requirement defined in the Income Statement.

TABLE N - 46 (CONTINUED)
EL SALVADOR FREE ZONE -- SCENARIO D PROJECTIONS -- ACCELERATED DEVELOPMENT

F I N A N C I N G S T R U C T U R E

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	11	12	13	14	15	16	17	18	19	20
LONG-TERM LOAN:										
PRINCIPAL (B.O.Y.)	20,543	18,489	16,434	14,380	12,326	10,271	8,217	6,163	4,109	2,054
DRAWDOWN										
INTEREST	2,927	2,619	2,311	2,003	1,695	1,387	1,079	770	462	154
AMORTIZATION /1	2,054	2,054	2,054	2,054	2,054	2,054	2,054	2,054	2,054	2,054
PRINCIPAL (E.O.Y.)	18,489	16,434	14,380	12,326	10,271	8,217	6,163	4,109	2,054	
EQUITY INVESTMENT										
WORKING CAPITAL LOAN:										
PRINCIPAL (B.O.Y.)										
DRAWDOWN										
INTEREST										
AMORTIZATION /1										
PRINCIPAL (E.O.Y.)										
EQUITY INVESTMENT /2										
DEBT SERVICE COVERAGE /3	2.82	3.48	4.35	5.47	6.95	8.90	11.49	14.99	19.79	26.51
DEBT/EQUITY RATIO /4	.54	.36	.24	.15	.10	.06	.04	.02	.01	

NOTES:
1/ Equal principal repayments are made with interest paid on the average outstanding balance.
2/ Equity is assumed to be the cost of land in year 1 plus equal annual investments of the balance of the 25% of total investment.
3/ Ratio of Net Income plus Interest and Depreciation to Interest and Amortization
4/ Ratio of Total Liabilities to Total Capital.
5/ Total investment in Wor of the Working Capital Requirement defined in the Income Statement.

TABLE [redacted] - 47
EL SALVADOR FREE ZONE -- SECOND FREE ZONE

CONSTRUCTION SCHEDULE AND REVENUE PROJECTIONS

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
ANNUAL INFLATION RATE	.0%	20.0%	20.0%	15.0%	15.0%	15.0%	10.0%	10.0%	10.0%	10.0%
CUMULATIVE INFLATION FACTOR	1.00	1.20	1.44	1.66	1.90	2.19	2.41	2.65	2.91	3.21
EFFECTIVE ANNUAL INFLATION RATE	10.7%									
DEVELOPMENT COSTS, OF WHICH:										
LAND VALUE /1			4,320							
LAND DEVELOPMENT COSTS /2			1,888	2,172	2,497	2,872				
CONSTRUCTION COST /2			10,649	12,246	14,083	16,195				
CONTINGENCY /3			1,065	1,225	1,408	1,620				
TOTAL DEVELOPMENT COST			13,602	15,642	17,989	20,687				
DEPRECIATION:										
CUMULATIVE TOTAL INVESTMENT /4			13,602	29,245	47,233	54,318	59,750	65,725	72,298	79,528
DEPRECIABLE ASSETS /5			11,714	25,184	40,676	58,491	58,491	58,491	58,491	58,491
ANNUAL DEPRECIATION /6			586	1,259	2,034	2,925	2,925	2,925	2,925	2,925
ACCUMULATED DEPRECIATION			586	1,845	3,879	6,803	9,728	12,652	15,577	18,501
SPACE AVAILABLE & REVENUE PROJECTION:										
ANNUAL NEW CONSTRUCTION (m2)	0	0	10,000	10,000	10,000	10,000				
ADMINISTRATION BUILDING	0		500							
CUMULATIVE SPACE AVAILABLE (m2)	0	0	9,500	14,500	24,500	34,500	39,500	39,500	39,500	39,500
AVERAGE OCCUPANCY RATE	.0%	.0%	90.0%	90.0%	95.0%	95.0%	100.0%	100.0%	100.0%	100.0%
RENTAL RATE (C/M2/MONTH) /7	13.22	15.86	19.04	21.89	25.18	28.95	31.85	35.03	38.54	42.39
ANNUAL REVENUE /8			1,953	3,428	7,032	11,387	15,096	16,605	18,266	20,093

NOTES:

1/ 20 Hectares total area @ C15 per m2)
2/ Unit construction costs: C. 739.50 for EFBs & C. 45.90 for land development; inclusive of architectural and engineering charges.
3/ Physical contingency allows 10.0% over EFB construction costs.
4/ Total cumulative investment; after Year 5 adjusted to current value according to inflation.
5/ Total cost of buildings and structures.
6/ Depreciation over 20 years by the straight line method.
7/ Annual rental rate, adjusted for inflation. The exchange rate used is C 5.00/US$ 1.0 for the rental payments, which are denominated in US$.
8/ Assumes an exchange rate of C5.00/US$ 1.0 on rental revenue.

TABLE M - 48
EL SALVADOR FREE ZONE -- SECOND FREE ZONE

FINANCIAL SUMMARY

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
REVENUES			1,953	3,431	7,117	11,481	15,125	16,865	18,420	20,397
NET INCOME			(1,665)	(3,223)	(3,177)	(2,730)	(760)	395	2,103	3,937
ASSETS			17,356	32,290	48,303	65,631	64,243	60,614	58,693	58,606
LIABILITIES			6,785	20,990	36,558	53,453	52,825	48,800	44,776	40,752
NET WORTH			10,572	11,299	11,744	12,179	11,419	11,814	13,916	17,854

YEAR	11	12	13	14	15	16	17	18	19	20
REVENUES	22,430	24,852	27,750	31,198	35,280	40,097	45,761	52,403	60,175	69,249
NET INCOME	5,048	7,291	9,956	13,110	16,835	21,225	26,388	32,448	39,549	47,860
ASSETS	60,257	64,153	70,712	80,426	93,866	111,695	134,687	163,738	199,892	244,356
LIABILITIES	37,356	33,960	30,564	27,168	23,772	20,376	16,980	13,584	10,188	6,792
NET WORTH	22,901	30,192	40,148	53,258	70,094	91,319	117,707	150,154	189,704	237,564

RETURN ON EQUITY (10 YRS) : 22.1%

FINANCING STRUCTURE:

Long Term Financing		C 67,921	$ 13,584
Of Which:	Equity	C 16,980	$ 3,396
	Debt	C 50,940	$ 10,188
Working Capital Financing		C 6,699	$ 1,340
Of Which:	Equity	C 1,675	$ 335
	Debt	C 5,024	$ 1,005
Total Financing		C 74,620	$ 14,924
Of Which:	Equity	C 18,655	$ 3,731
	Debt	C 55,965	$ 11,193

TABLE N - 49
EL SALVADOR FREE ZONE PROJECT -- COMBINED COSTS FOR TWO FREE ZONES

FINANCIAL SUMMARY

(Amounts in Thousands of Colones at Current Prices, Unless Otherwise Noted)

YEAR	1	2	3	4	5	6	7	8	9	10
REVENUES	607	2,358	6,943	11,157	17,591	23,597	28,323	31,427	34,675	38,737
NET INCOME	(1,990)	(2,662)	(4,186)	(5,508)	(3,842)	(2,381)	668	3,137	6,489	10,153
ASSETS	11,436	22,328	49,288	74,454	89,129	103,822	100,877	97,005	96,484	100,302
LIABILITIES	7,637	18,328	34,618	59,033	73,928	87,836	84,223	77,214	70,204	63,868
NET WORTH	3,799	4,000	14,670	15,421	15,202	15,986	16,654	19,791	26,280	36,434

YEAR	11	12	13	14	15	16	17	18	19	20
REVENUES	43,039	48,029	53,958	60,970	69,233	78,942	90,318	103,618	119,140	137,222
NET INCOME	12,509	17,028	22,379	28,699	36,147	44,905	55,187	67,238	81,340	97,822
ASSETS	107,103	118,424	135,095	158,086	188,525	227,723	277,202	338,733	414,366	506,480
LIABILITIES	58,161	52,453	46,746	41,038	35,330	29,623	23,915	18,207	12,500	6,792
NET WORTH	48,942	65,970	88,349	117,048	153,195	198,100	253,287	320,525	401,866	499,688

FINANCING STRUCTURE:

Long Term Financing		C 114,153	-	$ 22,831
Of Which:	Equity	C 28,538	-	$ 5,708
	Debt	C 85,615	-	$ 17,123
Working Capital Fina		C 14,784	-	$ 2,957
Of Which:	Equity	C 3,696	-	$ 739
	Debt	C 11,088	-	$ 2,218
Total Financing		C 128,937	-	$ 25,787
Of Which:	Equity	C 32,234	-	$ 6,447
	Debt	C 96,703	-	$ 19,341

ANNEX I

ECONOMIC ANALYSIS OF THE FREE ZONE PROJECT

Objective and Conclusions

This economic analysis has two objectives: to estimate and interpret the economic internal rate of return (EIRR) implicit in the conclusions of the demand, financial and capital cost analyses in the PP; and to estimate the potential impact of the Project on GDP, employment, and foreign exchange, also based on the same conclusions.

The results suggest that the Project is economically worthwhile, with acceptable EIRRs and potentially strong impacts on GDP, employment, and foreign exchange earnings.

Methodology

The basic approach consisted of estimating and comparing the flow of economic benefits and costs in with and without-project situations. To such end, a baseline scenario presents benefits and costs profiles under given assumptions. Alternative scenarios test the sensitivity of the EIRR to changes in the assumptions.

Baseline benefits were measured by the increased exports made possible by the Project. Costs indicate the value to society of the resources used because of the Project.

Benefits and costs were "economic" in the sense that output and resources were valued according to economic prices, i.e. prices that reflect the scarcity value to the Salvadoran society of such goods and resources. Those prices do not necessarily correspond to the prices at which actual financial transactions take place. The analysis, therefore, views the Project from the perspective of the whole society rather than a group of individuals -- the owners of firms, for example.

The specific economic prices were estimated as follows. The colón price of exports and imports was raised, relative to the reported or financial price, by a factor of 1.4 to reflect the overvaluation of the colón at the official rate (a conservative estimate according to recent studies). The real cost to the economy of using unskilled labor was taken as 85 percent of the financial cost of hiring such labor. This estimate was based on an open unemployment rate of around 8 percent plus an allowance for additional labor underutilization.

In contrast to financial analysis, neither interest nor depreciation payments were treated as costs in the economic analysis. The rationale for not deducting interest when calculating the net benefits associated with a Project is that interest is part of the return to capital, precisely what the economic analysis is trying to measure. Rather than treating depreciation as a cost, the cost of assets was shown in the year in which such cost is incurred. (However, data on depreciation was used as a proxy of replacement investment in the old establishments of the typical firms; see below.)

Data and Basic Procedures

The analysis is based in part on costs and sales estimates provided by the management of an apparel firm considered representative of the type of firm that will settle in the free zone(s). By treating this firm as typical and assuming that similar firms would lease space in the free zone along the lines indicated in the demand and capital cost analysis (see corresponding sections), it was possible to calculate the potential costs and sales of all firms in the free zone as multiples of the equivalent values for the typical firm. The analysis thus uses a typical firm construct to explore the potential returns to the Project.

Costs take place at both the firm and zone development level. Free zone development and operating costs were taken from the capital cost and financial analysis sections after adjusting for economic prices. Such costs are presented on Tables I-1 and I-2.

Economic analyses of free zones frequently treat the zones as enclaves and focus only on the transfer of funds to the domestic economy in exchange for resources. In such an approach, foreign exchange earnings of the free zone firms, predominantly foreign-owned, are not counted as part of the domestic stock of foreign exchange because these earnings, owned by the foreign firms, are not necessarily deposited in the domestic banking system, and remain only temporarily in the economy if at all. In the baseline scenario herein, the situation is different. In line with the thrust of findings in the demand analysis, the baseline scenario assumes that all free zone firms are domestically owned. Accordingly, export proceeds are considered as gross benefits (i.e. benefits not adjusted for costs) pertaining to the domestic economy. For this reason, the baseline scenario views benefits and costs as it would approach an industrial development project which gives rise to exports.

An alternative sensitivity scenario establishes a mix of domestic and foreign firms in the free zone. In this scenario the benefits arising from the foreign firms are measured by:

1. The excess of payments for unskilled labor over the real opportunity cost to the economy of unskilled labor. This reflects the assumption that, because of underutilization, wages for unskilled labor exceed the opportunity cost of such labor.

2. Rent payments.

3. The excess of the economic value of the foreign exchange used to pay for domestic resources and services at the official exchange rate. This reflects the assumption that foreign firms will pay for labor and infrastructure services using foreign exchange which continues to be undervalued according to the official rate.

4. Technological transfers embodied in management and skills training provided by foreign firms to domestic workers in the course of the operations of the firms. Such benefits were estimated as equivalent to 20 percent of the payments made by foreign firms to skilled labor.

5. The advantages involved in temporarily holding part of the declared foreign exchange proceeds of the foreign companies in the domestic banking system. To the extent that this occurs and because the economic value of foreign exchange is presumed to exceed its local currency equivalent at the official exchange rate, there is a gain to the domestic economy. It was assumed herein that the foreign firms would temporarily deposit part of their surplus foreign exchange proceeds in the banking system. (Surplus in the sense that they exceed the firms' needs for domestic resources.) The gains involved were assumed to be equivalent to 10 percent of the export sales of the foreign companies.

Analogously, in the scenario which allows for a mix of domestic and foreign firms, the costs to the domestic economy are not of the same nature as when all the firms are domestic. The only costs to the domestic economy arising from the operations of foreign owned firms were assumed to relate to the provision of labor, land, and infrastructure services. Other inputs to the foreign firms do not pass through the domestic economy and accordingly are not counted as costs. Other sensitivity tests examine how the EIRR changes, relative to the baseline scenario, if the occupancy rate falls, exports decrease, or free zone costs rise.

Except when otherwise indicated, all prices are in constant 1988 colones. The time horizon for measuring costs and benefits is 20 years.

The Typical Firm

The typical firm is an apparel producer which at present sells about 25 percent of its production in the domestic market and exports the rest. The firm would have two production establishments, one in a free zone, representing an expansion of its operations. The firm would also continue operations at the off-zone establishment presently occupied.

As an assembly "maquila" type operation, the firm does not pay for the imported intermediate inputs it requires to produce exports. Such intermediate inputs are financed by the firm's overseas clients. Accordingly, the intermediate inputs incorporated in the exported goods do not represent a cost for the Salvadoran economy.

In the free zone location, the firm would produce only for exports. With this exception, the establishment would basically replicate off-zone operations.

It was assumed that in the zone location, the firm would produce at 60 percent potential capacity in the first year, 90 percent in the second year, and 100 percent in the third year and beyond. The lag in reaching full capacity reflects installation lags and the need to train new workers and managers in the firm's procedures. See Tables I-3 and I-4 for the structure of the typical firm's benefits and costs.

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Assumptions

Estimates of cumulative lease space available over the years were taken from the capital cost analysis and are presented on Table I-5. The Table also shows the number of firms established in the free zone for any given year. Such number was arrived at by dividing the space available by the space required by the typical firm, 6,000 m^2.

Assumptions used in the EIRR calculation for the baseline scenario are presented in the footnotes of the text tables. Other basic assumptions were:

1. Full (100 percent) occupancy rate from the first year on. Given the existing domestic demand for free zone space calculated in the demand analysis, this is not unreasonable.

2. Free zone firms are able to effectively market their production overseas. This is consistent with the expectations of the firms consulted during the demand analysis.

3. Backward linkages with the rest of the economy are negligible. However, it is possible that, as El Salvador absorbs technology transfers and develops its industry, backward linkages will become significant. Such an event would raise the net returns associated with the Project.

Quantitative Results

For the typical firm, incremental net economic benefits, (the difference in economic benefits adjusted for economic costs between the with and without project scenarios), are shown on Table I-6. Because of production below potential and fixed investment incurred by the firm in the first year of operation, such benefits are negative in that year of operations.

Table I-7 shows the flow of incremental net economic benefits for all the firms in the free zone over the Project's time horizon. This flow is not adjusted for free zone development and operating costs. Benefits turn positive on year 5 and grow up to year 7, after which they level off.

Table I-8 presents the flow of incremental net economic benefits for the project. This was calculated by substracting the economic costs involved in developing and operating the free zone from the firms' incremental net economic benefits of Table I-7. The calculation is equivalent to the following formula:

With-project gross economic benefits less firm and zone-level economic costs

minus

Without-project gross economic benefits less firm level economic costs

equals

Incremental net economic benefits associated with the Free Zone Project

Table I-7 shows that the flow of the Project's incremental net economic benefits are negative up to year 4, after which they rise up to year 6. It can be estimated that it is only in year 6 that the stream of cumulative positive benefits (not discounted for time) offsets the cumulative undiscounted negative benefits that take place from years 1 through 4. Such result illustrates that the payoff from this type of project comes in the medium to long term.

The economic internal rate of return associated with the flow of incremental benefits in Table I-8 is 14 percent. One should note that the flow of benefits allows for no residual value of the free zone assets at the end of the time horizon. However, the economic value of land is likely to rise, and the buildings and related infrastructure may be worth as much as 20 or 30 percent of original cost. Therefore, the 14 percent EIRR should be considered a conservative estimate.

The results of the sensitivity analysis are shown on Table I-9. They indicate that, under the assumptions adopted in each case, everything else constant, and relative to the baseline scenario, the following changes occur:

1. When the assumed occupancy rate falls from 100 to 80 percent, the EIRR falls to 12 percent.

2. Approximately a 10 percent fall in expected export sales makes the EIRR zero. This result tends to exaggerate the fall in the EIRR because, in the long run, firms would adjust their costs to lower level of sales.

3. If a substantial number of foreign firms (40 percent in the exercise) settle in the free zone, the EIRR rises significantly. The reason for the rise is that there are benefits which take place with foreign firms but not with domestic firms; moreover, the only costs to the domestic economy from the operations of foreign firms relate to the provision of land, labor, and infrastructure services (see above section on procedures).

4. When zone development and operating costs increase by 10 percent, the EIRR drops to approximately 12 percent.

The baseline scenario Project impact in terms of GDP, employment, and foreign exchange generated through the Project is presented in Tables I-10 through I-12. GDP and foreign exchange generated in the free zone enterprises represent an increase of about 70 percent relative to off-zone operations. GDP generated in the firms rises from year 1 through year 7 when it levels off. Net foreign exchange generated in the free zone is negative in the first year because of the import component of land development and construction. It is positive in the second year and rises up to year 7. Employment is generated at both the firms and the free zone development and operation. Relative to employment in the off-zone establishment, employment increases by about 90 percent. During the first four years, zone development and operations account for a substantial amount of employment generated. After the construction phase ends, employment in the firms accounts for 98 percent of the total employment.

It should be noted that Table I-10 through I-12 have been prepared on one "typical" zone. Assuming the second zone financed under the Project is initiated a year after the first one, the GDP, foreign exchange, and employment figures would be approximately doubled for the total Project, not considering any future zones which may be developed utilizing reflows from the Project's credit facility. The estimated impact of the Project, then, is as follows:

TABLE I-13
ECONOMIC OUTPUTS

Output	Life-of Project	Year Five	20 Year Period
Employment[1]			
Zone 1	17,495	2,907	53,842
Zone 2	14,588	2,827	50,931
Project Total	32,083	5,734	104,773
Net FX Generations[2]			
Zone 1	75,670	33,450	614,320
Zone 2	42,220	23,356	578,383
Project Total	117,890	56,806	1,192,703
GDP Generated[2]			
Zone 1	93,944	33,450	632,594
Zone 2	60,494	27,525	596,656
Project Total	154,438	50,925	1,229,250

1 In person years.
2 In thousands of 1988 financial colones.

Evaluation of Results

Given the conclusions of the demand and capital cost analyses, and EIRRs above 12 percent for occupancy rates of 80% or higher, the Project is an economically worthwhile Project. The sensitivity of the EIRR to sales and costs highlight the need for a careful evaluation of the market potential of firms seeking credit under the Project, and for expert cautious management. Analogously, the results underline that, if foreign firms are attracted, the country is likely to gain more. The sensitivity to changes in the occupancy rate reinforce the arguments for a phased development and effective marketing of the zone. Finally, the potential favorable impact on GDP, employment, and foreign exchange is shown to be substantial.

TABLE I-1

ECONOMIC ANALYSIS, FREE ZONE PROJECT

CALCULATION OF THE ECONOMIC DEVELOPMENT COSTS OF THE FREE ZONE IN CONSTANT PRICES (thousand colones)

Financial Prices	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	YEAR 6	YEAR 7	YEAR 8	YEAR 9	YEAR 10	YEAR 11	YEAR 12	YEAR 13	YEAR 14	YEAR 15	YEAR 16	YEAR 17	YEAR 18	YEAR 19	YEAR 20
Land value	3.000.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Land development costs	1,160.0	1,574.0	1.511.0	1.737.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Construction costs	6.656.0	8,874.0	8,519.0	9,797.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Contingency	666.0	887.0	852.0	980.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Develop Costs Financ Prices	11.502.0	11.335.0	10.882.0	12.514.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Payments to unskilled labor	1.645.6	2.194.1	2.106.3	2.422.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Economic cost of unskilled labor	1.398.7	1.865.0	1.790.4	2,058.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Development Costs Adjusted for the Ec Cost of Unsk Lab	11.255.2	11.005.9	10.566.1	12.150.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Ec cost of import component of land dev & construction	6.582.2	8.776.3	8.425.2	9,688.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Ec cost of land dev & construction	9.716.6	12.955.5	12,437.2	14.302.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Development Costs Adjusted for the Ec Cost of Lab & Imports	13,135.8	13.513.4	12,973.3	14,918.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Dev Costs Adj for Ec Costs in Constant 1988 Prices	13.135.8	11.261.2	9.009.2	8.987.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Memorandum items

1. Labor was assumed to represent 35% of land development and construction costs.
   Unskilled labor was assumed to comprise 60% of such labor (i.e. 60% of 35%)
2. As in the capital cost analysis, imports were assumed to represent 60% of land development and construction costs.

TABLE I-2

ECONOMIC ANALYSIS, FREE ZONE PROJECT

CALCULATION OF THE ECONOMIC OPERATING COSTS OF THE FREE ZONE IN CONSTANT PRICES (thousand colones)

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	YEAR 6	YEAR 7	YEAR 8	YEAR 9	YEAR 10	YEAR 11	YEAR 12	YEAR 13	YEAR 14	YEAR 15	YEAR 16	YEAR 17	YEAR 18	YEAR 19	YEAR 20
Operating costs (unadj)	2,470.0	4,607.0	6,838.0	9,198.0	10,336.0	11,077.0	11,205.0	11,379.0	11,603.0	11,881.0	12,928.0	13,244.0	13,611.0	14,033.0	14,514.0	15,061.0	15,676.0	16,367.0	17,140.0	17,999.0
less																				
depreciation	366.0	854.0	1,323.0	1,861.0	1,861.0	1,861.0	1,861.0	1,861.0	1,861.0	1,861.0	1,861.0	1,861.0	1,861.0	1,861.0	1,861.0	1,861.0	1,861.0	1,861.0	1,861.0	1,861.0
interest	445.0	1,534.0	2,790.0	4,128.0	4,854.0	4,693.0	4,369.0	4,045.0	3,722.0	3,398.0	3,074.0	2,751.0	2,427.0	2,104.0	1,780.0	1,456.0	1,133.0	809.0	485.0	162.0
Oper costs adj for inter & deprec	1,659.0	2,219.0	2,725.0	3,209.0	3,621.0	4,523.0	4,975.0	5,473.0	6,020.0	6,622.0	7,993.0	8,632.0	9,323.0	10,068.0	10,873.0	11,744.0	12,682.0	13,697.0	14,794.0	15,976.0
adjusting for unskilled labor																				
total salaries	626.0	751.0	901.0	1,037.0	1,192.0	1,546.0	1,701.0	1,871.0	2,058.0	2,264.0	2,445.0	2,640.0	2,852.0	3,080.0	3,326.0	3,592.0	3,880.0	4,190.0	4,525.0	4,887.0
salaries paid for unsk labor	187.8	225.3	270.3	311.1	357.6	463.8	510.3	561.3	617.4	679.2	733.5	792.0	855.6	924.0	997.8	1,077.6	1,164.0	1,257.0	1,357.5	1,466.1
economic cost of unsk labor	159.6	191.5	229.8	264.4	304.0	394.2	433.8	477.1	524.8	577.3	623.5	673.2	727.3	785.4	848.1	916.0	989.4	1,068.5	1,153.9	1,246.2
skilled+semiskilled salaries	438.2	525.7	630.7	725.9	834.4	1,082.2	1,190.7	1,309.7	1,440.6	1,584.8	1,711.5	1,848.0	1,996.4	2,156.0	2,328.2	2,514.4	2,716.0	2,933.0	3,167.5	3,421.9
economic Cost of labor	597.8	717.2	860.5	990.3	1,138.4	1,476.4	1,624.5	1,786.8	1,965.4	2,162.1	2,335.0	2,521.2	2,723.7	2,941.4	3,176.3	3,430.4	3,705.4	4,001.5	4,321.4	4,667.1
Oper costs adj for eco cost of unskilled labor	1,630.8	2,185.2	2,684.5	3,162.3	3,567.4	4,453.4	4,898.5	5,389.8	5,927.4	6,520.1	7,883.0	8,513.2	9,194.7	9,929.4	10,723.3	11,582.4	12,507.4	13,508.5	14,590.4	15,755.1
less payroll burden	187.8	225.3	270.3	311.1	357.6	463.8	510.3	561.3	617.4	679.2	733.5	792.0	855.6	924.0	997.8	1,077.6	1,164.0	1,257.0	1,357.5	1,466.1
Economic Operating Costs (current prices)	1,443.0	1,959.9	2,414.2	2,851.2	3,209.8	3,989.6	4,388.2	4,827.5	5,310.0	5,840.9	7,149.5	7,721.2	8,339.1	9,005.4	9,725.5	10,504.8	11,343.4	12,251.5	13,232.9	14,289.0
Economic Operating Costs (in constant 1988 prices)	1,443.0	1,633.3	1,676.5	1,717.6	1,689.3	1,821.7	1,820.8	1,821.7	1,824.7	1,819.6	2,066.3	2,064.5	2,064.1	2,065.5	2,064.9	2,063.8	2,062.4	2,066.0	2,064.4	2,065.0

Memorandum items

1. It was assumed that unskilled labor accounts for 30% of total salaries paid.
2. Economic cost of unskilled labor was calculated at 85% of unskilled labor salaries.
   Economic cost of skilled and semiskilled labor was taken as equivalent to skilled and semiskilled salaries.
3. Payroll burden was deducted to calculate economic operating costs because burden was taken as being in the nature of taxes, i.e. a transfer payment.
4. Adjustment of current into constant prices was done by deflating by the cumulative inflation factors used in the projections for the financial analysis. Those factors were:

Year	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20
Factor	1.00	1.20	1.44	1.66	1.90	2.19	2.41	2.65	2.91	3.21	3.46	3.74	4.04	4.36	4.71	5.09	5.50	5.93	6.41	6.92

TABLE I-3

ECONOMIC ANALYSIS, FREE ZONE PROJECT

TYPICAL FIRM ESTIMATES (economic prices and constant 1988 prices) in thousand colones)

WITHOUT PROJECT SCENARIO

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	YEAR 6	YEAR 7	YEAR 8	YEAR 9	YEAR 10	YEAR 11	YEAR 12	YEAR 13	YEAR 14	YEAR 15	YEAR 16	YEAR 17	YEAR 18	YEAR 19	YEAR 20
BENEFITS (SALES)																				
Domestic	2,500.0	2,500.0	2,500.0	2,500.0	2,500.0	2,500.0	2,500.0	2,500.0	2,500.0	2,500.0	2,500.0	2,500.0	2,500.0	2,500.0	2,500.0	2,500.0	2,500.0	2,500.0	2,500.0	2,500.0
Exports	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0
Total	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0
COSTS																				
Labor																				
Unskilled	1,014.9	1,014.9	1,014.9	1,014.9	1,014.9	1,014.9	1,014.9	1,014.9	1,014.9	1,014.9	1,014.9	1,014.9	1,014.9	1,014.9	1,014.9	1,014.9	1,014.9	1,014.9	1,014.9	1,014.9
Skilled	4,900.0	4,900.0	4,900.0	4,900.0	4,900.0	4,900.0	4,900.0	4,900.0	4,900.0	4,900.0	4,900.0	4,900.0	4,900.0	4,900.0	4,900.0	4,900.0	4,900.0	4,900.0	4,900.0	4,900.0
Total	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9
Intermediate Inputs	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0
Investment	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0
Rent	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0
Total Costs	7,488.9	7,488.9	7,488.9	7,488.9	7,488.9	7,488.9	7,488.9	7,488.9	7,488.9	7,488.9	7,488.9	7,488.9	7,488.9	7,488.9	7,488.9	7,488.9	7,488.9	7,488.9	7,488.9	7,488.9
NET BENEFITS (REVENUE)	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1

Memorandum items

1. This firm is essentially dedicated to maquila operations. Figure given as export sales is really value added by firm.
2. Firm produces for both the domestic and the export market. Sales to domestic market are 29% of total sales.
3. A shadow exchange rate of 7C=$1 used. Accordingly, imports & exports were adjusted by a factor of 1.4.
4. Economic cost of unskilled labor was estimated at 85% of financial cost.
5. Intermediate inputs recorded refer only to inputs used in production for the domestic market. Those are the inputs for which the company pays and which represent a cost to the Salvadoran economy. 80% of such inputs are imported and thus were shadow priced. Inputs for exports are also imported but their cost is paid for by overseas clients and thus do not represent a cost to El Salvador.
6. Depreciation was used as a measure of annual fixed investment by the firm.
7. Rent was imputed as the firm owns its premises. Figure for rent is an estimate of what other firms pay for similar premises.

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TABLE I-4

ECONOMIC ANALYSIS, FREE ZONE PROJECT.

TYPICAL FIRM ESTIMATES (economic and constant 1988 prices; in thousand colones)

WITH PROJECT SCENARIO

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	YEAR 6	YEAR 7	YEAR 8	YEAR 9	YEAR 10	YEAR 11	YEAR 12	YEAR 13	YEAR 14	YEAR 15	YEAR 16	YEAR 17	YEAR 18	YEAR 19	YEAR 20
BENEFITS (SALES)																				
Original establishment	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0	11,250.0
Free zone (all exports)	5,250.0	7,875.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0	8,750.0
Total	16,500.0	19,125.0	20,000.0	20,000.0	20,000.0	20,000.0	20,000.0	20,000.0	20,000.0	20,000.0	20,000.0	20,000.0	20,000.0	20,000.0	20,000.0	20,000.0	20,000.0	20,000.0	20,000.0	20,000.0
COSTS																				
Labor																				
Unskilled	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9	5,914.9
Skilled	5,350.0	5,350.0	5,350.0	5,350.0	5,350.0	5,350.0	5,350.0	5,350.0	5,350.0	5,350.0	5,350.0	5,350.0	5,350.0	5,350.0	5,350.0	5,350.0	5,350.0	5,350.0	5,350.0	5,350.0
Total	11,264.9	11,264.9	11,264.9	11,264.9	11,264.9	11,264.9	11,264.9	11,264.9	11,264.9	11,264.9	11,264.9	11,264.9	11,264.9	11,264.9	11,264.9	11,264.9	11,264.9	11,264.9	11,264.9	11,264.9
Intermediate Inputs	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0	1,056.0
Investment																				
In free zone establishment	7,900.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
In original establishment	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0
Total	10,118.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0	218.0
Rent (original establishment)	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0	300.0
Total Costs	22,738.9	12,836.9	12,838.9	12,838.9	12,838.9	12,838.9	12,838.9	12,838.9	12,838.9	12,838.9	12,838.9	12,838.9	12,838.9	12,838.9	12,838.9	12,838.9	12,838.9	12,838.9	12,838.9	12,838.9
NET BENEFITS (REVENUE)	(6,238.9)	6,286.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1
Memorandum items																				

1. See previous table for basic procedures. Figures in this table incorporate estimates for both original and free zone establishments.
2. It is estimated that, during the first year of operations, the free zone establishment will produce at only 60% of capacity. During second year it produces at 90% of capacity, and from the third year on at 100% of capacity.
3. Investment reflects new fixed investment in the free zone establishment, as well as annual investment in the original establishment. Financial investment in free zone establishment was estimated at the colon equivalent of $1.5 million. 80% of such amount would go into imports and was thus shadow priced. The remaining 20% is to be spent on local materials and thus was not shadow priced. The shadow priced amount came to C 8,400,000 (1,500,000 x .80 x 7). The local component of the free zone investment was calculated as 1,500,000 x .20 x 5.

TABLE I-5

ECONOMIC ANALYSIS, FREE ZONE PROJECT

CUMULATIVE LEASE SPACE AVAILABLE IN FREE ZONE AND NUMBER OF TYPICAL FIRMS LEASING PER YEAR

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	YEAR 6	YEAR 7	YEAR 8	YEAR 9	YEAR 10	YEAR 11	YEAR 12	YEAR 13	YEAR 14	YEAR 15	YEAR 16	YEAR 17	YEAR 18	YEAR 19	YEAR 20
Cumulative space (m2)	4250	13500	22500	30500	34500	34500	34500	34500	34500	34500	34500	34500	34500	34500	34500	34500	34500	34500	34500	34500
Number of firms	1.0	2.25	3.75	5.00	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75	5.75

Memorandum items

1. Assumes 100 percent occupancy (baseline scenario).

TABLE I-6

ECONOMIC ANALYSIS, FREE ZONE PROJECT

TYPICAL FIRM ESTIMATES (economic and constant 1988 prices; in thousand colones)

INCREMENTAL NET BENEFITS

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	YEAR 6	YEAR 7	YEAR 8	YEAR 9	YEAR 10	YEAR 11	YEAR 12	YEAR 13	YEAR 14	YEAR 15	YEAR 16	YEAR 17	YEAR 18	YEAR 19	YEAR 20
With project net benefits	(6,239.9)	6,286.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1	7,161.1
Without project net benefits	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1	3,761.1
INCREMENTAL NET BENEFITS	(10,000.0)	2,525.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0

TABLE I-7

ECONOMIC ANALYSIS, FREE ZONE PROJECT

FLOW OF INCREMENTAL NET BENEFITS FOR ALL TYPICAL FIRMS IN THE FREE ZONE (economic and constant 1988 prices; in thousand colones)

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	YEAR 6	YEAR 7	YEAR 8	YEAR 9	YEAR 10	YEAR 11	YEAR 12	YEAR 13	YEAR 14	YEAR 15	YEAR 16	YEAR 17	YEAR 18	YEAR 19	YEAR 20
Initial firm	(10,000.0)	2,525.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0	3,400.0
Year 2 firms	0.0	(12,500.0)	3,156.3	4,250.0	4,250.0	4,250.0	4,250.0	4,250.0	4,250.0	4,250.0	4,250.0	4,250.0	4,250.0	4,250.0	4,250.0	4,250.0	4,250.0	4,250.0	4,250.0	4,250.0
Year 3 firms	0.0	0.0	(15,000.0)	3,787.5	5,100.0	5,100.0	5,100.0	5,100.0	5,100.0	5,100.0	5,100.0	5,100.0	5,100.0	5,100.0	5,100.0	5,100.0	5,100.0	5,100.0	5,100.0	5,100.0
Year 4 firms	0.0	0.0	0.0	(17,400.0)	5,382.5	5,950.0	5,950.0	5,950.0	5,950.0	5,950.0	5,950.0	5,950.0	5,950.0	5,950.0	5,950.0	5,950.0	5,950.0	5,950.0	5,950.0	5,950.0
Year 5 firms	0.0	0.0	0.0	0.0	(19,800.0)	2,800.0	2,244.0	2,244.0	2,244.0	2,244.0	2,244.0	2,244.0	2,244.0	2,244.0	2,244.0	2,244.0	2,244.0	2,244.0	2,244.0	2,244.0
All firms	(10,000.0)	(9,975.0)	(12,443.8)	(13,962.5)	5,533.5	12,972.5	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0

Memorandum items

1. A given year firms are the firms which settle on the free zone on that year.

2. After year 5 there is no additional space to lease.

TABLE I-8

ECONOMIC ANALYSIS, FREE ZONE PROJECT

FLOW OF INCREMENTAL NET BENEFITS FROM THE FREE ZONE PROJECT AND THE IMPLICIT ECONOMIC INTERNAL RATE OF RETURN (economic and constant 1988 prices; in thousand colones)

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	YEAR 6	YEAR 7	YEAR 8	YEAR 9	YEAR 10	YEAR 11	YEAR 12	YEAR 13	YEAR 14	YEAR 15	YEAR 16	YEAR 17	YEAR 18	YEAR 19	YEAR 20
Flow of Incremental Net Benefits at the Firms' Level	(10,000.0)	(9,975.0)	(8,443.8)	(1,962.5)	9,533.5	18,972.5	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0	19,550.0
Minus the sum of :																				
Free Zone Economic Operating Costs	1,443.0	1,633.3	1,676.5	1,717.6	1,669.3	1,621.7	1,620.8	1,621.7	1,624.7	1,819.6	2,066.3	2,064.5	2,064.1	2,065.5	2,064.9	2,063.8	2,062.4	2,066.0	2,064.4	2,065.0
and																				
Free Zone Economic Development Costs	13,135.8	11,281.2	9,009.2	8,967.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Flow of Free Zone Project Incremental Net Benefits	(24,578.8)	(22,889.5)	(19,129.4)	(12,647.4)	7,844.2	17,150.8	17,729.2	17,728.3	17,725.3	17,730.4	17,483.7	17,485.5	17,485.9	17,484.5	17,485.1	17,486.2	17,487.6	17,484.0	17,485.6	17,485.0

Economic Internal Rate of Return for the Free Zone Project (%) 14.1

TABLE I-9
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ECONOMIC ANALYSIS, FREE ZONE PROJECT
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SENSITIVITY SCENARIOS RESULTS
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SCENARIO	EIRR %	RISE(+) OR FALL(-) RELATIVE TO BASELINE EIRR
Given a baseline EIRR of:	14.0	n.a.
What if:		
1. The occupancy rate is 80% 1/	12.0	- 15.0
2. Sales with project are approximately 10.0% less than expected	0.0	-100.0
3. 40% of the firms are foreign	26.0	+ 86.0
4. Free zone costs are 10% higher	12.0	- 15.0

1/ An occupancy rate of 90%, as utilized in the Financial Analysis, yields an EIRR of 13%.

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TABLE I-10

ECONOMIC ANALYSIS. FREE ZONE PROJECT

GROSS DOMESTIC PRODUCT GENERATED IN THE FREE ZONE ENTERPRISES (in financial 1988 thousand colones)

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	YEAR 6	YEAR 7	YEAR 8	YEAR 9	YEAR 10	YEAR 11	YEAR 12	YEAR 13	YEAR 14	YEAR 15	YEAR 16	YEAR 17	YEAR 18	YEAR 19	YEAR 20
Year 1 firms	3,750.0	5,625.0	6,250.0	6,250.0	6,250.0	6,250.0	6,250.0	6,250.0	6,250.0	6,250.0	6,250.0	6,250.0	6,250.0	6,250.0	6,250.0	6,250.0	6,250.0	6,250.0	6,250.0	6,250.0
Year 2 firms	0.0	4,687.5	7,031.3	7,812.5	7,812.5	7,812.5	7,812.5	7,812.5	7,812.5	7,812.5	7,812.5	7,812.5	7,812.5	7,812.5	7,812.5	7,812.5	7,812.5	7,812.5	7,812.5	7,812.5
Year 3 firms	0.0	0.0	5,625.0	8,437.5	9,375.0	9,375.0	9,375.0	9,375.0	9,375.0	9,375.0	9,375.0	9,375.0	9,375.0	9,375.0	9,375.0	9,375.0	9,375.0	9,375.0	9,375.0	9,375.0
Year 4 firms	0.0	0.0	0.0	5,025.0	7,537.5	8,375.0	8,375.0	8,375.0	8,375.0	8,375.0	8,375.0	8,375.0	8,375.0	8,375.0	8,375.0	8,375.0	8,375.0	8,375.0	8,375.0	8,375.0
Year 5 firms	0.0	0.0	0.0	0.0	2,475.0	3,712.5	4,125.0	4,125.0	4,125.0	4,125.0	4,125.0	4,125.0	4,125.0	4,125.0	4,125.0	4,125.0	4,125.0	4,125.0	4,125.0	4,125.0
GDP generated in all firms	3,750.0	10,312.5	18,906.3	27,525.0	33,450.0	35,525.0	35,937.5	35,937.5	35,937.5	35,937.5	35,937.5	35,937.5	35,937.5	35,937.5	35,937.5	35,937.5	35,937.5	35,937.5	35,937.5	35,937.5

Memorandum item 1

1. Year "t" firms refers to firms selling in the free zone on year t.

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I. CENTRAL RESERVE BANK AND COMMERCIAL BANKS

A. Central Reserve Bank (BCR):

The BCR was established in 1934 to promote and maintain monetary, foreign exchange, credit and financial conditions most favorable for the development of the domestic economy. Accordingly, the BCR is the institution charged with the implementation of policies formulated by the Monetary Board--the highest policy decision-making organization of El Salvador--in this area. Its most important functions are: balance the means of payment and the credit policy to the country's necessities and to the development of productive activities; coordinate the different economic and financial activities of the Government that affect the monetary, capital and credit markets of the country; promote the liquidity, solvency and good functioning of the national financial system; prevent or moderate the inflationary, speculative and deflationary trends; maintain the external value of the domestic currency and its convertibility; administer the international monetary reserves and the international tranfers regime, and carry out the activities, operations and services established by the Monetary Regime Law and other legal dispositions related to central banking.

The BCR is governed by a seven member Board of Directors composed of four members named by the Monetary Board, the Commercial Banks, other financial institutions, and the industrial/agricultural associations; in addition, the President and the two Vice-Presidents of the BCR are Board members. The BCR President and the two Vice-Presidents are appointed by the President of El Salvador.

The Board of Directors is in charge, of among other things, agreeing on the measures necessary to fulfill the BCR objective; approving all credit operations; proposing to the Monetary Board all the monetary, credit, foreign exchange and financial policies; approving the annual BCR budget, salaries and fringe benefits of its personnel; approving the BCR internal regulating procedures; approving the creation or elimination of advisory, technical, operating and administrative units within the BCR; naming the members of special committees that are judged to be necessary to create, and authorizing the contracting of technical assistance on a temporary basis.

One of the special committees created by the BCR Board of Directors is the Credit Committee. The Credit Committee is in charge of examining all applications, documents, and securities to be discounted, rediscounted, or purchased by the BCR or that are presented to the BCR as guarantee. The Committee decides on the acceptability of the applications and the eligibility of the documents in accordance to the credit policy of the BCR, and communicates its decisions to the BCR Board of Directors. The Credit Committee is comprised of the BCR Second Vice-President, Manager, Deputy Manager for Credit and Values, and a Department Chief to be selected by the BCR President.

To develop its functions, the BCR carries out different operations in accordance with which its internal organization has been designed:

1. Foreign Operations: Through its Departments of Exchange Control and Exterior, the following foreign exchange operations with the GOES, official autonomous institutions, the banking system and the public in general are carried out: purchases and sales of foreign currency and drafts, issues letters of credit and payment orders, etc.

2. Deposits Operations: Through the Department of Deposits and Agencies, the BCR handles all of the public sector and banking system current accounts and operates the check compensatory mechanism for the banking system.

3. Values Operations: Acting as the Fiscal Agent for the Government, the BCR sells securities issued by the Government and official autonomous institutions and makes the interest payments and pay-offs of said titles. In addition, the BCR can purchase directly from the issuer or the market or accept as guarantee, securities issued or countersigned by the Government.

4. Currency Issuing Operations: The BCR is the only authorized entity to issue domestic currency, which has legal recourse and unlimited liberatory power to cancel any cash obligations in the national territory.

5. Credit Operations: For a period of up to one year the BCR carries out credit operations in the form of discount, rediscount or advance facilities with the banking institutions, the Government of El Salvador, oficial autonomous institutions and entities that promote the production, processing and/or distribution of basic goods. The Bank can provide credit at terms over one year to the public sector and the banking system utilizing foreign or local funds obtained by the BCR at the same terms (special lines of credit).

Currently, the BCR operates approximately 42 special lines of credit for different subsectors: coffee, cotton, sugar cane, cereals, other crops, livestock, working capital for the industrial manufacturing sector, export and pre-export, export of capital goods, the Economic Development Fund 1/, and the Industry Recovery Fund.

1/ This Fund finances some 15 different types of investment (agricultural, education, health, agro-industry, marketing, fishing, lumber, mining, stock acquisition, etc). Funds are available to final borrowers through intermediate credit institutions for periods from 2 to 25 years. For the great majority of uses, interest rates to the final borrower range from 6 to 10%.

The credit operations are supervised and implemented by the Deputy Management of Credit and Values (Subgerencia de Crédito y Valores) through its Departments of Financial Analysis and Credit. The Financial Analysis Department is in charge of analyzing all credit applications received from the commercial banks 1/. In turn, this Department presents the credit applications to the Credit Committee with a recommendation for approval or disapproval. The Credit Committee approves credit applications of up to ₡1.0 million ($250,000), ratification by the BCR Board of Directors is required before the decision is communicated to the commercial bank. Applications above this limit must be approved by the BCR Board of Directors. Once a credit application has been approved and the decision has been communicated to the commercial bank, the Credit Department is in charge of the operational aspects of the credit (contracting, making disbursement, and following up on interest and principal payments).

Together the Deputy Management of Credits and Values and the Departments of Credit and Financial Analysis count with 65 employees of which 42 are technical personnel (approximately 65%).

The credit application approval process has been described by some private sector representatives as "long and tortuous"; at times, delays in the credit delivery system have hampered the success of their efforts. However, significant improvement has been reported for the last six months. Mission efforts and the establishment of public/private sector working groups have greatly reduced the average processing time. The ultimate goal is that the loan approval process would take a maximum of 30 days at the commercial bank and 15 working days at the BCR.

In general, BCR staff (a total of 883 people, with approximately 50% being technical personnel) is considered well qualified and relatively efficient. Most of its operational difficulties are traced to be minor problems of organization and control. Given the small numbers of loans to be made under the Project and the fact that the BCR currently operates 42 credit lines, the BCR should have no problem, implementing this Project's credit facility with its currenty staff. However, personnel from the two relevant Departments (Financial Analysis and Credit do require and will receive training in financial/credit analysis of free zone projects).

B. Commercial Banks:

There are ten commercial banks, including one foreign owned bank, and a Mortgage Bank (Banco Hipotecario). The nine locally owned commercial banks are all nationalized. Four of them (Banco Agrícola Comercial, Banco Cuscatlán, Banco de Comercio and Banco Salvadoreño) handle approximately 80% of the aggregate portfolio of the eleven banks. They and the Banco Hipotecario, accounted for approximately 62% of the net credit outstanding for the entire financial system in 1985, for 66% in 1986. The Mortgage Bank is not nationalized, but its president is appointed by the President of El Salvador.

1/ At this stage of the credit application process, the commercial bank's credit department has already analyzed and approved the credit application.

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The reserve requirements are high: 20% on all deposits (seasonal increases and decreases are established by the BCR). At the same time, capital/lending rations are kept low with regard to capital and reserves, and vary according to the purpose of the loan, for example, for the industry credit line and the Economic Development Fund the ratio is 4 to 1 and for the small business credit lines the ratio is 10 to 1. Savings account rates are set at a 6% annually and the basic time deposit rate allowed is 15% for 180 days.

The commercial banks implement all of the BCR's credit lines. While not as efficient and expeditious as desired the banks as capable of handling the Free Zone line with current staff. As with the BCR staff, they will receive training under the Project.

II. MINISTRY OF FOREIGN TRADE

A. Overview

The Ministry of Foreign Trade (MICE) was created by the Salvadoran Government in 1981 to consolidate and expedite the operations of the government related to foreign trade. With the formation of MICE, the activities formerly discharged by the Salvadoran Institute of Foreign Trade (ISCE) and the duties of the Ministry of Economy relating to international commerce were brought together in one organization. The Salvadoran Customs Service, however, remains outside the Ministry's portfolio and is housed within the Ministry of Finance.

As originally established, MICE was broadly viewed as a foreign commercial planning ministry with both regulatory and promotional activities. Its basic objective is to regulate, monitor and promote foreign trade in El Salvador. To attain its objective, MICE executes a variety of functions including:

- Orient and coordinate the export and import policies and activities in accordance with the Government of El Salvador (GOES) broad goals.

- Formulate and propose foreign trade and investment policies to the GOES Executive Office.

- Promote the diversification and increase of exports and investment, both domestic and foreign.

- Regulate the orderly importation of goods and services.

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- Participate in the application of foreign trade policies and in the negotiations of treaties, agreements and commercial arrangements with other countries.

- Formulate and draft, in consultation with other GOES institutions, foreign trade and investment laws and implementing regulations.

- Approve, regulate and monitor the inflow of foreign capital as well as approve and monitor all repatriations of said capital.

- Authorize any persons or corporations not domiciled in El Salvador to carry out industrial and commercial activities in the country.

- Promote the development of credit and fiscal incentives oriented towards the diversification of exports and markets.

B. Organization

The Ministry is headed by the Minister and Vice-Minister. It has two staff offices, Legal Counsel and General Counsel. The Legal Counsel Unit drafts all legal agreements, bilateral and multilateral treaties, laws and implementing regulations and advises the Ministry and Vice-Ministry on the negotiations of all treaties, agreements and commercial arrangements. The General Counsel acts as a general advisory unit to both the Minister and Vice-Minister on the thrust and direction of the Ministry.

At the operational level, MICE's organization has been modified several times in response to its evolving regulatory and promotion roles. Currently, MICE has three Directorates: Planning, Exports Promotion and Administration; and five divisions not linked with any Directorate, Free Zone Management (San Bartolo); Once-Stop Export Documentation Center (CENTREX), Capital and Technology Transfer Division, Fiscal Incentives Unit, and Commercial Information Center.

The Directorate of Planning houses four divisions: Economic Studies and Commercial Policy, International Economic Negotiations, Institutional Coordination and Data Processing. The functions and objectives of this Directorate are: (a) to develop the MICE strategy within the GOES Global Plan; (b) to advise the Minister and Vice-Minister as to the specific trade (foreign and domestic) policies that should be followed by the GOES; (c) to develop macro and microeconomic studies to define specific products that can be produced for exporting in El Salvador; (d) to prepare requests for assistance for submission to international organizations; and (e) to prepare and submit MICE's operating budget and program to the Budget Office of the Central Government.

The Exports Promotion Directorate performs its duties through the following offices:

- Internal Promotion Division: involved in identification and testing of specific products for the export market, structuring of financial arrangements, provision of technical assistance to exporters in financial administration, quality control, and development of specific export projects.

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- External Promotion Division: seeks to penetrate new foreign markets, maintain Salvadoran exports to said markets, and develop the marketing infrastructure to export from El Salvador.

- Training Division: strives to create export awareness in the Salvadoran business community by organizing seminars, conferences and workshops for Salvadoran small and medium entrepreneurs already exporting or interesting in exporting. Through these activities, MICE provides information on new export products and markets, steps to be followed to start an export operation, assistance available through MICE and other Salvadoran institutions/organizations, etc.

- External Support Unit: gathers, maintains and provides information on all trade fairs and special events.

The Free Zone Management executes its functions through the Division of Physical Development and the Investment Promotion Unit. This office is in charge of the general management and administration and physical maintenance and expansion of the San Bartolo Free Zone (SBFZ). In addition, this office is responsible for negotiating leases with old and new zone tenants, preparing expansion plans and designs for San Bartolo, and supervising construction of new factory space.

CENTREX, the "one-stop-export-shop" established in the Export Promotion Law, consolidates and expedite the licensing and regulatory procedures related to foreign and domestic firms' export production activities.

The Capital and Technology Transfer Division, the Commercial Information Center, and the Fiscal Incentives Unit discharge the activities formerly developed by the Investment Promotion Division. The Capital and Technology Transfer Division has a control and regulation function of all foreign investment in the country. This MICE Division has responsibility for ensuring that all foreign investment in El Salvador is in keeping with GOES rules and regulations. In carrying out its regulatory and control function, the Division is required to interpret legal requisites as they apply to individual investors or pending investments. Specific duties include regulating joint venture agreements, controlling repatriation of profits by foreign firms, and quantifying levels of foreign investment.

Activities related to encouraging both foreign and domestic investment in and exports from El Salvador are developed by the Commercial Information Center and the Fiscal Incentives Unit. Therefore, these offices should be able to provide accurate information on the benefits of locating in the country and the applicable government regulations. In addition, the Fiscal Incentives Unit reviews and approves the applications received from firms that are currently exporting or that wish to export.

Finally, the Directorate of Administration, handles the administrative and management activities of the Ministry.

C. Export and Investment Promotion

With A.I.D. assistance provided under the Industrial Stabilization and Recovery Project 519-0287, MICE plans to provide training to its personnel in order to upgrade their investment promotion capabilities. Such training will permit MICE's staff to thoroughly understand such key elements to investment promotion as: preferential trade agreements (CBI, USGSP, 806.3/807, and other bilateral agreements); industry-specific locational requirements, cost data, and investment patterns; the services, facilities and basic production factors offered by El Salvador (availability, cost, and quality of industrial space, utilities and basic services, labor at all skill levels, international cargo service, etc.); and, the regulatory framework within which such investment will take place (investment incentives, free zone regime, Customs requirements, regulation of foreign exchange, et al).

With respect to exports development and promotion, MICE has taken important steps to create a supportive institutional framework. It was the primary government agency responsible for the drafting and passage of the 1986 Export Promotion Law which authorized generous tax and regulatory benefits for firms (foreign and domestic) engaged in export production and allowed for the establishment of private free zones in El Salvador. Furthermore, it has taken important steps to facilitate export documentation procedures and investment registration. Proof of this is the creation of CENTREX.

However, to date CENTREX effectiveness has been hampered somewhat by the lack of representation from the BCR, which plays a crucial role in regulating the access of firms to foreign exchange. There have been complaints from nontraditional exporters that the staff of CENTREX is unfamiliar with the exigencies of their production operations and is oriented more toward traditional, agricultural export activities. The net result has been delays in licensing and document processing and frustration on the part of the affected businesses. To remedy this, the 519-0287 Project is providing resources to computerize CENTREX's data base management as well as to upgrade staff. Moreover, the BCR has expressed its willingness to centralize its processing of export permits within the institution. Such actions, if executed, will greatly enhance the organization's ability to meet its objectives and the attractivenes of the regulatory environment for free zone users under this Project.

D. Relationship to Project

Free Zone Division has the most relevance to this Project. The MICE's Division is being restructured to have two units: one overseeing San Bartolo, and the other supporting private free zones in El Salvador.

This Project plans to provide MICE with technical assistance to establish the unit that will execute the supervision of private and public free zone development, technical assistance and training to the San Bartolo Free Zone management in order to make the zone financially and economically profitable, and in the long-term, to become an autonomous and self-sufficient operation; and coordinate the training for the GOES institutions related to free zones.

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MICE does not have the financial or human resource capability to effectively implement the GOES portion of the Free Zone Development Project. The Project represents a major undertaking for which MICE is very supportive, but constrained by the GOES' hiring freeze and salary schedules. Therefore, A.I.D. will fund the establishment and support of a Project Coordination Unit within the Free Zone Division consisting of a coordinator, an assistant, and a secretary. A.I.D. will directly contract these individuals as well as other procurement actions for MICE throughout the Project. MICE staff will be trained to assume responsibility for private free zones throughout the Project, enabling them to perform effectively thereafter.

MICE STAFFING PATTERN

Office	Number of Professional Employees	Number of Administ. Employees	Total
1. Directorate of Planning	16	5	21
a. Director	1	1	
b. Economic Studies and Commercial Policy Division	4	1	
c. Internal Economic Negotiations Division	4	1	
d. Institutional Coordination Division	4	1	
e. Data Processing Unit	3	1	
2. Directorate of Exports Promotion	18	10	28
a. Director	1	1	
b. Internal Promotion Division 1/	8	6	
c. External Promotion Division	4	1	
d. Training Division	3	1	
e. External Support Unit	2	1	
3. Directorate of Administration	2	65	67
a. Director	1	1	
b. Administrative Services Division	1	64	
4. San Bartolo Free Zone Management *	8	9	17
a. Division of Physical Development	5	8	
b. Investment Promotion Unit	3	1	
5. One-Stop Export Documentation Center	14	5	19
a. Director	1	2	
b. Export Documentation Division	9	2	
c. Data Processing	1	1	
d. Control Division	3	1	
6. Capital and Technology Transfer Division	5	1	6
7. Fiscal Incentives Unit	6	4	10
8. Commercial Information Center	7	2	11
TOTAL			179

This division is currently being reorganized to have two offices: (1) San Bartolo Free Zone Management, and (2) Private Free Zone Development. The latter will consist of the Project funded coordination unit as well as MICE staff assigned to assume these functions.

III. MINISTRY OF PLANNING AND COORDINATION OF THE ECONOMIC AND SOCIAL DEVELOPMENT

The Ministry of Planning (MIPLAN) is the GOES institution charged with the design and supervision of the government's strategy for national development. Working with the other GOES ministries, MIPLAN coordinates and guides the development activities and programs undertaken by the GOES. MIPLAN serves as both advisor and facilitator within the executive branch.

Specific duties discharged by MIPLAN include: policy analysis of economics and national finance, the development of budgetary policy; coordination of the financial and economic planning commission sponsored by the private sector, and on a national, regional and international level, the study, management and administration of the technical assistance provided to El Salvador by bilateral and multilateral development programs. MIPLAN accomplishes this last task through the Technical Secretariat for External Financing (SETEFE). As such, SETEFE will oversee the public works/infrastructure financed with GOES counterpart to the Project.

Notwithstanding the breadth of this mandate, MIPLAN is generally regarded as an efficient organization in terms of its ability to coordinate government policy development and program execution.

TECHNICAL SECRETARIAT FOR EXTERNAL FINANCING

Created in May 1983, SETEFE is the unit responsible for the coordination, administration and management of external financing through a legal instrument known as the Extraordinary Budget for Economic Reactivation (PERA). SETEFE also acts as the liaison office between the GOES and A.I.D. Although SETEFE was created under a decree law, organizationally it is a department of MIPLAN under the Directorate of Financial Cooperation and the General Directorate of External Cooperation.

The basic objectives of SETEFE are: (a) centralization of administration and monitoring of programs financed with A.I.D. and other donor resources and (b) reduction of administrative procedures in order to expedite program implementation. In order to achieve these objectives, SETEFE executes the following functions:

1. Advise senior elected officials on external financing.

2. Serve as liaison between the donors and the implementing agencies of Extraordinary Budget programs.

3. Negotiate loan and grant agreements with donor agencies, including document drafting and coordinating the GOES authorization process for entering into agreements with donors.

4. Ensure that the GOES complies with the commitments made to donors through agreements and Memoranda of Understanding.

5. Channel Extraordinary Budget resources to project implementing agencies.

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6. Follow up on the execution of projects, to evaluate their achievements, and to prepare progress reports.

7. Analyze and propose appropriate administrative/financial arrangements to facilitate optimum use of the loan and grant resources.

SETEFE's basic instruments for carrying out its functions are: (a) Legislative Decree No. 206, which created the Extraordinary Budget for Economic Reactivation and defined SETEFE's functions and authority; and (b) Instruction No. 1,204 and its amendments, jointly issued between the Ministries of Finance and Planning, which represent the authority and define the administrative regulations of the aforementioned budget.

At the time of its creation, SETEFE did not have a definition of its functional organization. It started with a Director and a group of technical staff, who rapidly differentiated their functions between budgetary control and project management. Informally, an evaluation committee was created, whose responsibility was to analyze project proposals and to decide which ones would be financed. Along the way, a Deputy Director was added to the staff, whose responsibilities were the operations and administration of SETEFE. In May 1985, in order to respond to an increase in responsibilities, a reorganization took place which created two divisions: Operations and Finance. The following is a description of SETEFE's current offices and functions.

- Executive Directorate and Deputy Directorate: Charged with overall supervision of SETEFE's operations and overall responsibility for the successful implementation of the programs financed under the Extraordinary Budget.

- Programming Division: Charged with negotiation and contracting of external financing, as well as preparation of reports.

- Operations Division: (a) Formulates the Extraordinary Budget operating procedures, (b) identifies, promotes, coordinates, incorporates, monitors, controls and evaluates programs financed under the Extraordinary Budget, (c) provides assistance to the GOES implementing agencies in the preparation of action plans, reprogramming of funds, disbursement, reimbursement and liquidating procedures.

- Finance Division: Responsibility for the general accountability and administration of the funds allocated to the Extraordinary Budget, including: preparation of annual budgets, cash flows, make disbursements to the implementing agencies, audits, personnel management, and institutional development.

This 58 person unit has proven capable of handling complex financial and inter-institutional programs. MIPLAN, through SETEFE, will be directly involved in the Free Zones Development Project, serving as the coordinating agency for the various autonomous utilities and service providers who will install the requisite external infrastructure for the private free zone

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project(s). Given the capabilities of its staff the limited burden that this Project would place on SETEFE, and the large portfolio currently managed, SETEFE will be able to oversee infrastructure activities with no additional staff or training. The relevant entities which will receive the financing allocated through the Extraordinary Budget under this Project include:

CEL - the Comisión Ejecutiva Hidroeléctrica del Río Lempa, El Salvador's national power company, for installation of power lines for zone hookup;

ANTEL - the Administración Nacional de Telecomunicaciones, which provides El Salvador's telephone, telex, radio and television service, both domestic and international; for installation of communications lines up to the zone site;

ANDA - the Administración Nacional de Acueductos y Alcantarillados, which will provide water and sewer lines up to the zone.

MOP - the Ministry of Public Works, which is in charge of planning, construction, and maintenance of the public infrastructure of the country (roads, highways, and bridges).

Since the beginning of the civil conflict and increasing greatly with the 1986 earthquake, donor resources have been channelled to these institutions to finance improvements or repairs to Salvadoran infrastructure and they have proven capable of effectively utilizing that assistance for targetted purposes. With SETEFE serving as the coordinator for the local currency counterpart funding under this Project, no problem is foreseen in the capability of either MIPLAN or the public utilities to execute their responsibilities.

IV. MINISTRY OF FINANCE (HACIENDA)

The Ministry of Finance is the GOES agency responsible for administering the national budget and for the regulation of matters related to national financial policy and procedures. It is important to the realization of this Project because of its role in the free zone designation and supervision process and because it houses customs.

Current staff will be assigned to review zone applications and, upon establishment of the new zones, to work full-time in the private zones. Both Customs and Ministry personnel assigned to review the free zone applications will need assistance in order to execute their responsibilities which fall to the institution under the free zones reglamento. Given the technical nature of much of the data contained in the applications which lies outside the Ministry's area of expertise, a portion of the technical assistance and training contemplated under the proposed Project will be devoted to this purpose.

V. FUSADES

A. Overview

The Salvadoran Foundation for Economic and Social Development (FUSADES) is a private, non-profit organization founded in 1983 by a group of Salvadoran businessmen. The institution works toward the improvement of the country's social and economic conditions and to stimulate national economic growth.

FUSADES is headed by a General Assembly of members from which a Board of Directors is elected. The Board, in turn selects the Executive Committee to implement its directives. The Chief Executive Officer is the Executive Director, who is supported on an operational level by the Legislation Commission, the Operations Committee and three Departments -- finance and administration, planning and development, and marketing and communications. Funding for the organization's activities comes from member contributions and financial assistance provided by national and international donor agencies.

The program activities of FUSADES are designed, managed and implemented through six technical departments. Each department is headed by a director or manager. Areas of specialization include:

- Economic and Social Studies (DEES)
- Agricultural Diversification (DIVAGRO)
- Association Strengthening (FORTAS)
- Small and Micro Enterprises (PROPEMI)
- Export Finance (FIDEX)
- Export and Investment Promotion (PRIDEX)

The capabilities of FUSADES have expanded considerably over the past five years, due in no small part, to the financial and technical assistance provided to the organization by USAID. Each technical department has a great deal of autonomy and a proven ability to execute its projects. The specific department treated in detail in this discussion is PRIDEX, which is the intended implementing agency for the technical assistance and training to be provided to the private sector free zones as well for the promotional activities financed under the Project.

B. PRIDEX

1. Background

The Export and Investment Promotion Program (PRIDEX) of FUSADES was authorized in September 1984 through a Cooperative Agreement with FUSADES under the Industrial Stabilization and Recovery Project (No. 519-0287). The purpose of the Project is to provide technical assistance and funding to both the public and private sectors in El Salvador to support the development of nontraditional exports. The implementing agency for the public sector component is MICE, discussed in Section II above.

The FUSADES component of the 519-0287 Project provided $26.9 million to support the activities of two existing program departments: (1) FORTAS - to provide technical assistance and training to improve the

capabilities of Salvadoran business associations; and (2) DEES - to undertake economic and social analyses and make policy recommendations to GOES on issues related to trade, investment and export expansion. In addition, grant funds were made available to support the establishment of an entirely new program within FUSADES dedicated to providing the technical assistance, business support services and promotional support required to facilitate the nontraditional export activities of the Salvadoran business community.

The PRIDEX program was launched in January 1985; its initial staff consisted of an Executive Director, four project managers and two support personnel; its present staff consists of eleven professionals and 3 secretaries. From August 1985 through 1987, PRIDEX operated under the guidance and support of technical assistance provided by Arthur Young, Inc. Since that time, FUSADES has taken over direct control of the program.

Through its technical assistance and promotional efforts thus far, PRIDEX records indicate that the program has been responsible for the creation of an estimated 5,723 jobs, $19,949,000 in export earnings, and $5,816,000 in new investment. 1/ The bulk of this economic activity has taken place in the apparel and light manufacturing sectors, operations especially relevant to the Project under consideration. In terms of both jobs created and export earnings, 1987 was a vast improvement over 1986 for these sectors and extrapolations from first quarter 1988 indicate that similar performance levels will be achieved this year, providing the political and social climate remains relatively stable.

2. Structure and Functions

The organizational structure of PRIDEX includes both administrative staff (in operations, systems production, information and contracts) and 6 sector specialists in the following areas:

- textiles/apparel (2)
- agro-industry (1)
- services, electronics, metal-mechanical (1)
- artisan crafts, pharmaceuticals (1)
- footwear, leather goods, wood, plastic, minerals (1)

Since its inception the PRIDEX program has provided direct assistance to over 130 clients through its sector analyses, business plan development, market studies and feasibility analyses for non-traditional business development. It has sponsored the participation of local companies in international conferences and trade fairs in the region and the United States and has hosted trade missions of Salvadoran business leaders to the U.S. and Mexico. A trip to the Far East is planned for the near future.

1/ Consolidation of PRIDEX records through first quarter 1988.

The services and resources of PRIDEX are available to all Salvadoran businesses engaged in nontraditional export activity. The program has established general criteria for project selection to ensure that its resources are targeted to viable projects; assistance is not automatic. In discussions with members of the business community, PRIDEX appears to have generated considerable support from those firms who have utilized or are aware of its services. However, it should also be noted that several of the companies contacted that had been working with PRIDEX were unfamiliar with the relevant various preferential trade programs and others appeared to have "fallen by the wayside" somewhere in the assistance process. It is unclear from these brief discussions whether such shortcomings have arisen from failure to followup in the case of the client or the organization. In either case, it appears that project tracking and information distribution could be improved, based on these informal discussions.

The 1988 Action Plan submitted by PRIDEX to USAID sets forth general objectives for the organization, they include: (a) to provide comprehensive client support; (b) to promote export growth; (c) to support infrastructure development; (d) to develop adequate lines of finance; (e) to improve national and domestic trransportation.

Specific tasks to be undertaken in support of these objectives are also enumerated, such as business plan development, market studies, technical assistance to be provided to PRIDEX clients; overseas promotion of investment opportunities in El Salvador through trade shows, commercial missions and preparation of informational materials; and facilitating the improvement of the investment climate in El Salvador by providing support to GOES to develop needed infrastructure, working with the BCR in its credit reviews, and assisting firms to obtain investment incentives available to them under the Export Promotion Law. The Action Plan also includes the sponsoring of ten "pilot projects", essentially the provision of full-service assistance (technical, managerial and financial) to high-potential initiatives to both develop new export generators and serve as a showcase for the potential that exists for export activities within El Salvador.

The program activities are complemented by operational and administrative objectives to improve the staff capabilities and administrative efficiency of PRIDEX, including the drafting of a personnel manual which defines each staff position and its performance objectives; the development of an internal system of planning and controls; and the drafting of a five-year plan for the Program as a whole, in coordination with key supporting organizations such as COEXPORT, DEES, and PRIDEX subcontractors.

It should be noted that since the expiration of the Arthur Young contract in 1987, PRIDEX has employed the services of International Technology Investment, Ltd. (ITI), formerly a subcontractor under the Arthur Young contract. The services offered by ITI are at two levels: direct assistance and training to PRIDEX executives, and the performance of studies and ongoing technical assistance for/to PRIDEX clients. For the most part, ITI's contracted duties focus in the area of market strategy development, market analysis, and business partnership promotion. In addition, PRIDEX has established an office in Miami to facilitate their investment promotion activities.

3. Implications

Given the obstacles to investment promotion, both foreign and domestic, in El Salvador the achievements of PRIDEX to date although short of project goals, are still significant. In a climate of uncertainty, the stimulation and effective implementation of long-term investment is a difficult task. The proven resiliency of the Salvadoran business community is perhaps the organization's greatest asset, nearly 400 clients have come to PRIDEX over the past three years seeking information and assistance, despite the continuing conflict.

The present organizational structure of PRIDEX is well-suited to the addition of a new "sector" specialist in free zone development. Given the present staffing patterns, a single direct hire will be hired to launch the program. Free zones are cross-sectorial industrial developments which increasingly include office or service-oriented components as well. The technical assistance required to conduct pre-investment analyses encompasses a knowledge of locational analysis, long-term financing, and property management principles, in addition to the market studies, demand analyses, and promotional strategy development upon which the efforts of the PRIDEX program are presently focussed. Free zone analysis, however is different from the industry-specific assistance now provided by the PRIDEX managers and project officers.

The optimal approach appears to be to hire an college-educated Salvadoran with a background in business who is familiar with free zones and experienced in nontraditional export activities, who can then be trained in the specifics of free zone development and serve as the contact point for the PRIDEX free zone program. Drawing from a roster of outside consulting firms, free zone specialists, and engineering/construction companies, PRIDEX can then contract out for both the training of its new staff member and for ongoing technical assistance in the execution of the free zone work program. The free zone specialist would bear responsibility for developing and implementing the program with the outside assistance of the contracted firm.

Working with a contractor will conserve resources and fast-track the program in a manner which would otherwise be impossible were PRIDEX to endeavor to develop the full spectrum of capabilities internally. The free zone specialist will also utilize existing resources of PRIDEX in market evaluations, promotional strategy development and informational efforts in support of the free zone program, with the guidance of the contractor.

There are a number of readily identifiable benefits to this approach. It not only allows PRIDEX to broaden its area of expertise to include free zones, but provides the immediate technical assistance required to get the project up and running. It guarantees the ongoing involvement of a firm with proven capabilities in the field to guide the development of the program until such a point is reached that PRIDEX can implement (directly or indirectly) the various components on its own. Finally, it takes into account the breadth of the ambitious institutional objectives that have been established by PRIDEX so that the organization can avoid spreading itself to thin. PRIDEX appears satisfied with the performance of ITI to date and should be able to establish a new working relationship with another firm successfully, drawing upon its past experiences.

VI. OTHER PRIVATE ENTITIES

The other private entities which, while not directly involved in the Project development, may be called upon to provide support services or designated as sub-grantees include COEXPORT, which is discussed briefly below.

A. COEXPORT

The Salvadoran Exporters Corporation (COEXPORT) is a membership organization made up of 160 individuals and firms with the objective of promoting Salvadoran exports. It produces a bimonthly publication with information on export production, related laws and governmental initiatives and data on topics of interest to exporters - potential markets, freight and cargo costs, actions of competitors, etc. It also offers seminars and workshops related to export development for its membership. Staffing is comprised of a manager, assistant manager, industrial engineer, public relations and computer specialists and support personnel. Funding is provided by member fees, special activities charges and contract work.

It is possible that PRIDEX will co-sponsor seminars related to the free zone project with COEXPORT, to broaden the potential audience. However, COEXPORT does not possess the experience or the organizational capacity to implement a Project of this size on its own, or to lead the work program with external support, in the short-term future.

B. Other Alternatives

COEXPORT, which is discussed above, is the most relevant, capable Salvadoran business associations which could be considered to provide the support to private developers and to undertake the promotion activities. There are no other private entities involved in investment promotion or free zones. The possibility of contracting a U.S. or Salvadoran firm to carry out promotional activities was considered and discarded for several reasons. One, augmenting PRIDEX' existing capacity is much more cost effective. Second, problems of duplication and gaps have arisen in other countries when more than one entity was involved in promotional activities. Three, one objective of the Project is to develop the capacity of a Salvadoran organization to effectively support and promote investment in free zones; utilizing a contractor does not develop institutional capabilities. Lastly, evaluations of PRIDEX have been very positive of its work; it make sense to go with a proven program rather than with an unknown.

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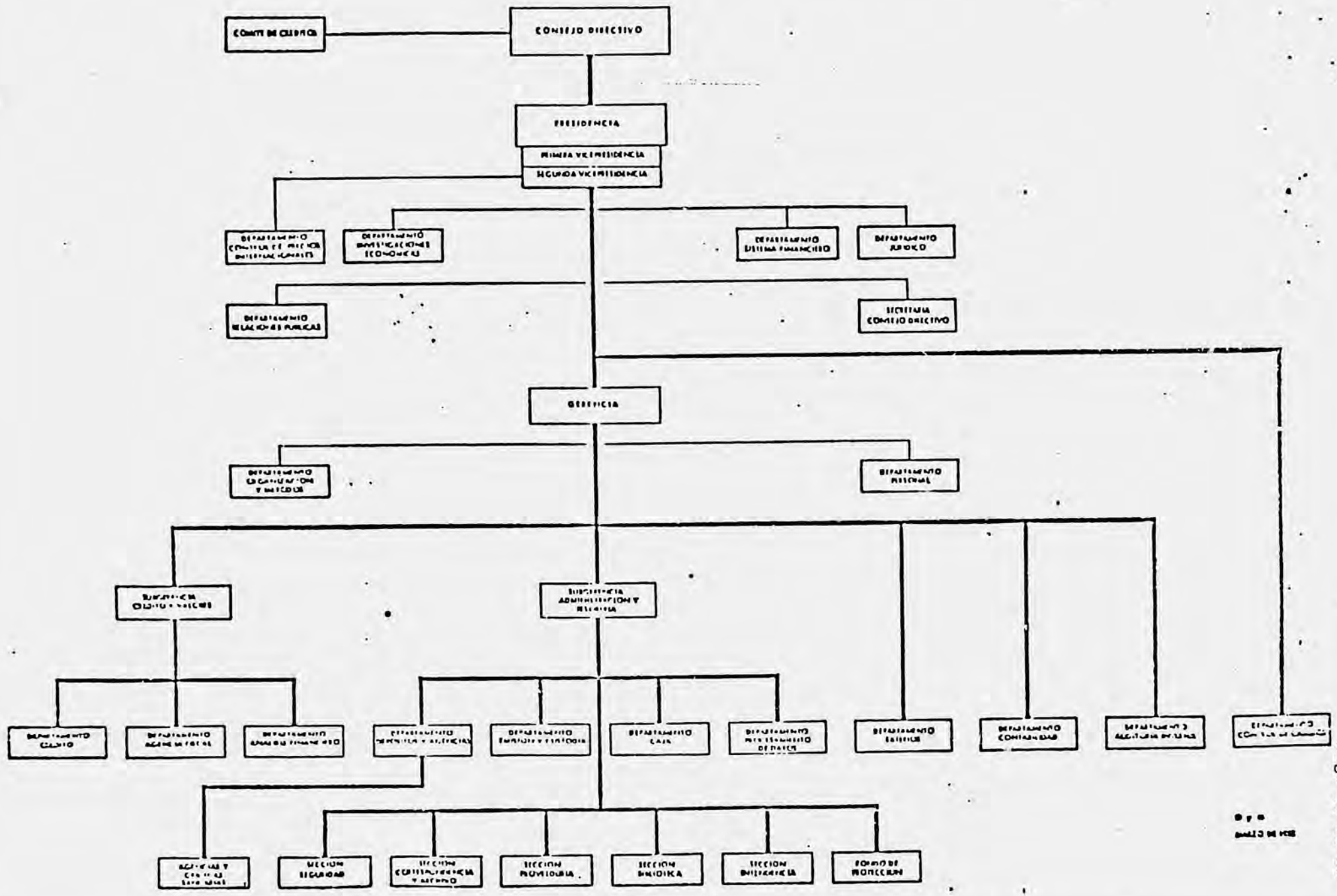

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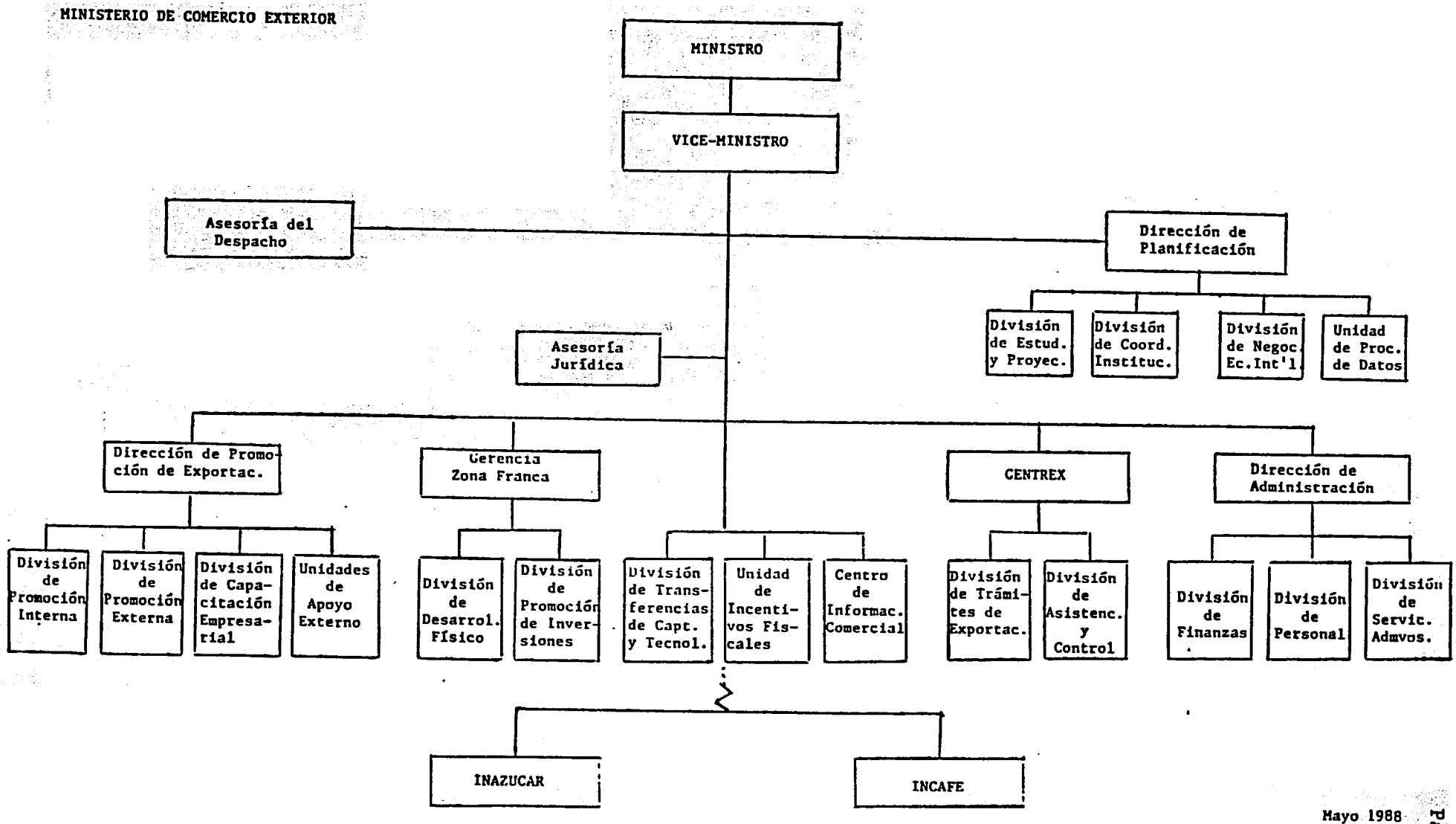

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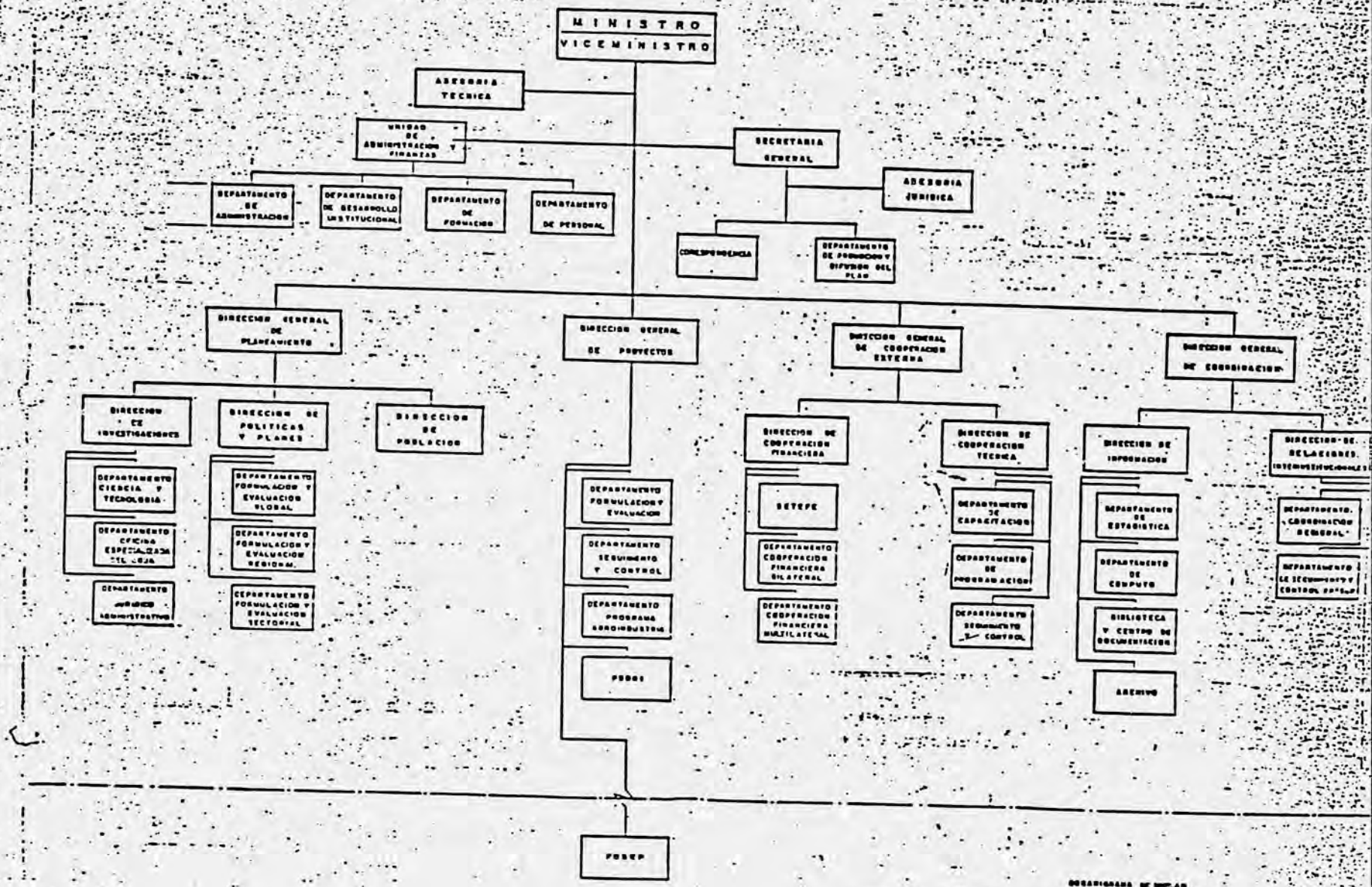
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DEPARTAMENTO DE PERSONAL
SECRETARIA GENERAL
ASESORIA JURIDICA
CORRESPONDENCIA
DEPARTAMENTO DE PROMOCION Y DIFUSION DEL PLAN
DIRECCION GENERAL DE PLANEAMIENTO
DIRECCION GENERAL DE PROYECTOS
DIRECCION GENERAL DE COOPERACION EXTERNA
DIRECCION GENERAL DE COORDINACION
DIRECCION DE INVESTIGACIONES
DIRECCION DE POLITICAS Y PLANES
DIRECCION DE POBLACION
DEPARTAMENTO CIENCIA Y TECNOLOGIA
DEPARTAMENTO OFICINA ESPECIALIZADA TELEJA
DEPARTAMENTO ADMINISTRATIVO
DEPARTAMENTO FORMULACION Y EVALUACION GLOBAL
DEPARTAMENTO FORMULACION Y EVALUACION REGIONAL
DEPARTAMENTO FORMULACION Y EVALUACION SECTORIAL
DEPARTAMENTO FORMULACION Y EVALUACION
DEPARTAMENTO SEGUIMIENTO Y CONTROL
DEPARTAMENTO PROGRAMA AGROINDUSTRIA
FOBOI
DIRECCION DE COOPERACION FINANCIERA
DIRECCION DE COOPERACION TECNICA
SETEPE
DEPARTAMENTO COOPERACION FINANCIERA BILATERAL
DEPARTAMENTO COOPERACION FINANCIERA MULTILATERAL
DEPARTAMENTO DE CAPACITACION
DEPARTAMENTO DE PROGRAMACION
DEPARTAMENTO SEGUIMIENTO Y CONTROL
DIRECCION DE INFORMACION
DIRECCION DE RELACIONES INTERINSTITUCIONALES
DEPARTAMENTO DE ESTADISTICA
DEPARTAMENTO DE COMPUTO
BIBLIOTECA Y CENTRO DE DOCUMENTACION
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DEPARTAMENTO COORDINACION REGIONAL
DEPARTAMENTO DE SEGUIMIENTO Y CONTROL
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ORGANIGRAMA DE MIPLAN
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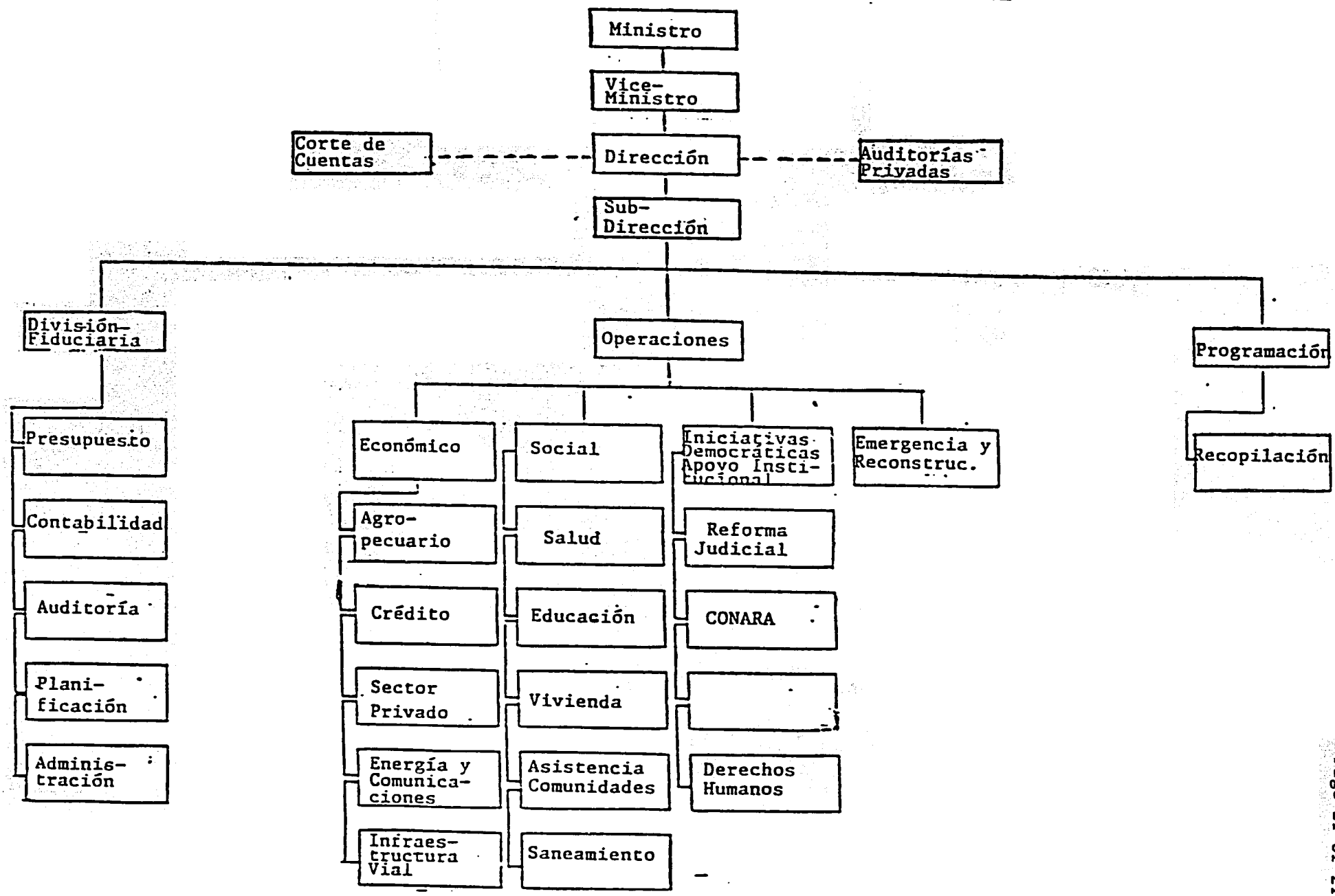

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UNOFFICIAL TRANSLATION

ANNEX L

FREE ZONE REGULATION

DECREE No.

THE PRESIDENT OF THE REPUBLIC OF EL SALVADOR

WHERE AS:

1) The Export Promotion Law emitted by Legislative Decree 315, dated March 13, 1986, published in the Official Newspaper No. 55, volume 290, dated March 21, 1986, authorizes the establishment and development of free zones. National and foreign enterprises may initiate any of the activities approved by this Law.

2) The following provisions are considered necessary to facilitate and ensure the application of the Law.

THEREFORE,

In the use of its constitutional powers given by Art. 168, volume 14 of the Constitution, the following is decreed:

GENERAL PROVISIONS OF FREE ZONES
CHAPTER I
PROVISION OBJECTIVE

Art. 1.- The objective of this provision is to develop basic norms for the promotion of exports related to the establishment and funcioning of free zones as one of the most important mechanisms of this Law to promote nontraditional exports.

Art. 2.- The Export Promotion Law is referred to herein as "the Law", the Ministry of Foreign Trade as "MICE", and the Free Zones Committee as "Comittee".

Art. 3.- For the purposes of this Law, commercial and industrial free zones are those "ex-customs" areas of national territory, previously qualified as free zones in which national and foreign enterprises directly export their entire production, including export products, export assembly and "maquila", and others enterprises performing related or complementary activities, are considered as beneficiaries under this Law.

Art. 4.- Free zones may be owned by the government, private individuals or entities, either national or foreign, in accordance with this provision.

Art. 5.- The establishment and exploitation of free zones by private parties shall be authorized by the Executive Body in the Ministries of Foreign Trade and Finance, after hearing the opinion of other government entities related to the development of works of this nature.

These government institutions will, in addition, exercise the surveillance and control of free zones owned by private parties, and shall set forth the operating rules.

Art. 6.- The Executive Body in the Ministry of Free Trade may, through a Resolution, delegate the management of free zones owned by the government to decentralized entitites or to a private individual or entity, national or foreign, for which purpose it shall enter into an agreement, in which the government shall be represented by the Minister of Foreign Trade, or the person he should designate.

In order to comply with the contract, MICE or the MICE-designated representative, will sign on behalf of the government the contract with the interested party in charge of the free zone administration or his designee.

Art. 7.- Free zones can be administered by private individuals or the government, to serve national or foreign enterprises exporting directly their entire production including export products, assembling parts, "maquila" or related activities.

The person in charge of free zones or his representative will be in charge of allocations to ensure that activities do not interfere with one another.

Art. 8.- Free zones owned by private institutions may be administered by national or foreign private individuals or entities.

CHAPTER II

THE FREE ZONES NATIONAL COMMITTEE

Art. 9.- The Free Zones National Committee is responsible for the execution of financial and administrative policies, geographical location and promotion related to free zones activities.

Art. 10.- This Committee will be comprised of MICE, MIPLAN, the Ministry Finance, the President of the Central Reserve Bank or their designees, and three members from the private sector appointed by the MICE and nominated by CODEXI.

Art. 11.- The Committee will be headed by the Minister or the Vice-Minister of MICE, or any person acting during their absence, or the President of the Central Reserve Bank.

Art. 12.- The Committee will have the following responsibilities:

a) promote the development of the operations and activities of free zones,

b) Study the feasibility of different areas for free zones, whether property of the government or natural persons.

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c) Free zones resolutions on prequalification.

d) Any other determination to be provided by the Committee.

CHAPTER III

FREE ZONES PRE-QUALIFICATION AND AUTHORIZATION OF EXPORTS

Art. 13.- Private individuals or entities, either national or foreign, interested in obtaining authorization to establish free zones in the country must submit a request to MICE for pre-qualification together with the following documentation:

a) Free zone areas, together with the certificate of property duly inscribed in the Property Register Office, a promise purchase contract authorizing its use as a free zone, for a period of at least 30 years.

b) Prefeasibility studies, charts and qualifications.

c) Evidence of services to be provided by the corresponding office.

MICE will submit these documents to the Committee within 15 days of receipt; the Committee which will decide whether to recommend the pre-qualification or not.

Art. 14.- MICE will request the following of the benefiaries once prequalification has been obtained:

a) Charts duly authorized by the corresponding office including the infrastructure such as roads or streets, location of the buildings and offices for the free zone administrators and customs, and any other places that may be considered necessary.

b) Technical/financial feasibility study.

Art. 15.- MICE will submit its final decision within 30 days of receipt of all documentation.

Art. 16.- MICE, based on the final decision and hearing other opinions from other public institutions involved in these activities, will provide its decision within 20 days upon receipt of the documentation, and will send it to the Ministry of Finance for its review. The Ministry of Finance will provide its decision within 20 days. If both entities approve the pre-qualification, the Designation Approval will be submitted within 20 days, authorizing the utilization and establishment of Free Zone. This agreement must be then published in the Official Newspaper as well as in one of the major newspapers of the country.

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Art. 17.- In the event the Ministry of Finance does not approve the designation, and the reasons for such rejection can be corrected, the Ministry of Finance will return all documentation to MICE, requesting the interested party resolve any anomaly for MICE's and the Ministry of Finance's analysis. The documentation will then be analyzed by the MICE-designated office, following the same procedure established in Art. 16 of this provision.

Art. 18.- In case of denial, the interested party may request reconsideration of MICE within 15 days of notification. MICE and the Ministry of Finance will then make the final decision in 20 days; otherwise it will be considered authorized.

CHAPTER IV

THE CONTENT OF THE DESIGNATION APPROVAL

Art. 19.- The document authorizing the establishment and utilization of free zone must contain the following:

a) All rights provided in Art. 30 of the Law.

b) Authorization period for the establishment and utilization of the free zone for not less than 30 years. This period can be extended for similar periods of time.

c) The initial infraestructure construction program of the free zone will specify the estimated starting and ending dates of construction.

d) Activities to be developed in the free zones such as: assembly, process, purification, manufacture, storage, packaging, unpackaging and repackaging, inspections, destroy and/or re-ship national or international merchandise, sell, exhibit and all other activities related with imports/exports, handling and resell are in accordance with this Law and provision.

e) Authority to build or contract the construction for the free zones, with adequate security, either for private use or rent.

f) Establish customs, security and health regulations in accordance with the requirements and recommendations by the Ministries of Finance and Public Health and Social Assistance.

g) Authorization to build, contract and coordinate the infrastructure construction and public services.

h) Authorization to execute any other activity related to this provision.

i) The designation approval will be valid for up to one year.

CHAPTER V

THE OPENING AND ADMINISTRATION OF FREE ZONES

Art. 20.- Upon completion of the first phase of the construction previously approved by MICE, the interested party will request authorization of the free zone opening.

Art. 21.- The corresponding office at MICE will inspect the construction to verify procedures stipulated in the original designation request and approved by a contract have been complied with. The following will be inspected:

a) Free zone construction.

b) Customs Offices designated to the Ministry of Finance in charge of free zone control.

Art. 22.- After eight days of inspection, the corresponding office at MICE will authorize the opening of the free zone if all requirements are met -- after which the developer may proceed with construction activities.

If the free zone requirements are not in compliance with this Law and provision, MICE will notify the interested party to resolve any problem.

The opening will take place once problems have been corrected, in accordance with the previous article.

Art. 23.- The free zone owner is responsible for establishing the physical limits of the zone to non-authorized personnel.

The areas of incoming and outgoing vehicles and persons to and from the free zone will be determined by the free zone administration.

Art. 24.- If the owner of the free zone has delegated responsibilities to any other person, he(she) must sign a contract approved by the MICE in accordance with Art. 8 of this provision.

If the delegation of authority by the free zone owner takes place before the opening, the contract will be submitted for approval prior to inspection.

In this event, all notifications related to free zone administration made by MICE and the Ministry of Finance will be channeled directly to the free zone administrator, keeping a copy for the owner of the free zone.

Art. 25.- It will be responsibility of the free zone administration to contract security services, which will:

a. Assure that all provisions for incoming or outgoing persons and vehicles be followed.

b. Protect free zone goods.

c. Security of all persons.

d. Other activities designated by the administration.

CHAPTER VI

THE INTERNAL REGULATIONS OF FREE ZONES

Art. 26.- The free zone representative will administer, control and handle free zone activities, providing and maintaining structures, buildings and services in perfect function.

In general terms, the designated administrator will perform general administration of free zone assigned directly to the owner pursuant to this law, to any resolution or authorization.

The free zone owner is responsible for the execution of these activities, and cannot transfer them to any other person including the administrator, even if he so appointed.

Art. 27.- The free zone owner or the administrator will perform the following activities:

a) Provide potable water, energy, and garbage systems, telecommunication, security and other public services necessary to carry out activities for the free zone users. Public institutions are committed to provide these kind of services.

b) Ensure that users cooperate with Customs Police in the application of this law and its provisions.

c) Coordinate free zone preventive maintenance such as roads, water supplies, garbage, gardens and electricity.

d) Authorize, when appropriate, the establishment of entities performing related or complementaries activities such as: cargo, discharge, unpacking, warehouse, packaging, transport, banking, mail, food service or any other service.

e) Construct and maintain warehouses, facilities, commercial buildings, externatal warehouses, cargo and discharge areas and other facilities.

To this effect signed contracts and concessions with private individuals or corporations for construction or provisions can be made.

f) Accept requests for its review and select entities willing to initiate activities covered under the Law or will be covered.

g) Perform activities of selling, leasing or sub-leasing and other concessions related with the land, facilities or any other construction located in the free zone in accordance with the terms and conditions that may be appropriate.

h) Provide the Ministry of Finance with the requested assistance and facilities to carry out their responsibilities related to the inspection and control of incoming-outgoing materials and merchandise of the free zone exports area.

Art. 28.- The lease contract must be notorized or a private authenticated document; its clauses will be negotiated between the owner or administrator of free zone and the user. The payments shall be in dollars, the national currency of the United States, and the equivalent in colones.

CHAPTER VII

ENTRY OF FOREIGN GOODS REQUIRED IN FREE ZONES

Art. 29.- The entry of goods requested by enterprises will be subjected to this Chapter.

Art. 30.- Goods shipped from foreign markets to Free Zones, must be consigned to the owner including brands and labled stating: "FREE ZONE__, EL SALVADOR".

If the consignation is not in accordance with the above, Customs is not responsible for any delays. However, Customs, upon the owner's written request, and through Amendment Letter would solve any problem.

Art. 31.- The transportation of goods from Customs to the free zone will be done by submitting a temporary import authorization or airway bill.

The temporary authorization will be given to Customs upon arrival to the free zone; and the airway bill, if any, will be given to the Customs employee.

Art. 32.- Goods will be unloaded at the free zone warehouse directly, either with the acting free zone Customs on behalf of and with previous authorization of the Customs Directorate.

After unloading, goods will be at the consignee's disposal when previous authorization of the temporary receipt or "póliza" Customs has been obtained. If the merchandise is admitted on a inter-customs bill, it will be subject to the control and registration of Customs.

All enterprises are required to submit to the free zone administration, copies of invoices within 24 hours of receipt of each shipment.

Art. 33.- In case of fraud, the administrator and Customs will be notified immediately and will keep the merchandise inside the free zone, without authorizing its delivery to the interested enterprise while Customs solves the problem, which will be done within eight days of receipt of the written notification.

Art. 34.- In the event of an infraction, the Customs General Directorate will apply penalties pursuant to his authority and will notify it to the interested party or administrator. Should the infractions comitted result in a crime or misdemeanor, the Ministry of Foreign Trade will turn the matter over to the Attorney General's Office in order that it may initiate and exercise the proper actions.

CHAPTER VIII

EXIT OF FREE ZONE GOODS TO THE FOREIGN MARKETS

Art. 35.- To return capital goods imported with a customs "franquicia", the interested party must obtain authorization from the Ministry of Finance, submitting a request together with the Import Authorization or "franquicia". The return of such goods is not subject to any taxes or other charges. The return of raw materials or accessories and components, will not require a request be submitted; the approval of the Ministry representative in the zone will be sufficient. The return of such goods is not subject to taxes or other charges.

Art. 36.- The transportation of goods to Customs will be authorized by the free zone Customs representative, following established mechanisms to avoid any risk during transportation.

The corresponding office at Customs, upon receipt of all documentation, will authorize the shipment. Goods will be inspected only when anomalies are detected; i.e. possible fraud.

Art. 37.- After shipment, the interested party will submit to the corresponding office at the Ministry of Finance, a set of copies to legally prove the return of the goods within three business days after shipment.

CHAPTER IV

GOODS IN FREE ZONES

Art. 38.- Goods in the free zones must be stored temporarily at the Customs area and are subject to Chapters 22, 44, 45 and 49 of the Law. The free zones owners are authorized to import goods and necessary inputs for their productive process, if they are are not subject to fiscal exceptions, ruled as per Art. 48 of the Law.

Art. 39.- All goods warehoused in free zones can be sold by the producers in accordance with Articles 42, number 2, and 46 of the Law. The value for customs purposes will be adjusted as per current legislation on Customs tax regulations; the free zone administration will make appropriate recommendations to MICE and the Ministry of Finance and will establish the procedures and forms to be used.

Art. 40.- The transfer of goods produced or stored in free zones should be previously authorized by the administration and Ministry of Finance. The administration will establish the procedures and forms to be used.

Art. 41.- Goods deposited in free zones will not receive this treatment in the following cases:

a) When the owner or legal representative abandons the goods, and

b) When there is evidence that the enterprise abandoned of goods.

The corresponding legislation will be applied to both cases. Import duties will be paid to Customs and to the administration for any expense incurred due to warehouse, maintenance or any other service in order to proceed with auction.

CHAPTER X

OBLIGATIONS OF USERS OF FREE ZONES

Art. 42.- In addition to obligations set forth by the Law and provisions, free zones enterprises must:

a) Maintain a permanent inventory of goods to allow fiscal control at any time.

b) Submit quarterly reports to the free zone administration indicating operational status, including the percentages they may dispose of, and an account of manufacturing leftovers or deduction for waste.

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c) Submit to the Central Reserve Bank, the corresponding foreign exchange form with a copy to the free zone administration on monthly basis. The information should include units, kilos and costs in local currency and in US dollars.

Art. 43.- All accounting books and forms should be authorized and reviewed by the corresponding office at MICE.

Art. 44.- The users and the free zone administration are committed to facilitate to the Ministry of Finance employees the necessary documents and accounting books to determine application of Art. 47.

CHAPTER XI

THE USE AND MANAGEMENT OF FOREIGN EXCHANGE

Art. 45.- All transactions in foreign currency requested by the free zones enterprises will be subject to regulations established by the Central Reserve Bank and the Monetary Board.

Art. 46.- Transactions and operations of free zone enterprises, private individuals or entities domiciled in national territory requesting goods, payment of general services, banking, or any other services that require foreign exchange, will be subject to regulations established by the Central Reserve Bank and the Monetary Board.

Art. 47.- Commercial transactions between enterprises outside and inside of free zones will be considered as national exports subject to exchange rate regulations.

Art. 48.- Merchandise produced in free zone and sold in El Salvador will be considered as national imports subject to national exchange rate regulations.

Art. 49.- Goods and services provided by the free zone administration such as water, electricity, insurance, telephone, telex, cleaning and maintenance are basic conditions for the free zone functioning, users will have free access to the facilities with no tax implication since they are not considered export activities.

Art. 50.- Foreign exchange requirements of free zones enterprises will be requested through commercial banks based on availability and converted to local currency, based on exchange rates in accordance with legal regulations.

Art. 51.- Enterprises will be subject to proof that payments in colones were made by commercial banks. All transactions must be reported on the corresponding form provided by the Central Bank, stating that currency exchange procedures are in accordance with legal regulations.

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Art. 52.- In order to statistically control all foreign exchange transactions requested by free zone enterprises, they will be subject to submit a special form provided by the Central Bank every month, sending the original to the Bank and a copy to the Free Zone Administration within eight days of the following month.

CHAPTER XII
OBLIGATIONS AND PENALTIES

Art. 53.- Violations to the Law and its Provisions are subject to the Criminal Code and other legal regulations.

Art. 54.- Pursuant to Chapters 51 and 52, the Ministry of Foreign Trade will fine the guilty parties in accordance with their economic capacity and the type of infraction.

Art. 55.- Fines referred to under the previous article shall be applied to: a) failures in the health, hygiene and security norms such as unacceptable maintenance levels and warehouse of of dangerous materials, b) weakness in the security systems, and c) providing false data when requested.

Art. 56.- The execution of fines will be pursuant to number 2 of Chapter 52 of the law, granting right of appeal of the interested party within 24 hours of notification.

The MICE resolution will be considered as an Executive Order. If within 15 working days of notification, the fine is not paid voluntarily by the interested party, MICE will turn the matter over to the Attorney General's Office in order to initiate and exercise proper actions.

Art. 57.- MICE will temporarily suspend payment of the incentives granted by this law as established in Art 52 due to: imports of prohibited articles, drugs, weapons and others.

Art. 58.- After MICE has been notified of infractions referred to under the previous article, the guilty party will be notified accordingly within three consecutive days of the alleged infraction and given the right to appeal within the following eight days the previous opinion by the Ministry of Finance, which will issue a resolution within the next five days of appeal.

The guilty party will be notified of the corresponding resolution. In event of a revocatory or temporary suspension, the party may request reconsideration within three days of notification to MICE.

A resolution will be issued within 15 days after the reconsideration is requested.

Art. 59.- Should the infractions comitted result in a crime or misdemeanor, the Ministry of Foreign Trade will turn the matter over to the Attorney General's Office in order that it may initiate and exercise the proper actions arising form such infractions against the guilty parties.

Art. 60.- The beneficiaries of the fiscal incentives granted by this law, in the event of failure to perform the obligations contained herein, in addition to any penalties that might be applied under the Criminal Code, shall be excluded definetely from the granting of fiscal incentives.

CHAPTER XIII
GENERAL PROVISIONS

Art. 61.- The free zones beneficiaries are subject to the execution of laws, regulations and any other labor and social security regulations as well as all other obligations, except for exenorated activities.

Art. 62.- The Executive Body in the Ministry of Foreign Trade within its respective competence, will issue instructives , orders and other provisions necessary for developing and complementing the principles established in this law, in order to expediting its application.

Art. 63.- Non-provided stipulations under this law are subject to common law but without interfering with this law and its provisions.

Art. 64.- This Provision shall become effective eight days after its publication in the Official Newspaper.

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ANNEX M: DETAILED BUDGETS

A. Private Zone Development

1. Credit: Fifteen hectares is generally considered the minimum practical size for free zones/industrial estates to achieve economies of scale in their development and operation. The size of the "typical" free zone to be funded under this Project has been estimated at 20 hectares. Precise cost data are not available because sites have not been specified, and targeted industrial sectors and accompanying facilities and services requirements have not been identified. However, based on the detailed cost analysis contained in Annex H, it is estimated that the cost of developing 1/2 a free zone of 20 hectares in current terms is $9,947,622. The A.I.D. Grant will finance up to 75% of the total development cost of 1/2 the "typical" free zone and the developer will contribute with the other 25%, but there is no certainty on the exact size of the free zone that the private developer will wish to build. Based on this, $20.0 million have been budgeted to finance at least two free zones, depending on the needs of the private developer.

2. Technical Assistance to Private Zones: From the experience in other countries of the region, it is estimated that the cost of a full pre-investment study can range from $500,000 to $1,000,000. These studies should contemplate site selection/location analyses, prefeasibility, and feasibility studies, which can cost approximately $75,000, $200,000, and $500,000, respectively. Under the Project, $2,020,000 has been budgeted to finance up to 75% of the cost of approximately five pre-feasibility and three feasibility studies, most of which will be carried out during the first two years of the Project. The beneficiary will pay at least 25% of the cost of the activity.

3. Zone Management Training: International training costs have been estimated based on the figures provided by the USAID/El Salvador's Office of Education and Training Office (OET), which show a cost of $5,000 per month for short and long-term training. An analysis conducted by the Mission for Project 519-0349, Technical Support, Policy Analysis, and Training, showed that the average participant/month cost for in-country training is $1,734. The $120,000 budgeted for this sub-component of the Project will finance up to 75% of the cost of each activity and the participant will pay the remaining 25%.

International training activities may include courses offered by international free zone associations (e.i. World Export Processing Zone Association) in subjects such as the concept, role and development of free zones; physical planning; financial management; promotion; negotiations with clients, and services. During the Life-Of-Project, it is estimated that 24 person/months will be required to fully train two to three free zone managers, at a minimum. In-country training will be carried on a much lower scale and will consist of seminars on Salvadoran free zone development and investment regulations and procedures. Approximately, 6 participant/months will be financed with Project funds throughout the five year LOP.

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In addition, observational travel to free zones in other countries of the region (Dominican Republic, Costa Rica, México, Honduras) will be financed for the purpose of acquainting the participants with the operational/ management procedures used in these countries. The estimated cost of each trip is $3,000. It is envisioned that 9 observation trips will be sponsored by the Project.

Summary of Expected Expenditures

a)	Short-term International Training Up to 75% of 24 person/months at $5,000/month	$ 90,000
b)	Short-term In-country Training Up to 75% of 6 person/months at $1,734/month	$ 7,803
c)	Up to 75% of 9 observation trips at $3,000 each	$ 20,250
	Total	$118,053

4. PRIDEX Operational Support: This line item includes financing the additional staff member for PRIDEX during the life of the Project. The support includes salary and fringe benefits, office equipment, training and observational travel. The salary and fringe benefits have been made based on the compensation currently offered by FUSADES to PRIDEX staff. The training and observational travel costs were based on the figures used in item (3) above. It is expected that the sector specialist to be hired by PRIDEX will attend at least two short-term courses on free zones and will make approximately seven observational trips to other free zones in the region. The training will be carried out mainly during the first two years of the Project, while the trips will be done throughout the life of the Project. (See Table 1 for detailed budget.)

5. A.I.D. Project Manager: The amount budgeted will cover salary and fringe benefits, international travel and training, a project vehicle and maintenance thereon, and office equipment. Compensation costs and fringe benefits were provided by the Executive Office, USAID/El Salvador for a Grade 12 FSN position. The same criteria used for the training to be provided to the PRIDEX staff member has been applied for the calculations of the A.I.D. Project Manager training costs. Based on Mission experience, it has been estimated that vehicles prices can range from $15,000 to $18,000. An additional 30% of the cost of the vehicle is calculated for maintenance costs. (See Table 2 for detailed budget.)

B. Promotion and Marketing

Under this component A.I.D. will support PRIDEX' efforts to increase the scope of its present activities to encompass a concentrated free zone promotional effort. Funds will also be provided to PRIDEX to contract outside technical assistance to help in the formulation and execution of a zone promotional strategy and the development of promotional materials. Costs of promotional efforts can vary depending on the types of activities that are carried out. PRIDEX has budgeted approximately $200,000 for its 1988 promotion activities carried out for Projects 519-0265, 519-0287 and 519-0327,

which include observation trips and publications. However, given the negative image of El Salvador internationally, it is expected that a higher amount will be required to undertake a free zone promotional effort. This is confirmed by the results of a study prepared for A.I.D. by Coopers and Lybrand in February of 1986, which showed that even though El Salvador offers many of the same advantages as other countries of the region, it has not been able to compete effectively due, in no small part, to a "poor promotion as well as the lack of a concerted marketing effort to change adverse investor perceptions". A total of $1.16 million has been budgeted under the Project for promotion activities, which may include publications, seminars, videos, promotional materials, invitational travel, direct mailing, etc. Distribution of the funds among these various activities will be made once it has been determined what would be the most effective tool for both local and international promotion.

With regard to the technical assistance, since PRIDEX has already established a solid institutional foundation for promoting investment opportunities in El Salvador and the development of export-based production activities within the country, it is estimated that 15 person/months of technical assistance at $20,000 per month (a total of $300,000) will be enough to enable PRIDEX to undertake a multi-faceted promotional effort in support of the free zones in El Salvador.

C. Infrastructure and Institutional Support

1. Public Sector Training: This includes training for at least one credit analyst at each of the 12 Salvadoran commercial banks and one or two at the BCR. In-country seminars/workshops will be organized to train these individuals in free zone project credit analysis. An international expert or team of experts will be contracted to carry out the seminars. It is estimated that groups of 4-6 persons will formed and that at least two training sessions will be undertaken with a duration of approximately one month each. In addition, training will be provided to Customs personnel on free zone related customs procedures utilizing a method similar to the above. The Project also contemplates training to MICE staff (other than the Project Coordination Unit) and the Ministry of Finance (other than Customs). Overall, it is estimated that some 60 person/months of in-country training and 8 person/months of international training will be required. Training will be an ongoing activity during the five years of the Project.

Summary of Expected Expenditures

a)	In-country training (*) 60 person/months at $1,734/month	$104,040
b)	International training 8 person/months at $5,000/month	$ 40,000
	Total	$144,040

(*) Foreign experts will be contracted to conduct the seminars in-country. Since this may raise the cost per person/month of the training, the total amount budgeted is $160,000 to cover for this possible increase.

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2. Public Sector Technical Assistance: This sub-component will support GOES efforts to increase the effectiveness of its existing free zone, develop a master plan for public zone development, establish and effective regulatory system for assessing and supervising the development of private free zones in El Salvador, and carry out a detailed pre-investment analysis of a new public free zone project. Fifteen person/months of technical assistance at $20,000 per month are estimated to be required for this effort, or a total of $300,000. This activities will probably start in the second year and will go on until the end of the Project.

3. Infrastructure: It is difficult at this stage to determine the exact cost of the up-to-the-gates infrastructure to be required by the Project as the sites where the zone(s) will be located have not yet been identified. However, since the most probable locations are the Soyapango (Department of San Salvador) and the Comalapa (Department of La Paz) areas. The USAID/El Salvador Office of Infrastructure, Regional Development, and Earthquake Reconstruction (IRD), in consultation with CEL, prepared estimates on costs for public infrastructure upgrades in these areas. Based on their experience, the Mission considers that the amount budgeted for this effort adequate enough to cover all the infrastructure needs costs.

4. MICE Project Coordination Unit: Institutional support to MICE will be provided under this sub-component to carry out the functions assigned to this Ministry by the Free Zones Regulating Procedures and the activities contemplated under the Project. This support will include technical assistance to create and organize a Project Coordination Unit to be composed of three local staff members. The cost of this activity has been calculated based on the recent Mission experience with Project 519-0287, Industrial Stabilization and Recovery, under which the CODEXI Local Support Coordinating Unit at MICE is financed. (See Table 3 for detailed budget.)

D. Capital Expenditures (FUSADES Building Fund): A total of $700,000 has been budgetted as this Project's contribution to the construction costs of FUSADES' new office building. The office building is located in Urbanizacion Santa Elena on the road to Santa Tecla (on the border of the Departments of La Libertad and San Salvador), approximately 15 minutes from the city of San Salvador. The Mission has reviewed the plans and cost estimates for the building and finds them reasonable. The proposed sizes of the individual offices are in keeping with standard sizes for AID office space, per Handbook 23. FUSADES has purchased an 11,340 m^2 piece of land for the building site with its own funds. The three story building will house approximately 135 of individuals, at an estimated cost of $2.6 million.

E. Evaluation/Audit

Funds are budgetted for two formal evaluations to be carried out in mid-1990 and 1993. The required annual audits by local affiliates of U.S. CPA firms of the implementing entities will not be funded by A.I.D. under the Project. In the event that an additional audit of the Project is deemed necessary, it will be funded out of this line item ($200,000).

F. Contingencies

A contingency line item of $350,000 (about 1.35% of total A.I.D. cost of the Project) is included. Due to the degree of flexibility in each of the cost components, a greater contingency factor is not needed.

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FREE ZONES DEVELOPMENT PROJECT
PRIDEX OPERATIONAL SUPPORT ESTIMATED BUDGET

TABLE 1

LINE ITEM	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	LOP
		(COLONES)				
1. Compensation	108,000	118,800	130,680	143,748	158,123	659,351
2. Fringe Benefits (22%)	23,760	26,136	28,750	31,625	34,787	145,057
Sub-Total	131,760	144,936	159,430	175,373	192,910	804,408
3. Training, Travel and Per Diem (International and in-country)	45,000	40,000	35,000	20,000	15,000	155,000
4. Office Equipment	25,000	5,000	4,000	2,000	2,000	38,000
TOTAL COLONES	201,760	189,936	198,430	197,373	209,910	997,408
TOTAL DOLLARS	40,352	37,987	39,686	39,475	41,982	199,482
		(US DOLLARS)				
COLONES COMPONENT (in US$)						
Compensation	26,352	28,987	31,886	35,075	38,582	160,882
Office Equipment	5,000	1,000	800	400	400	7,600
Sub-Total	31,352	29,987	32,686	35,475	38,982	168,482
DOLLARS COMPONENT						
Training & trips	9,000	8,000	7,000	4,000	3,000	31,000
Sub-Total	9,000	8,000	7,000	4,000	3,000	31,000
TOTAL	40,352	37,987	39,686	39,475	41,982	199,482

FREE ZONES DEVELOPMENT PROJECT
AID PROJECT MANAGER ESTIMATED BUDGET

TABLE 2.

LINE ITEM	YEAR 1 Grade 12/1	YEAR 2 Grade 12/2	YEAR 3 Grade 12/3	YEAR 4 Grade 12/4	YEAR 5 Grade 12/5	LOP
		(COLONES)				
1. Compensation and Bonus	119,408	124,395	129,382	134,369	139,356	646,910
2. Danger Pay (15%)	14,974	15,611	16,248	16,884	17,521	81,238
3. Health Insurance	290	290	290	290	290	1,450
4. Life Insurance	923	923	923	923	923	4,615
5. Overtime (based on 200 hrs./year)	10,152	10,576	10,998	11,422	11,844	54,992
Sub-Total	145,747	151,795	157,841	163,888	169,934	789,205
6. Training, Travel and Per Diem (International and in-country)	50,000	45,000	25,000	25,000	15,000	160,000
7. Contingencies (15% of 1 thru 5)	21,862	22,769	23,676	24,583	25,490	118,381
TOTAL COLONES	217,609	219,564	206,517	213,471	210,424	1,067,586
TOTAL DOLLARS	43,522	43,913	41,303	42,694	42,085	213,517
		(US DOLLARS)				
COLONES COMPONENT						
Salaries + Contingencies	33,522	34,913	36,303	37,694	39,085	181,517
Gasoline	2,880	2,880	2,880	2,880	2,880	14,400
Sub-Total	36,402	37,793	39,183	40,574	41,965	195,917
DOLLARS COMPONENT						
Training & trips	10,000	9,000	5,000	5,000	3,000	32,000
Vehicle	18,000	0.00	0.00	0.00	0.00	18,000
Vehicle maintenance (30% of cost)	1,080	1,080	1,080	1,080	1,080	5,400
Office Equipment	6,000	0.00	0.00	0.00	0.00	6,000
Sub-Total	35,080	10,080	6,080	6,080	4,080	61,400
TOTAL	71,482	47,873	45,263	46,654	46,045	257,317

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FREE ZONES DEVELOPMENT PROJECT
MICE PROJECT COORDINATING UNIT

TABLE 3

LINE ITEM	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	LOP
		(COLONES)				
A. Technical Assistance						
International consultant (6 person/months at $20,000)	250,000	200,000	150,000	0.00	0.00	600,000
B. Local Project Coordinating Unit						
1. Compensation						
a. Coordinator	120,000	132,000	145,200	159,720	175,692	732,612
b. Assistant	48,000	52,800	58,080	63,888	70,277	293,045
c. Secretary	30,000	33,000	36,300	39,930	43,923	183,153
Sub-Total	448,000	417,800	389,580	263,538	289,892	1,808,810
C. Training & Travel	40,000	35,000	25,000	20,000	15,000	135,000
D. Office Equipment and Materials	24,000	9,000	7,500	7,500	7,500	55,500
TOTAL COLONES	512,000	461,800	422,080	291,038	312,392	1,999,310
TOTAL DOLLARS	102,400	92,360	84,416	58,208	62,478	399,862
		(US DOLLARS)				
COLONES COMPONENT						
Local Project Coordinating Unit	39,600	43,560	47,916	52,708	57,978	241,762
Office Equipment and Materials	4,800	1,800	1,500	1,500	1,500	11,100
Sub-Total	44,400	45,360	49,416	54,208	59,478	252,862
DOLLARS COMPONENT						
Technical Assistance	50,000	40,000	30,000	0	0	120,000
Training & Travel	8,000	7,000	5,000	4,000	3,000	27,000
Sub-Total	58,000	47,000	35,000	4,000	3,000	147,000
TOTAL	102,400	92,360	84,416	58,208	62,478	399,862

ANNEX N: SUMMARY OF EXPORT AND INVESTMENT POLICIES, LAWS, AND REGULATIONS

CURRENT EXPORT AND INVESTMENT INCENTIVES IN EL SALVADOR

FISCAL INCENTIVES

I. EXPORT PROMOTION LAW

Qualifying enterprises receive total export duties exemption, total income tax exemption for up to 10 years, total tax exemption on assets or equity for up to 10 years. Additional benefits include:

a) Enterprises directly producing nontraditional products and exporting 100% of their production outside Central America:
   - Total import duties exemption.

b) Enterprises directly producing nontraditional products and exporting 25% of their production outside Central America:
   - Total import duties exemption for up to 10 years extendible for an equal term (when the business does not enjoy other fiscal incentives).

c) Enterprises engaged in assembly or drawback:
   - Total import duties exemption (for industrial firms for up to 10 years)

d) International marketing enterprises outside the Central American Region:
   - Total import duties exemption for up to 10 years extendable for an equal term

e) Enterprises exporting services:
   - Total import duties exemption

f) Enterprises developing free zones:
   - Total import duties exemption

g) Tax Credit Certificate (CDT)

Exporters of nontraditional products are entitled to obtain tax credit certificates for up to 30% of the f.o.b. value of exports, depending on the type of products. The CDTs are, in principle, are fully negotiable and can be used for the payment of taxes or other obligations with the Government.

II. FOREIGN INVESTMENT LAW

The Law permits unrestricted repatriation of net profits and foreign capital invested in the country for net dollar producing entities, and up to 50% for financial, commercial and services enterprises.

FINANCING AVAILABLE

I. BCR EXPORT CREDIT LINE

Finances up to 100% of f.o.b. value of non-traditional exports. Terms: up to 180 days for consumer goods, up to 365 days for capital goods; interest rate: outside CACM 13%, CACM 15%.

II. BCR PRE-EXPORT CREDIT LINE

Finances working capital for placed orders of traditional and nontraditional exports. Terms: up to 180 days for consumer goods, up to 365 days for capital goods; interest rate: outside CACM 13%, CACM 15%.

III. BCR LINE OF CREDIT FOR PURCHASES AND PROCESSING OF NONTRADITIONAL EXPORTS

Finances up to 100% of the value/value added of domestic products for export, required industrial inputs, national handicrafts requiring special finishing or packing before exporting. Terms: up to 180 days for placed orders; interest rate to be established by the Monetary Board.

IV. INDUSTRY AND AGRO-INDUSTRY CREDIT LINE

Finances temporary and permanent working capital; export related investment; processing or purchases not-for-export goods; construction or remodelling of industrial buildings, machinery and equipment, spare parts, and import and installation costs; feasibility studies for new or expansion projects, and refinances debt, except debt obtain from FRI, export and pre-export lines of credit. Terms: up to C5.0 million for individual firms, up to C8.0 million for groups of firms; interest rates: financing 14% interest, refinancing 19%, different terms of repayment according to the purpose of the loan.

V. BCR EQUITY INVESTMENT CREDIT LINE

Finances up to 100% of the nominal value of stocks or other documents representing in industrial firms. Terms: investment in small industries, 13% interest; investment in medium and large industries, 15% interest; up to 15 years with 2 years grace.

FOREIGN EXCHANGE INCENTIVES

Preferential treatment is given to exporters with relation to the exchange control system.

1. Exporters of nontraditional products can open and maintain dollar denominated (or other currencies, i.e. quetzales or lempiras) accounts with their exports proceeds, use their foreign exchange for their own imports and sell to importers of industrial products the surplus, at a negotiated exchange rate above the official exchange rate.

2. Exporters of nontraditionals that sell their foreign exchange proceeds to the BCR within 180 days after the shipment, the BCR will reimburse their financing costs with a "Certificado de Bono de Pronto Reintegro" issued in Colones. These Certificates do not gain interests and can be freely negotiated, used as credit guarantee, used as guarantee deposit for imports, or for payments on loans obtain through special lines of credit.

ADMINISTRATIVE INCENTIVES

1. A new exporters registration was created with the purpose of facilitating exports. This exporters registration system is administered by MICE.

2. A One Stop Export Documentation (CENTIFEX) was created within MICE with the purpose of consolidating and expediting the licensing and regulatory procedures related to forein and domestic firms' export production activities.

3. FUSADES EXPORT PROMOTION AND INVESTMENT PROGRAM

The Export and Investment Promotion Program (FRIDEX) at FUSADES provides the following services to local or foreign firms wishing to establish or expand nontraditional exports operations: market research, assistance in project development, assistance in co-investments, concessions/contracts, technical assistance, and economic assistance.

FISCAL INCENTIVES	FINANCING AVAILABLE	FOREIGN EXCHANGE INCENTIVES	ADMINISTRATIVE INCENTIVES
	VI. BCR LINE OF CREDIT FOR THE PRODUCTION OF HANDICRAFTS Finances working capital, purchases of machinery and equipment, buildings, and technical assistance in production and marketing. Terms: up to 1 year for production with placed orders, up to 4 years (one year grace) for permanent working capital and technical assistance, up to 8 years (one year grace) for purchase of machinery and equipment, and up to 15 years (4 grace) for construction; interest rate: 10%.		
	VII. LINE OF CREDIT FOR REFINANCING INDUSTRY AND AGROINDUSTRY REHABILITATION Refinancing default on obligations, refinancing of overdue capital payments, and refinancing of of overdue interest payments. Terms: up to 10 years, with one year grace; interest rate, 4 points below the interest on current loans.		
	VIII. PROINVER (Investment Promotion Insurance System) The principal objective of PROINVER is to promote and protect private sector investment in El Salvador against terrorism and politically motivated violence by providing indemnities to replace or repair plants damaged or destroyed due to terrorism or politically motivated violence. This insurance is available for all firms qualifying under the Export Promotion Law.		
	IX. FUSADES INVESTMENT PROMOTION FUND (FIDEX) FUSADES has available $15.0 million for the FIDEX Program for local currency or foreign exchange financing. Through the FIDEX Program FUSADES can provide funding for loans or equity investments to local or foreign firms wishing to establish or expand industrial maquila operations or light manufacturing or assembly business in El Salvador, and can fund loans with the purpose of increasing the production and in El Salvador.		