PD-ABC-002

R O C A P

COUNTRY PROGRAM STATEMENT

FY 1985 - FY 1989

April 1984

COUNTRY PROGRAM STATEMENT

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I. BACKGROUND

A. Origins of the Current Economic Crisis in Central America

When growth in the industrialized countries began to falter under the impact of the oil price shock —and the domestic inflation and the international monetary disorder that came in its wake— the Central American economy, buoyed by good commodity prices, demonstrated considerable resilience by growing at a 5.5% real annual rate between 1970 and 1978. However, underneath this strong economic performance lay a fragile basis; the gap in the balance of payments, caused principally by the increase in oil prices, was increasingly covered by large external borrowing, both public and private.

The Fall in Coffee Prices. In 1978, the bubble burst and economic growth rates in Central America began their long downward slide. The trigger was the collapse in coffee prices; in 1977, this single commodity accounted for 60% of commodity exports and 44% of total exports. When its price fell by 31% in 1978, followed a year later by a doubling in oil prices, the Central American economy reeled under the decline in the terms of trade. Overall, regional terms of trade fell 37% between 1977 and 1978, bringing about a dramatic drop in real incomes and a widening gap in the balance of payments.

Political Turmoil. The political strife in Nicaragua and El Salvador accelerated the decline in the region's economy. The insurgency in El Salvador contributed to the 1.5% decline in the Salvadoran economy in 1979, and, in the same year, the civil war in Nicaragua came to a climax and the economy contracted 25% in real terms.

The Reduction In Net Capital Flows. The coup de grace to the regional economy was the virtual disappearance of private capital flows in 1979. Concerned by the economic downturn —and especially by the ominous political situation developing in Nicaragua, El Salvador and Guatemala— foreign suppliers ceased to extend short-term credits, foreign direct investment slowed, and Central Americans began to send their liquid holdings outside the region. Foreign bankers, also worried by these conditions and concerned about their exposure in Central America, began to cut back on net lending the following year. Consequently, official flows and net reserves began to take on the burden of closing the balance of payments after 1979; in 1980 alone, net international reserves declined by $900 million.

The Near Collapse of Regional Trade. A further critical factor in accelerating the downward economic spiral in the region was the 42% real contraction in intraregional trade between 1978 and 1983. Since 1960, such trade had absorbed a growing percentage of the output of the region's manufacturing sector; in 1978, 12% of all industrial output of the five countries —and perhaps 25% of the output of the modern industries that had appeared in Central America since 1960— was traded intraregionally. In the past, bilateral deficits in regional trade were cleared through foreign exchange earned on other accounts; but the adverse terms of trade and the reversal of private capital flows made it progressively more difficult to clear deficits through the regional clearing house. In spite of various trade restrictions applied by the CACM countries to force the level of regional trade down to a point supportable with available foreign exchange resources, deficits that could not be settled had reached $355 million by October 1983.

TABLE I

TRENDS IN INTRAREGIONAL TRADE
($ MILLIONS)

	Current ($)	In 1980 ($)2/
1978	862.7	1130.7
1979	891.7	1035.7
1980	1125.7	1125.7
1981	922.6	834.2
1982	775.01/	681.6
1983	760.01/	649.8

1/ estimated

2/ deflated by the U.S. industrial price index

Source: SIECA and IMF

Fiscal Contraction. To complete the economic disaster, public sector finances deteriorated to the point where the Central American countries could no longer apply countercyclical fiscal policies. Most of the region's governments initially increased public sector employment and investments in order to offset growing unemployment in the private sector. But as the worsening economic situation led to declining revenues from income and foreign trade taxes, these fiscal deficits could no longer be sustained and stabilization programs, sponsored by the IMF in four of the Central American countries, required substantial cuts in current and capital expenditures.

B. Dimensions of the Crisis

The Decline in Investment. The prolonged recession in Central America has cut deeply into the stock of productive and social capital of the region. National accounts data, as well as anecdotal evidence, point to declining investment rates in the private and public sectors. In the private sector throughout the region (less Nicaragua) between 1978 and 1982, there was a $2.8 billion (in 1983 prices) shortfall in investment[1/]. This number reflects replacement investment that did not take place and increases in plant capacity that would have been necessary to expand the GDP in real terms beyond the 1978 level. If 1983 is included, this number would approach $4 billion. This foregone investment —in manufacturing, in agriculture, and in services-- must be undertaken if the Central American economy is to regain 1978's real level of output, if it is to achieve positive real rates of growth beyond the 1978 level, and, most importantly, if it is to diversify the productive sectors into products that offer the best promise for future economic growth.

The decline in public sector investment probably has not been as steep as that in the private sector since, as a group, the Central American governments continued high rates of investment expenditure until 1982. This trend was not consistent among the CACM countries, however; Guatemala and Honduras maintained large capital spending well into 1982, while Costa Rica and El Salvador began to effect deep cuts as early as 1980. Consequently, the region has suffered a virtual investment moratorium in social infrastructure such as housing, and in productive infrastructure such as roads, ports and telecommunications.

The Fall in Incomes. A key indicator of the current economic crisis has been the fall in living standards throughout the region. Between 1978 and 1983, the GDP of the five CACM members contracted by 4.2% in real terms, while the region's population grew by 18%. This translates into a 19% fall in the region's real per capita GDP over that period. The decline in income (net national product) has been even greater. When adjusted for the terms of trade effect, real incomes have plummeted perhaps 30% or more.

1/ This number was derived by calculating the difference between private sector investment at its actual levels between 1978-82 and what it would have been if the level had been 14% of GDP, or the rate that was achieved during the last high growth period for the region, 1971-78. It is worth noting that this level of investment drove the regional economy at a 5.5% real rate of growth annually.

TABLE II

TRENDS IN REGIONAL GDP, POPULATION AND REAL PER CAPITA GDP

	GDP (1970 US Millions)	Population (Millions)	GDP per Capita ($)
1978	8290	19.2	432
1979	8328	19.9	418
1980	8435	20.7	407
1981	8332	21.3	391
1982	8035	21.9	366
1983	7945	22.6	352

Source: SIECA and IMF

The Rise in Unemployment. Mirroring the fall in living standards has been the rise in unemployment. An accurate estimate of the extent of unemployment suffers from the absence of consistent and methodologically uniform surveys among the Central American countries and from the fact that a large number of people, especially in Guatemala, Honduras and El Salvador, participate in only varying degrees in the wage economy. Nevertheless, it is sufficient to point out that, since 1977, more than 1.5 million people have joined the economically active population in the five countries of the CACM. With no real growth in the region's GDP since 1978, this increment to the labor force has been forced to join the already expanded pool of open unemployment in the modern sector and/or the ranks of the underemployed in the urban and rural sectors.

C. The Role of the Regional Institutions in the Future Economic Growth in Central America

In spite of the problems discussed above, the 23 years of economic cooperation in the region have not only strengthened the collective economies of Central America, but have enhanced their ability to recover from the present crisis and to meet the challenges of the 1980s and beyond. Due to the creation of a regional trading area, Central America now possesses a larger and more diversified manufacturing sector with strong linkages to the agricultural sector, which is the principal source of raw materials. The rapid growth in intraregional trade since 1960 --from $30 million in 1960 to $1.1 billion in 1980-- has increased manufacturing's participation in GDP from 14% in 1960 to about 18.5% in 1980. And not only is it larger; it has become more balanced and now produces a wider variety of products. In 1960, intermediate goods --textiles, chemicals, paper products-- accounted for 20% of all manufacturing productions; by 1977, this figure had risen to 33%.

The growth in manufacturing has spurred investment that has deepened the social and productive infrastructure of Central America. Transportation and communications have vastly improved; the road network in Central America has doubled and telephones per thousand inhabitants has trebled since 1964. Furthermore, an industry-oriented entrepreneurial class and work force has been created.

Also significant has been the evolution of a number of regional institutions involved in development activities in Central America. These institutions, by serving the entire region, are able to provide assistance at a per unit cost well below what each Central American country would have to pay to maintain similar capabilities on a national level. As documented in several recent evaluations and institutional assessments, these institutions offer better facilities and a continuity of professional staff that does not always exist at the national level, as well as a capacity to obtain resources from international sources. These institutions include:

--The Central American Bank for Economic Integration (CABEI) which is engaged in long term lending, mainly for social and productive infrastructure.

--The Central American Research Institute for Industry (ICAITI) which supports industrial development and applied technology.

--The Nutrition Institute for Central America and Panama (INCAP) which supports regional acitivties in the fields of nutrition, food production and processing, and nutrition education and planning.

--The Tropical Agricultural Research and Training Center (CATIE) which plays an active role in the promotion of applied research and technology advancement in animal, crop and forestry production and management in Central America.

--The Central American Business Administration Institute (INCAE) which, as a private organization, provides graduate training as well as specialized professional level training in business administration and management.

—The Latin American Agribusiness Development Corporation (LAAD), a small private lending institution, which finances non-traditional agribusiness development with increasing emphasis on exports.

—The Latin American Export Bank (BLADEX) which finances primarily short-term pre-export and export credit requirements for non-traditional Latin American exports.

D. The Regional Economy and Extraregional Export Growth

The promotion of new sources of long-term growth among Central America's productive sectors and the strengthening of the regional market are not mutually exclusive policy alternatives. Central American manufacturing must continue to grow if the region is to further reduce its vulnerability to the violent swings in the terms of trade that accompany fluctuations in world commodity prices. Rapid growth in manufacturing must necessarily come from export expansion into extraregional markets, but it does not follow that the regional market is no longer important. A larger market has made possible the production of many new products at an economically efficient scale, a scale that will permit price competition in markets outside the region. The CACM has served this purpose in the past and will continue to do so in the future.

The World Bank and other institutions have supported this view of the regional market. In its 1979 report on the CACM[2/], the World Bank stated that, "for a wide variety of products whose output has been stimulated, domestic prices do not appear to be, at most, more than marginally above internationally competitive levels." It follows from this that the CACM has not only increased the size of manufacturing in the region, but that the basis has been created for a substantial export effort towards third markets.

The Interamerican Development Bank (IDB) conducted an extensive survey of manufacturing firms in Guatemala and Honduras to support the development of their industrial recovery projects in both countries[3/]. The analysis covered 361 firms grouped into 67 four-digit industrial subsectors in Guatemala and 110 firms in 40 subsectors in Honduras. The purpose of the exercise was to segregate inefficient from efficient producers by means of a test that relates the domestic resources used in production to output, both valued in terms of shadow or opportunity prices. Those subsectors found to have a high percentage of inefficient firms would not receive benefits under

2/ IBRD, Central America: Current Situation of the Common Market, May 1979. P.71

3/ IBD, Project Reports, Guatemala and Honduras, Industrial Recovery Program, GU-0086 and HO-0086 the project. It was found that in 50 of the 67 subsectors in Guatemala --in such product areas as chemicals, glass, paper and metal manufacturers-- over 80% of the firms are efficient producers. In Honduras, 26 of the 40 subsectors --in textiles, tobacco, furniture and chemicals-- met the same test. These results, covering two of the five CACM countries, point strongly to the fact that much of the region's industry could compete price-wise in third markets.

In a separate study, the Economic Research Center for the CACM Permanent Secretariat (ECID) carried out a survey of producers of clothing and textiles in the five countries of the CACM4/. The purpose of the study was to compare producer prices with the closest CIF imported counterpart. The results showed that in all countries, producers were pricing at levels equal to or far below (30% in some cases) the imported item. In spite of high effective protection, many Central American manufacturers produce at prices that are competitive in world markets.

One explanation for this is that industrial development since 1960 has been characterized by competition among producers of similar commodities in different CACM countries. The existence of this phenomenon was supported by a World Bank study in 19795/ and a 1983 ROCAP study of industrial growth in the CACM6/.

Many CACM firms have already used their price competitiveness to enter into markets outside the region. As can be seen in the accompanying table, in 1977, before the current economic crisis began, the CACM countries were exporting a significant percentage of their manufactured output. Overall, the five countries were exporting 10% of their total manufacturing output extraregionally. Some of this was semi-processed goods, such as beef and sugar. More impressive has been the growth of intermediate goods exports to third markets, especially in textiles, wood products and chemicals. Honduras has been very active in exporting wood products and furniture outside the region. Costa Rica has been successful in exporting electrical machinery. Guatemala has specialized in rubber products and chemicals.

4/ SIECA (ECID). Comparative Study of the Level and Structure of Prices in Central America (Guatemala 1982)

5/ Bela Bacassa. Intra-Industry Trade and the Integration of Developing Countries in the Third World (Washington 1979) World Bank Staff Working Paper No. 312

6/ Development Associates, Inc. Final Report: Central American Common Market Study (Arlington 1983)

TABLE III

CACM: EXPORT COEFFICIENTS[1/] FOR EXTRAREGIONAL TRADE IN INDUSTRY
1977 (PERCENT)

	Central America
Production of Finished Consumer Goods	12
1. Food Products	13
2. Clothing and Shoes	1
3. Furniture	3
4. Printing	*
5. Leather Products, ex. shoes	7
6. Other	16
Production of Intermediate Goods	8
1. Textiles	6
2. Wood and Cork Products	32
3. Paper and Paper Products	1
4. Rubber Products	1
5. Chemical Products	6
6. Non-metallic Mineral Products	1
7. Basic Metals	15
Production of Capital Goods	4
1. Non-electrical Machinery	4
2. Electrical Machinery	6
3. Transportation Equipment	1
All Manufacturing	10

1/ Extraregional exports (total export --intraregional exports)/gross value of production
* Less than 0.5

Source: Computed from data in "Compendio Estadistico Centroamericano," SIECA, 1981.

II. ROCAP SHORT AND LONG RANGE ASSISTANCE GOALS

A. The Proposed Program

The ROCAP program for FY 1985 through FY 1989 focuses on three of the four basic elements which make up the strategy for the Central American region: stabilization, creation of a basis for long term growth and the promotion of equity. The strengthening of democratic institutions and heightened respect for human rights are political goals which do not appear to lend themselves to action by ROCAP at a regional level, nor do we have the expertise to address these goals.

Beginning in FY 1985, and in response to NBCCA recommendations, we will orient the program in these principal thrusts:

1. Revitalization of intraregional trade to a $1 billion annual level, based on a proposal by the Central Americans, which would have a rapid impact on stabilization and growth.

2. Encouraging the resumption of capital flows to the region and strengthening regional financial institutions, particularly CABEI with its current liquidity problem, enabling it to finance a portion of the large amount of investment needed to move the region toward export-oriented growth. As a corollary to stimulating exports, we will continue programs aimed at increasing national productivity in the industrial and agricultural sectors, utilizing the capabilities of the regional institutions, where appropriate.

3. Establishing a regional venture capital company to stimulate additional domestic and foreign investment.

4. Continuing to address equity concerns: small farmer income, improved health and nutrition, and shelter needs.

The proposals presented here give rise to several policy questions which we must address, first with AID/W and, ultimately, with the Central Americans. For example, one of the policy issues to be discussed concerns the conditions which might be attached to sizable U.S. assistance which has been requested by the Central American Monetary Council's Common Market Fund to deal with intra-regional trade deficits.

The policy questions, which we present in detail in the next section, are intended to stimulate the discussion required to reach a Bureau consensus and elicit clear program guidance on the proposals advanced in this paper. Such guidance will enable us to develop further the specific actions toward the long-term goals or, if so decided, develop a program at a different level of effort.

The following table summarizes the proposed ROCAP program for the CDSS period at levels considerably below those proposed in the FY 1985 CP and the Bureau guidance cable. The difference between the planning figures and the levels proposed here ($119.1 million in DA and $229.4 million in ESF) would be available for LAC regional activities such as the formation and operation of CADO, regional training, development of democratic institutions, strengthening the judicial system, etc. (A funding breakdown for ROCAP by appropriation category is presented at the end of the document.)

ROCAP Activities
($000)

	FY 1985	FY 1986	FY 1987	FY 1988	FY 1989
DA	49,600	52,000	50,000	54,000	62,000
ESF	115,000	118,000	75,000	50,000	50,000

B. Economic Stabilization

ROCAP has been tasked with implementing the AID goal cited in the regional section of the FY 1985 CP: "The first element in our stabilization strategy is to restore the value of intraregional trade to $1 billion within two years (1985-1986)." ROCAP believes that it can also play an important role, through CABEI, in achieving another AID goal specified in the FY 1985 CP: "The second element of our strategy is to improve the balance of payments by encouraging the early resumption of capital flows to the region."

Two separate, yet closely related, projects with CABEI have been conceptualized as a means to help achieve these goals. One would finance a part of the projected deficits in intraregional trade, and the other a part of the cost for investing in machinery and equipment needed to provide the capital base for increased output and extraregional exports. The projects would be structured to encourage increased capital flows from other donors and commercial sources, and both would be directly linked to regional policy reforms. In the short term, they will assist the Central Americans to take the self-help steps necessary to restore intraregional trade and resolve CABEI's liquidity and administrative problems. Over the longer term, they will assist the Central Americans to bring about reforms which will provide the policy framework to increase exports and bring about a more outward looking regional economy.

Goal: <u>To restore intraregional trade to the $1 billion annual level as quickly as possible.</u>

The target level of $1 billion is some $240 million above the probable 1983 level of trade. The restoration of this level of trade will have a quick impact on employment and economic activity, forestall even further contractions in the regional economy, help to preserve the region's industrial base and reinstill a measure of local investor confidence.

The Board of Directors of the Central American Monetary Council (CAMC), composed of the Presidents of the Central Banks of the five Central American countries, has presented a proposal to restore intraregional trade to the $1 billion level within a period of about two years. The formula presented involves external financial assistance from AID and other donors as well as very substantial cooperation and self-help on the part of the Central Americans. As indicated in the ROCAP submission for the Dam Exercise, which was devoted entirely to a discussion of this goal and described the proposal in detail, ROCAP believes the Central American initiative for reviving intraregional trade is realistic and feasible. In essence, the Central Americans would clear existing debts (about $400 million) and for future deficits pay 30% from reserves and provide 35% in central bank credit. The remaining 35% would be financed by loans from external donors. Under the proposal, AID and other donors would provide approximately $376 million over a five-year period. These external resources would be provided to the Central American Common Market Fund which is administered by CABEI for the Monetary Council.

This proposal was submitted by the Central Americans, in coordination with IDB, to LAC Bureau officials in February of this year. Based upon the NBCCA recommendation, $95 million was included for this type of assistance in the FY 1985 CP, and an additional $93 million in ESF assistance has been programed during the planning period to meet half of the total projected requirement for external assistance.

In addition to the benefits of restoring trade, ESF assistance will also provide an important opportunity to initiate the policy dialogue on regional reforms. An accelerated growth of manufactured exports to extraregional markets, as well as more rational growth of manufacturing trade within the region, can be encouraged by key changes in the policy matrix. As indicated in the Background Section, although much of Central American industry is economically efficient and is pricing its output at levels that are competitive in extraregional markets, the protectionist character of some of the policies so far adopted in the CACM makes it possible that a serious misallocation of resources, such as uneconomic investments in intermediate goods industries, could occur in the future.

The main components of this policy matrix are the Common External Tariff (CET) and the Common Agreement on Fiscal Incentives. The principal characteristic of the present CET is higher nominal protection for final consumer goods than for intermediate or capital goods. High nominal tariffs on final goods, together with low nominal tariffs --or even tariff exonerations under fiscal incentives-- on imported inputs, result in high levels of effective protection for a wide range of final products. A study undertaken by the Permanent Secretariat for the CACM (SIECA) found only moderate averages for effective protection among the countries --varying from 33% to 58%-- but with an extreme dispersion among products. In some cases, effective protection ranged from 25% to 150%. It is this dispersion that poses the most serious threat of future resource misallocation.

In September, 1981, a technical group at SIECA completed work on a proposed new CET that would reduce nominal rates for final goods and raise nominal rates on raw materials, intermediate goods and machinery. These provisions would provide effective tariff protection at levels below the current average levels and, most important of all, would greatly reduce the dispersion among product groups.

Linked to the adjustment in the structure of nominal tariffs would be a change in the Common Agreement on Fiscal Incentives to eliminate tariff exonerations on industrial inputs such as raw materials and industrial machinery. The effect of this measure would be to reinforce the reduction in the average level and range of effective protection, as well as to strengthen the revenue base of the Central American governments. The proposed changes in the CET and fiscal incentives would preserve the benefits of the CACM while opening up the economies and providing more incentives to investments in industries exporting outside the region.

ROCAP will sponsor a review of the SIECA proposal for changes in the CET and Fiscal Reforms to make sure that they would, if adopted, provide an adequate regional policy framework consistent with AID's growth objective of increasing exports beyond the region. This review would establish a reasonable time table and implementation steps for the reforms. Once approved at the policy level in AID, these elements would constitute a part of ROCAP's negotiating instructions on conditionality and would be incorporated into a Project Paper submission on the financing for intraregional trade deficits.

ROCAP does not underestimate the difficulties in negotiating the adoption of such far-reaching regional policy reforms and in bringing about their actual implementation. A coordinated regional and bilateral strategy and approach will be vital to the success of such an effort, and we will discuss some suggested outlines for that type of approach in other sections of this submission.

U.S. leverage in bringing about the regional reforms would be significantly strengthened by providing additional ESF assistance on a regional basis. A proposal along these lines is presented in the context of the following goal.

Goal: To improve the balance of payments by encouraging the early resumption of capital flows to the region.

The rationale for a regional approach to this problem, including assisting CABEI with its liquidity problem and increasing the Export-Import Bank Trade Credit program and new insurance programs to be carried out by that institution and the Overseas Private Investment Corporation, was included in the NBCCA Report and CP. In summary, special efforts to increase capital flows are needed because of the region's present political and economic problems and the related difficulties in obtaining normal supplier credits, commercial bank loans and private investment.

CABEI, the strongest financial institution in Central America with a loan portfolio of $1.1 billion, has, along with other financial institutions, been adversely affected by the area's economic crisis. Because of short-term liquidity problems, CABEI is not able to play a more active role in helping revitalize and expand the productive sectors and foster exports, nor is it able to perform fully its traditional role in financing public sector infrastructure. Funds obtained abroad from commercial sources, e.g., a $119 million "Club loan" now in the final stages of negotiation, will merely permit CABEI to meet its dollar repayment obligations to foreign commercial banks. Similarly, repayments received on the outstanding loan portfolio will suffice only to finance already approved projects for infrastructure, housing, etc.

Based on the NBCCA recommendations, $35 million have been included in the CP for DA assistance to CABEI in FY 1985. These project funds, which support our Growth Goals, would provide financing for private capital investment in agroindustry and other productive areas. The IBRD is also planning to initiate project lending to CABEI for the first time, and has, for over a year, been carrying out an institutional analysis of CABEI's financial and administrative systems. The IBRD will issue an appraisal in the spring or summer of 1984 and will suggest adjustments and reforms in CABEI's procedures. AID/W and ROCAP should coordinate efforts in support of this IBRD initiative.

The proposal presented here for consideration and further discussion is whether the use of ESF funds channeled through CABEI could help resolve the Bank's liquidity problem and, in the process, by increasing its absorptive capacity and credit worthiness, be used as leverage by CABEI to increase capital flows from other donors and commercial sources. This type of assistance is consistent with the NBCCA recommendation "that the United States join the Central American Bank for Economic Integration (CABEI)....the infusion of new resources would help reinvigorate the bank, which could channel much-needed funds to small-scale entrepreneurs and farmers, provide working capital to existing private sector companies and encourage the development of new industries."

While we are aware that the U.S. is not considering taking an equity position in the Bank, increased ESF funding channeled through CABEI could accomplish the same objectives. Such assistance would also help the bank in its efforts to attract new members and capital from sources outside the region. As in the case of funding to revitalize trade, other donors will look to the U.S. to take the lead to finance new initiatives.

ROCAP proposes that a team of U.S. bankers and development officials examine the question of channeling ESF through CABEI and provide a report which would put CABEI's possible role in the context of the other proposals to increase capital flows to the region. The report would examine the impact on CABEI's liquidity of various levels of U.S. ESF assistance, and the potential impact of such assistance on CABEI's capacity to attract increased financing from other donors and commercial sources. Finally, the consultant team would assess the degree to which ESF funding channeled through CABEI could contribute to AID stabilization, growth and equity objectives.

For purposes of discussion, we offer an illustrative proposal on the use of ESF funding for CABEI which addresses several recommendations presented in the NBCCA Report:

1. Increasing the capital base and the productivity in the industrial and agricultural sectors needed for growth.

2. Addressing the region's equity needs in housing and infrastructure.

3. Bringing about regional policy reforms.

4. Strengthening the regional technical institutions.

We propose the use of ESF financing to increase the capital base of new export industries or existing industries which wish to modernize or expand their productive capacity. The loans would be used for short and medium term financing of modern machinery and equipment. CABEI would channel the ESF through national ICIs, including commercial banks, and would be required to raise additional funds from other sources, e.g., commercial banks.

We further propose that at least some of the ESF financing be provided to CABEI on a grant basis. This would permit borrowers to repay CABEI in local currencies which, in turn, could be used to establish a type of trust fund within CABEI for funding some of the infrastructure, housing and other developmental requirements of the region which have predominantly local currency funding needs.

We believe that this type of proposal is consistent with the NBCCA analysis that indicated the need to provide CABEI with "fresh capital" and the specific recommendation that the U.S. join CABEI. The use of ESF on a grant basis would, in a way, substitute for U.S. membership and the paid in and callable capital that such membership would imply. The ESF financing could be structured to provide CABEI with substantial assistance on its short-term liquidity problem, thus getting a financially sound entity over a crisis period, putting it in a better position to attract new members and obtain funds from traditional donor and commercial sources, and permitting it to make a major development impact over the short and medium terms.

The proposed mechanism for use of ESF funding could also be used to help bring about reforms in the Common External Tariff and Regional Fiscal Incentives. A regional package for CABEI would increase U.S. leverage significantly. If the first draw down of CABEI ESF loans to the countries were restricted to export activities, it would also provide a substantial impetus to export-led growth.

Finally, earmarking a small amount (1-2%) of the interest spread on local currency repayments for the regional technical institutions could help them expand their core budgets. This would put the regional institutions on a sounder financial basis, improve their services and permit them to take on additional donor-financed project assistance.

In terms of increasing capital flows to the region, ESF grant funding might be able to lever on the order of a three to one contribution from other donor and commercial sources. This ratio is consistent with the present relationship of CABEI's loan/capital portfolio. Thus, for example, ESF funding of $150 million should generate an additional $450 million in capital transfers. This is the type of relationship that would be examined within the context of the proposed study.

The following table summarizes the stabilization goals and some of the key benchmarks in their implementation. The section which follows the table describes in narrative form and in more detail the RCCAP implementation strategy and means of accomplishments.

STABILIZATION GOALS

-To restore intraregional trade to the $1.0 billion level as quickly as possible.
-To improve the balance of payments by encouraging the early resumption of capital flows to the region.

Short Term (FY 1984 & 1985)	Long Term (FY 1986 to FY 1989)
Policy Dialogue	
1. Agree on final Central American proposal to restore trade and a timetable to remove trade restrictions.	1. Monitor restoration of intraregional trade and compliance with terms of ESF project agreement.
2. Agree on longer term reforms of CET and Fiscal Incentives related to AID's growth goals.	2. Monitor programs on regional reforms and compliance with terms of ESF project agreement.
3. Develop technical proposal, for ESF financing, to resolve CABEI's liquidity problems and use CABEI as a mechanism to increase capital flows from other donors and commercial sources to region.	3. Monitor CABEI's progress in solving liquidity problems and increasing capital flows in accord with ESF project agreement.
4. Agree on CABEI institutional reforms in consultation with IBRD.	4. Monitor CABEI's progress in carrying out institutional reforms in accord with ESF project agreement.
Resource Transfers	
1. Develop and sign ESF project with CABEI to finance intraregional trade. (Conditionality would include policy reforms in CET and Fiscal Incentives.)	1. Provide incremental funding for ESF "intraregional trade" project, if conditions are met.
2. Develop ESF project based on technical proposal and policy guidance to assist CABEI mobilize additional capital, e.g. to finance up to medium term machinery and equipment needs of productive sectors with ESF linked to increased flows from other donor and commercial sources purposes. (Conditionality would reinforce CET and Fiscal Incentive reforms and CABEI institutional reforms.)	2. Provide incremental funding for ESF "equipment and machinery" project, if conditions are met.
Technical Assistance	
1. No TA projects are associated with Stabilization goals.	
2. Needed studies to examine regional policy reforms of CET and Fiscal Incentives as well as to develop a technical proposal to use CABEI to increase capital flows would be financed with PD&S.	

Program Implementation Strategy, Benchmarks and Timing and Means of Accomplishment for Stabilization Goals

Goal: To restore intraregional trade to $1 billion level.

As indicated in the ROCAP Dam submission, we believe that the Central American proposal constitutes an acceptable basis on which to proceed to design a specific project proposal. As part of the review of this document, the ROCAP proposal presented in the Dam Exercise should also be reviewed and any guidance that may be called for in discussing the proposal with the Central Americans and in presenting a PID for approval should be provided as part of the review process.

ROCAP plans, prior to the PP submission, to carry out a study of the proposed reforms on the Common External Tariff and Fiscal Incentives Agreement which, in addition to assessing their adequacy, would propose a timetable for their accomplishment. This study would be reviewed by the Bureau in order to provide policy guidance for the discussions that will take place with the Central Americans in connection with developing the PP.

In general, we wish to underline that the reforms proposed for the Common External Tariff are long term --i.e., implementation would be toward the end of the period being considered here. What we will be seeking as a pre-condition to the ESF loan is in the nature of "an approval in principle" for the reform framework and goals and a realistic timetable or benchmarks for implementation to which the Central American could agree. Our assistance, however, should have some teeth in terms of conditionality. For example, we might propose variable terms and conditions in return for assistance in restoring intraregional trade. Depending on whether or not the Central Americans were able to comply with a timetable for long term reforms in the Common Market mechanisms, we could either provide very concessional terms or, if they fail in their agreement, we could impose relatively hard terms. A proposal along these lines will be presented in the PID for further discussions and refinement.

The most difficult part of the proposed program will be in reaching agreement with the Central Americans on the proposed regional reforms and in actually getting them to carry out the reforms over the longer term. As we have found in the United States, industries that enjoy protection in both the industrial and agricultural sectors, (e.g., the U.S. auto, steel, textile, and shoe industries or the orange, sugar beet and rice growers) are able to command considerable political support when changes in tariff barriers are considered.

We are not able to estimate the degree of policital influence that protected industries enjoy in the individual countries in Central America. However, we believe that opposition to change will be substantial and vocal. Nevertheless, history shows that, in order to establish the Common Market, it was possible for the Central Americans to negotiate a Common External Tariff that had overall lower levels of protection than any of the previous national tariffs of individual countries (with the exception of El Salvador). Thus, a regional approach may offer the best potential for lowering tariff barriers and bringing about an export orientation for the economies of the region.

Exerting pressure for major regional reforms can probably only be successful using a coordinated U.S. approach. The use of U.S. influence through the IDB Consultative Group and the CADO mechanism, if established, would also be an important means of bringing about the reforms. Consideration and discussion of regional issues and reforms in U.S. bilateral negotiations with the individual countries of the region would also be an essential element of a coordinated approach.

Goal: <u>To improve the balance of payments by encouraging the early resumption of capital flows to the region.</u>

ROCAP expects that at least an initial AID/W reaction to the possibility of using ESF funding for loans and grants through CABEI would be arrived at in connection with the reviews of this paper. The key decision at this point is whether the proposal merits serious study by a team which would include representatives from the U.S. private banking community. The next steps would be to carry out the study, which we estimate would require about two months, and then have the findings reviewed by AID and perhaps other elements in the USG. If the reaction to the study is favorable, ROCAP will explore the outlines of the proposal in more detail with CABEI in early FY 1985 and develop a PP for consideration in mid FY 1985. The amount of funding for the type of program proposed could vary considerably depending upon the study's recommendations and resource availabilities. For example, a minimum program might be on the order of $50 million over a two or three-year period and a maximum program might be on the order of $200 million over a five-year period.

C. <u>Growth</u>

Goal: <u>To stimulate export led growth and a more outward looking regional economy through regional policy reforms and supporting efforts.</u>

ROCAP proposed ESF projects and the related regional policy reforms in the Common External Tariff and the Agreement on Fiscal Incentives under the stabilization goals described previously have a direct relationship to the growth efforts over the short and longer term. The assistance package proposed for stabilization would help bring the region to a level of economic activity approximately the same as that achieved in 1980, before the worst of the economic crisis was felt. Regional trade would be restored to the 1980 level. CABEI would again be in a financial position strong enough to permit it to contribute to the region's growth. Capital flows from commercial sources would resume, and renewed investment in machinery and equipment would help fill the gap/deficit that has developed in the capital stock. The sum of the stabilization effort would be to establish a sounder base for future growth, set up an appropriate regional policy framework and an improved investment climate, and restore a degree of confidence in the Central Americans that, with self-help measures and external financial assistance, many of the area's problems can be resolved. All of these elements will begin to make a contribution to growth objectives in the longer term. The AID resource transfer and technical assistance programs proposed in this growth section will build on the stabilization effort and, by the end of the planning period, the result should be a more open regional economy with its principal growth coming from a major export drive.

Goal: To help resolve key investment and financial constraints to agroindustry and export growth using regional financial mechanisms.

The bulk of the DA funding which we propose under the growth goal is related to financing new industries, expanding existing ones and providing the short-term financing needed by firms in order to export. In practical terms, the growth goal stated here is synonymous with getting the private sector moving again.

The key financial constraints to the accomplishment of this goal --the scarcity of investment and working capital and export credits-- will continue to be the targets of our program over the planning period. The current BLADEX loan promotes non-traditional exports to hard currency countries by providing short term pre-export and export financing. The agroindustry and rural enterprise loans with CABEI and LAAD have provided financing for capital equipment, working capital and raw materials. Both of those projects have strong backward linkages to the small farm sector. The new regional venture capital company should also play a strong role in developing large new projects in the agricultural and industrial sectors to take advantage of CBI trade incentives.

Assistance to these institutions can meet rigid developmental criteria, and the proposed projects can be compared on their merits with similar bilateral projects anywhere. The DA program which we propose is determined in part by the nature of these regional institutions with which we work and the excellent record that they have established in carrying out projects in the past.

AID loans made to these financial institutions can attract other capital to the region. The BLADEX loan is a case in point: the conditions on the current loan require BLADEX to raise capital from other sources on a two for one basis, or $50 million for our $25 million loan. In addition, the BLADEX loan, because of the short-term credits it provides, has been rolling over more than three times a year. Although on a much smaller scale, CABEI and LAAD also roll the AID funding over several times. Thus, AID assistance can have a large multiplier effect and a major cummulative impact on a large number of firms. These loans can also provide a significant impact on employment and income through their backward linkages to suppliers and through spread effects.

Goal: <u>To improve agricultural and industrial productivity and the management of the region's natural resource and energy problems.</u>

In addition to the substantial levels of DA loan assistance proposed under the first growth goal, ROCAP proposes to provide DA grant assistance for research on non-traditional crops and transfer of the technologies to the national level through both public and private sector efforts. We will also offer DA grants for technical assistance to provide the technology and quality control needed to modernize the region's manufacturing processes.

While the principal emphasis of the ROCAP strategy for technical assistance is on improving agricultural and industrial productivity, and is, therefore, closely related to the proposed loan program, there is also a continuing need to focus on improved management of the region's natural resources and energy problems. Deforestation, soil erosion, watershed degradation, etc., become increasingly important in terms of their future impact upon economic growth --in lost exports, low agricultural productivity and loss of installed hydroelectric capacity and potential.

ROCAP will continue to use regional institutions, particularly CATIE, INCAE and ICAITI to address research and technical assistance requirements in the course of attacking these problems.

Our experience with these organizations, borne out by the findings of the Coopers & Lybrand evaluations and the observations of AID/W technicians and other USAID Central America staff, convinces us that they have an important role to play in the development of the region. The breadth of view, long range approach, high quality and continuity of professional management and staff and economies of scale which the institutions offer on many projects is unequaled at the national level. They provide an important source of assistance for national institutions and often provide a catalytic effect in bringing about increased country-level effort and change. They offer strong advantages over U.S. consulting firms for use by AID from the point of continuity of effort, cost and knowledge of the culture and language. In some cases, the institutions have earned international reputations for the quality of their work.

We plan to continue work with CATIE on small farming systems to increase non-traditional exports and the production of domestic food crops. We will work with ICAITI and its technical assistance to the industrial sector in technology transfer and industrial energy conservation. Both CATIE and ICAITI will maintain their efforts in fuelwood production and the use of efficient energy systems by the rural population.

ROCAP and USAID/Costa Rica have been instrumental in financing the expansion of INCAE to include a new campus in Costa Rica. That institution is developing a solid base of information and technical expertise on the export problems of the region and can play an important role ranging from promotion of export-oriented policies with the Central American governments to the provision of management assistance for firms wishing to export.

Goal: <u>To provide policy incentives for the increased production of non-traditional crops and domestic food crops.</u>

While many of the needed policy changes for agriculture will have to take place at the national level, there is also a possibility of bringing about some change at the regional level and using regional mechanisms to promote improvements in national policies. The benefits of a common market, i.e., increased specialization and competition, also apply to agriculture, and having freer trade in agriculture within the region would tend to help large agroindustries involved in processing and exporting agricultural products.

The Agricultural Secretariat is a regional institution composed of the Ministers of Agriculture from the Central American countries, Panama and the Dominican Republic and backstopped with the technical assistance of IICA. It was established, with technical and financial assistance from ROCAP, to co-ordinate agricultural programs and to explore new agricultural policies which would benefit the sector at the regional level. This institution is just beginning to function well and it appears that it may gain additional importance over the planning period. A team from S&T/Agriculture is presently working with IICA and the Secretariat to define regional agricultural policy priorities to be examined over the next two years. Among those priorities, there will clearly be a need to provide incentives to maximize the production of non-traditional export crops and to increase production of domestic food crops.

The following table summarizes the growth goals and some of the key benchmarks in their implementation. The section which follows the table describes in more detail the ROCAP implementation strategy and the means for its accomplishment.

GROWTH GOALS

- To promote export led growth and a more outward looking regional economy through regional policy reforms.
- To help resolve key financial and investment constraints to agroindustrial and export growth using regional financia mechanisms.
- To improve agricultural and industrial productivity and the management of the region's natural resource and energy proble
- To provide policy incentives for increased production of non-traditional export crops and domestic food crops.

Policy Dialogue

Short Term (FY 1984 & 1985)	Long Term (FY 1986 to 1989)
1. Agree on CET and Fiscal Incentive Reforms in connection with stabilization goal.	1. Monitor progress in regional reforms in connection with ESF loans and reinforce at bilateral level.
2. Agree on use of CABEI to increase capital flows to region in connection with stabilization goal.	2. Monitor CABEI's progress in increasing capital flows in connection with ESF loan(s).
3. Agree on nature of Venture Capital Co.	3. Monitor Venture Capital Co.
4. Examine what is needed in terms of agricultural policy reform.	4. Use Agricultural Secretariat and other fora to bring about improved policies.
5. Build more awareness on natural resource problems.	5. Bring about improved policies in key areas related to growth, e.g., land use, forestry, watershed mgmt.

Resource Transfers

Short Term (FY 1984 & 1985)	Long Term (FY 1986 to 1989)
1. Develop new DA project for Venture Capital Co. to finance equity investments in export industries.	1. Provide follow on DA loans, if evaluations show merit.
2. Develop new DA project with CABEI to finance agro-industries and industries with strong export potential with medium and long term loans.	2. Provide follow on DA loans, if evaluations continue to show merit.
3. Evaluate LAAD agroindustry loan with view toward follow on loan in FY 1985.	3. Follow on loan for LAAD, if evaluations remain favorable.
4. Develop PP for follow on loan with BLADEX to provide increased short term export financing.	4. Follow on loans with BLADEX, if evaluations favorable.
5. Incremental funding for existing DA loans.	5. Incremental funding for DA loan projects.

Technical Assistance

Short Term (FY 1984 & 1985)	Long Term (FY 1986 to 1989)
1. Develop new DA Export Crop Diversification project with CATIE.	1. Possibility of follow on project in last year of planning period.
2. Evaluate INCAE Export Promotion Activities.	2. Follow on DA project with INCAE on Export Promotion.
3. Evaluate AG Secretariat project.	3. Possibility of follow on project on Ag. policies.
4. Incremental funding for existing DA projects.	4. Possibility of follow on project with ICAITI to increase industrial productivity and improve quality.
	5. Possibilities of follow on projects with CATIE in Natural Resources and Watershed Management.

Program Implementation Strategy, Benchmarks and Timing and Means of Accomplishment for Growth Goals

Goal: To promote export led growth and a more outward looking regional economy through regional policy reforms and supporting efforts.

The strategy for bringing about policy reforms necessary to advance this goal has been described in the section on stabilization, and its accomplishment depends largely on the leverage which can be exerted using ESF activities. The DA assistance proposed here will be used to provide some of the financial and technical support mechanisms needed to bring about export-led growth. Wherever possible, DA funds will be used to strengthen the negotiating leverage of ESF financing in bringing about policy changes. The study referred to previously will be completed in early FY 1985 and will establish the benchmarks and timing for reforms in the CET and Fiscal Incentives.

Goal: To help resolve key investment and financial constraints to agroindustry and export growth by using existing regional financial mechanisms or creating new ones.

The ROCAP strategy is to build on successful programs with BLADEX, CABEI and LAAD, and to create a new regional Venture Capital Co. which was recommended in the NBCCA report and included in the FY 1985 CP. The implementing strategy is discussed within that institutional framework:

BLADEX - The existing $25 million ROCAP loan to BLADEX is to assist in meeting some of the region's needs for short term export financing. The loan will be fully drawn down during FY 1984. BLADEX will also be able to meet the condition of providing its two to one contribution, thus there will be a fund of over $75 million to support exports --or, more specifically-- providing financing for inputs which go into the exports and providing the bridge financing from the time orders are placed and shipped until the purchaser accepts the goods and pays the bill. The $75 million fund is expected to be far below the demand for this type of financing, particularly as the region starts to take advantage of the CBI incentives, growth in the world economy takes place and bilateral efforts to increase exports begin to take effect. Thus, ROCAP contemplates a further DA loan financed program with BLADEX in FY 1986 and perhaps an additional project toward the end of the planning period. The latter would depend on the demand at that time and the possibilities of having commercial sources providing all export credit assistance as capital flows increase and the investment climate improves. The FY 1986 loan would again for call for BLADEX to generate cofinancing from commercial sources so that the total funding available for regional export financing would be much greater than the size of the ROCAP loan.

CABEI - In accordance with the NBCCA recommendations and the FY 1985 CP, ROCAP has already started to discuss with CABEI a $35 million DA loan and plans to submit a PID in early FY 1985 and a PP in mid FY 1985. The loan will be primarily for agroindustry and will be based on the experience with the earlier agroindustry loan which was fully disbursed in FY 1983. The new loan will have more of an export orientation, and the possibility of lending to non-agriculturally related industries which demonstrate a solid export record or potential and which need funds for expansion will also be explored. We would link the loan conditionality to the administrative reforms being developed with IBRD assistance and to CABEI efforts to obtain assistance from other sources. Later in the planning period, a second loan to CABEI may also be justified to expand agribusiness and export oriented industrial lending.

LAAD - The existing $6 million loan with LAAD to finance agroindustries will be fully disbursed in FY 1984. ROCAP plans a follow-on loan with LAAD in FY 1986, or in FY 1985, if funds can be made available earlier and, perhaps, a further loan late in the planning period. LAAD is a unique private sector financial institution in the region. The management and marketing assistance which they provide to their clients are particularly important. Many of the projects financed are models of the types of exports that can be developed from Central America with strong linkages throughout the economy and important employment and income effects. Consequently, LAAD will become increasingly important as opportunities open up under the CBI for new exports. ROCAP plans to attempt to maximize LAAD's contributions to future programs and contemplates that with a new loan of $10 million, LAAD will have total funding or portfolio available in Central America and Panama for agroindustry on the order of $35 million.

Venture Capital Company - The creation of a Venture Capital Company was recommended in the NBCCA report and ESF funding has been included in the FY 1985 CP for this purpose. As in the case of bilateral private development finance institutions, the merits of the Venture Capital Company depend largely on the entrepreneurs who participate in its organization and management, and who commit their own resources to its capitalization. ROCAP believes that much more thought is needed on the nature of the type of institution to be established and its role vis-a-vis other financial institutions in the region. In connection with the AID/W review of this paper, ROCAP will be discussing with LAC/DR the next steps to be taken with regard to the venture capital company. Aside from technical issues, other questions which need discussion include the timing and methods for developing a project.

Goal: To improve agricultural and industrial productivity and the management of the region's natural resource and energy problems.

The regional technical institutions are a valuable resource to Central America because of their long-term stability, expertise and experience in areas crucial to sustained growth in the region. The ROCAP strategy is to continue utilizing the capacity of these institutions to develop and transfer technologies to national counterparts.

Several projects in the existing portfolio will be active well into the planning period, and their successful implementation is essential to the strategy for achieving this goal. Following the recent trend in several ROCAP projects with these institutions, more priority will go to technology and information transfer than to traditional research activities.

In the short-term, a new export crop diversification project, to be implemented by CATIE, is planned for initiation in FY 1985. This project will be carefully designed to support bilateral efforts and the agroindustry regional lending program outlined above. While some continuing research is an obvious requirement, the focus of the proposed project will be to collect existing information on producing non-traditional export crops and on increasing CATIE's ability to work directly with the private sector on specific export projects.

Over the longer term, ROCAP plans modest follow on technical assistance projects with CATIE, ICAITI and INCAE. These projects will be designed in close coordination with the USAID's to support national level efforts. For example, INCAE can play an important role in continuing to carry out export promotion seminars and in providing management level technical assistance to industry; ICAITI can do far more to increase productivity and quality control at the level of the firm; and CATIE can provide the technical base for increased productivity of specific export and food crops.

During the planning period, ROCAP also anticipates follow on projects with CATIE in the natural resource area, and with ICAITI in energy. The outlines of such projects will be based on evaluations which are planned to take place over the next two years.

Goal: To provide policy incentives for increased production of non-traditional export crops and domestic food crops.

The existing Agricultural Secretariat project is the principal mechanism for achieving this goal. The project will be closely monitored and evaluated during FY 1985 to assess progress and suggest how the Secretariat can take on a more substantive role. Further discussion is also needed with LAC/DR, the

USAID RDOs, IICA and the ministers of agriculture to develop a consensus on the types of policy changes and reforms that might be undertaken through a coordinated regional/bilateral approach and to establish related benchmarks. This consensus on policy changes and the record established over the next year in carrying out the Agricultural Secretariat project would provide the outline for developing a follow-on project and identifying specific policy studies that it would include.

D. Equity

Goal: To reduce infant mortality and improve child health by using regional mechanisms to provide research, training and technical assistance to help the Central American countries on oral rehydration therapy, supplementary feeding, breastfeeding and on other technologies.

The NBCCA report placed strong emphasis on the need to improve the health of the region's population and recommended a number of regional initiatives to reduce infant and child mortality. Consistent with the NBCCA recommendations, the FY 1985 CP includes two new initiatives aimed at this goal. A PID for an Oral Rehydration Therapy (ORT) project, to be carried out through INCAP, has been developed with technical design assistance provided under the AID/W funded PRITECH activity. As part of the design process for the PP, a regional ORT strategy will be developed and, as one element of project implementation, national ORT plans and programs will be designed or improved.

The proposed ORT project will be carried out over most of the planning period. INCAP will provide the bulk of the research, training and technical assistance needed by the countries to carry out effective ORT and related nutrition programs. The regional project will also draw on the experience of the AID-financed project in Honduras and upon the considerable institutional and technical expertise built up in Costa Rica over the past years which has demonstrated the positive impact that ORT can have on infant and child mortality in Central America.

The other regional health initiative included in the CP is directed toward improving supplemental and emergency feeding programs. The NBCCA report recommended major increases in these PL-480 feeding efforts, yet it is recognized that there are serious targeting, monitoring, and logistical problems at existing levels of food distribution, not only for AID, but for other donors as well. This new initiative, which we will carry out with INCAP, is at a more preliminary stage than the ORT proposal. A regional assessment of the food distribution problem is now being carried out with the assistance of CARE. A planning workshop, with participation of the PVO's, international and national institutions involved, will go over the results of the assessment in May. Common problems will be examined to see if they can appropriately be addressed on a regional basis. If there is merit to a regional approach to improving distribution systems, a regional technical assistance strategy will be developed which would then form the basis for a PID and the design of a PP in FY 1985.

Over the longer term, there may be possibilities for other regional health and nutrition initiatives with INCAP. For example, INCAP has long been involved in research and pilot activities to improve family food security, e.g., food preservation and storage, the swine project in El Salvador, and in helping food cooperatives in Guatemala and Honduras. INCAP has also been involved in helping implement an AID/W-financed regional project in breast-feeding and, more recently, in implementing an AID/W-financed breastfeeding promotion project in Panama. The results of these activities may well lead to further ROCAP regional projects with INCAP in later planning years.

Goal: <u>To increase employment and relieve pressing social needs by using ESF generated local currency through CABEI for labor intensive infrastructure and housing programs.</u>

The NBCCA report recommended that AID support infrastructure programs as a means of dealing with the region's pressing unemployment and social problems, but was not explicit on how this should be done. The NBCCA report also examined the region's housing needs and recommended a major AID program emphasis on low cost housing. The FY 1985 CP established a very ambitious goal in housing (an increase of 25% in the rate of construction of low-income housing) without spelling out how it would be accomplished. CABEI has made major contributions to meeting both the region's infrastructure requirements and its housing needs over the past decades and has considerable skills and implementational ability in these areas. In housing, CABEI's abilities would be further enhanced by the AID/W proposed technical assistance project proposed in the FY 1985 CP.

As noted in previous sections of this paper, CABEI, because of its liquidity problems, will not be able to have a substantial impact on the region's development in infrastructure, housing and other sectors without an infusion of fresh capital and loans from the IFIs and other donors for new projects. The proposed ESF project to support the restoration of intra-regional trade and the possibility of an ESF project to finance the dollar costs of equipment and machinery imports opens up the opportunity of generating local currencies or having CABEI use loan repayments (depending on how the funds are made available and on how the projects are structured) to finance these activities. CABEI could create a fund for this purpose which would make a substantial contribution on providing employment and dealing with other equity concerns in line with the NBCCA recommendations. The team which we have recommended look at CABEI and its possible role under the growth goals could also examine the alternatives and possible role of CABEI under this equity goal.

CABEI could also contribute to this equity goal through other efforts. For example, recent evaluations of HIG 005 show that CABEI has established an effective secondary mortgage operation, has substantially improved its housing policies and implementing procedures, and has exceeded the AID goals established in the agreement in terms of providing housing to low income groups. CABEI is also interested in seeing if they have an appropriate role in helping the countries develop and finance sites and services projects.

CABEI would also be the mechanism to channel some of the interest spread on ESF and DA projects to the regional technical institutions to strengthen their financial status. INCAP, ICAITI and CATIE all have significant programs related to equity concerns, yet these are the very areas where it is difficult to obtain financing on a continuing basis or to cover their costs through sales of their services to the private sector. If it is possible to use interest spreads to generate financial support for the regional technical institutions, the funds could be programmed in a way that would increase the institutions' ability to provide services dealing with equity problems to the countries.

We do not recommend that funds from interest spreads should be made available as general budget support to the regional technical institutions; rather we see the funds being programmed primarily to increase their core professional staff. This would increase the absorptive capacity of the institutions and facilitate the implementation of long term equity and growth programs on their own. We expect that some of the increased staff that the institutions need could be trained under the LAC training project at U.S. universities and then linked to increased core funding which would be available to pay salaries on their return. Another alternative which should be considered, at least over the short and medium term, is the possibility of using some of the funds coming from interest spreads to finance chairs to pay part of the cost of visiting U.S. professors and specialists in certain areas where Central American skills are in short supply.

The impact on the regional institutions of being able to increase their core staff by even as few as five or ten professionals would be very substantial in terms of their research and outreach capabilities. The long run exposure to U.S. educational opportunities and expertise would have a healthy and lasting development impact not only on the institutions, but also on the Central Americans that they train.

Goal: <u>To enable small farmers to increase productivity and to improve their income and living conditions by using regional institutions to develop and transfer appropriate technology for mixed farming systems and for meeting rural energy needs.</u>

Small farmers will continue to have an important part in producing many of the domestic food crops and should have a role in producing non-traditional export crops, if they are to share directly in the benefits of an export drive and growth opportunities. The existing ROCAP Small Farmer Production Systems project with CATIE has developed appropriate mixed farming systems methods for working with small farmers. The approach has shown that it can have a significant impact on improving small farmer productivity, incomes and nutritional status. However, there is still a need to provide continuing research and technology transfer in this area and the possibility of a follow on project with CATIE will be considered. The Export Crop Diversification project, discussed under the growth section, will develop much of the research and data base needed to produce these crops efficiently, and will examine appropriate linkages with the mixed systems approach.

The existing Fuelwood and Alternative Energy Sources project deals primarily with equity problems of helping rural people meet their energy needs. It is also an important element in upgrading the status of rural women by improving cooking conditions and reducing the time spent in gathering and transporting fuelwood. As additional lands are cleared for agricultural crop and livestock uses, fuelwood availability will continue to decline while prices increase. Dissemination of the technologies developed or adapted by CATIE for fast growing trees, and by ICAITI to conserve fuelwood will take on increased importance over the next decades as rural demands for energy at a reasonable cost continue to grow. Availability and price of fuelwood also have an important impact on small rural industries (e.g., bakeries, brick kilns, salt making, food processing, etc.). Both biogas, in terms of meeting some rural energy needs and providing fertilizer, and solar energy, in terms of crop, meat and fish drying, are technologies that can help many rural people. While the NBCCA report did not address the energy problem in a significant way, ROCAP believes that this is a growing and important long term problem, and that AID should continue to build on the investments that it has made in research, institutional development and technology. Therefore, ROCAP will propose a follow on Fuelwood II project in FY 1985 which will be consistent with AID's overall fuelwood research priorities, but have most of its emphasis on dissemination efforts within the Central American countries.

The following table summarizes the equity goals and some of the key benchmarks in their implementation. The section which follows the table describes in narrative form and in more detail the ROCAP implementation strategy and means of accomplishment.

EQUITY GOALS

-To reduce infant mortality and improve child health by using regional mechanisms to provide research, training and technical assistance to assist countries on ORT, supplementary feeding, breastfeeding, etc.
-To increase employment and relieve pressing social needs by using ESF generated local currency through CABEI for labor intensive infrastructure and housing programs.
-To enable small farmers to increase productivity and improve their income and living conditions by using regional institutions to continue to develop and transfer appropriate technology for mixed farming systems and for meeting rural energy needs.

	Short Term (FY 1984 & 1985)	Long Term (FY 1986 to 1989)
Policy Dialogue		
	1. Develop regional strategy for ORT.	1. Assist countries develop or improve national programs.
	2. Develop regional TA strategy to improve supplementary feeding programs.	2. Agree on institutional reforms for regional technical assistance institutions (INCAP, ICIAIT and CATIE based on Coopers & Lybrand and other recommendations).
	3. Participate in regional meetings to evaluate breastfeeding programs and develop policies.	
	4. Develop policies for low cost housing, sites and services and labor intensive infrastructure programs with CABEI.	
Resource Transfers		
	1. Proposed ESF projects with CABEI to restore regional trade and finance equipment and machinery may open up the possibility of generating local currency and establishing a fund within CABEI to finance low cost housing and labor intensive infrastructure programs.	1. Monitor local currency programs, if established. 2. Further HIG programs with CABEI should be considered, if local currency not available. 3. Use part of interest spreads on ESF and DA to CABEI to strengthen regional technical institutions, particularly in equity aspects of their programs.
Technical Assistance		
	1. Prepare PP for Regional ORT project with INCAP.	1. Monitor ORT project.
	2. Prepare PID for regional TA project to improve supplementary feeding programs.	2. Monitor Supplementary Feeding Project.
	3. Develop TA project to assist CABEI in housing.	3. Monitor Fuelwood Project.
	4. Develop follow on Fuelwood project with CATIE and ICAITI.	4. Develop new project with CATIE to improve small farmer productivity with emphasis on export crops.
	5. Incremental funding for existing DA projects.	5. Possible new project with INCAP to improve family food security.

Program Implementation Strategy, Benchmarks and Timing and Means of Accomplishments for Equity Goals

Goal: To reduce infant mortality and improve child health by using regional mechanisms to provide research, training and technical assistance to help the Central American countries on ORT, supplementary feeding, breast feeding and on other technologies.

The PID for the proposed ORT project has been sent to the USAIDs for comment and will be reviewed while ROCAP officials are in AID/W for the review of this paper. The design of the PP will be closely coordinated with the USAIDs and with LAC/DR in order to include a proposed ORT strategy for the region. The PP will also spell out goals and benchmarks. In the policy dialogue to help develop or improve national ORT programs, INCAP will use the techniques developed under the AID/W-financed regional breastfeeding project, i.e., hold regional and national conferences and assist the countries in preparing the program planning documents for their proposed efforts.

The design process and related problems in developing a regional technical assistance project to help resolve common problems in emergency and supplmentary feeding are still unclear. The outlines of a possible project will start to evolve after the planning workshop is held to discuss the findings of the regional assessment and to discuss the desirability of a regional approach to the problems. We anticipate that there will be a considerable degree of consensus and enthusiasm on the part of the participants in the planning workshop to have INCAP involved in providing training and technical assistance under a new project. A PID will be prepared for consideration by the LAC Bureau and USAIDs in late FY 1984 or early FY 1985. A PP would be prepared in FY 1985.

Goal: To increase employment and relieve pressing social needs by using ESF generated local currency through CABEI for labor intensive infrastructure programs.

The possibility of generating local currency will depend largely on the AID/W reaction to the proposed use of ESF funds for a project to increase CABEI's liquidity and to finance some of the equipment and machinery needs of the region. The team of development officials and private bankers that would look at the pros and cons of providing capital transfers through CABEI using ESF funds would also look at the possibilities of designing the capital transfers in a way that would make available local currency which would then be used by the bank for financing housing and infrastructure.

While it may also be possible to design the ESF loan to help restore intraregional trade in a way that would generate local currency, the financing needs of restoring intraregional trade are spread over a five year period and local currency reflows would not be available until the countries started to make their repayments to CABEI. Giving CABEI (and, indirectly, the regional economy) the benefit of AID's most concessional terms for ESF would mean that ESF loan repayments would not be a further external debt burden over the medium term and that CABEI could use the country repayments on the ESF funds provided over the longer term to assist the region's development.

The proposal to use part of the interest spreads to assist regional technical insitutions would be a relatively easy proposition to negotiate with CABEI, and we believe it would meet with the full approval of the Bank's member countries as a painless way of increasing their contributions and, in turn, obtaining increased services from INCAP, ICAITI and CATIE.

This method of assuring adequate member country contributions to the principal regional institutions would answer the only major adverse finding of the Coopers & Lybrand assessment, namely that the core budgets of the regional institutions had not kept pace with inflation and the increased services that the regional institutions were providing. In the case of all three institutions, this approach would help them diversify their sources of funding and could be used to assist the institutions carry out other specific Coopers & Lybrand recommendations. None of the institutions have been able to do as much as they would like in terms of long-range planning, mainly because of funding uncertainties. CATIE, for example, needs to develop a master plan to provide for future research and construction of training facilities as well as for related housing needs for its students and staff, and with some reasonable assurances of future financing, such planning would be undertaken.

Goal: To enable small farmers to increase productivity and to improve their incomes and living conditions by using regional institutions to develop and transfer appropriate technology for mixed farming systems and for meeting rural energy needs.

A follow-on Fuelwood and Alternative Energy Sources project was included in the FY 1985 CP. ROCAP will present a PID for the project in early FY 1985, and plans to present the Project Paper late in FY 1985. Additional activities which would allow CATIE to develop improved technology and mixed system methods need further discussion at the technical level with the ADOs of the bilateral USAIDs and LAC/DR. These discussions would take place in connection with refining the ROCAP long range goals.

III. SPECIAL CONCERNS

A. Absorptive Capacity

Although the size of the proposed regional program gives cause for concern about absorptive capacity, two factors dispell that concern:

The majority of the ESF regional assistance will be to finance intraregional trade deficits through the existing CACMF mechanism. As such, it will not be projectized or subjected to bottlenecks which slow down disbursements. The level of funding proposed responds to an identified short-term requirement which will not only keep production levels up, but also assist in creating the conditions for expanded trade outside of the Central American region. Equally important will be the policy dialogue and conditions associated with this assistance which will be designed to reduce trade barriers and promote extra-regional exports.

Where DA project assistance is contemplated, most of it (i.e., loans with CABEI, LAAD and BLADEX) will be private sector oriented where significant excess productive capacity exists and the demand for short and medium-term investment credit is high. Overall, it has been estimated that the entire Central American aid package proposed by the NBCCA will raise investment from 18% of GNP to 22%, which is still lower than investment levels reached in the late 1970s. With respect to DA and ESF projects with CABEI, ROCAP suggests starting with assistance based on earlier CABEI success in implementing an agribusiness loan which disbursed fully in 1983. Considerable borrower demand which could not be met under the loan still exists and is ready for financing. With subsequent loans, we would move cautiously to assure that CABEI undertakes the financial and administrative reforms recommended by the IBRD. A year to two years between the FY 1985 DA loan for CABEI and any subsequent DA funding would allow the implementation of all internal reforms and provide a basis for an estimate on our part as to whether CABEI could carry out an expanded DA loan effort.

Because of the nature of the ESF loans which we are proposing for CABEI, i.e., short to medium term financing of capital equipment, we do not expect any difficulty in terms of institutional absorptive capacity, implementational delays or lack of demand for credit. CABEI has several years of experience with such programs buying short-term paper from commercial banks under its Economic Stabilization Fund.

With respect to the regional technical institutions, grant projects will be carefully selected and phased so as not to over burden them. It is also planned that some expansion of their physical infrastructure will occur so that they will be better able to respond to the demands of their clients and, as indicated earlier, we are recommending the use of some of the interest spread on CABEI loans to expand the core budgets of regional organizations which, in addition to providing additional personnel, will expand the capacity of the institution to undertake appropriate activities. Finally, grant funding levels are planned in amounts consistent with the size of previous projects, which the institutions have demonstrated a capacity to implement.

B. Relations with other USG Agencies

Where appropriate, links with other USG agencies will be encouraged by the regional program. The most obvious link is with the Peace Corps where volunteers can have a significant role in technology transfer. Under the Fuelwood and Alternative Energy project, volunteers in Guatemala and Costa Rica are already working with communities on Lorena stove construction. For the planned second phase of the project, a continued role for the volunteers is anticipated. Similarly, the new IPM project includes plans to train volunteers in pest management techniques. During the planning period, other opportunities for such linkages will be explored.

Where regional projects involve specialized research or technical assistance, linking with USG agencies which have the required expertise (such as USDA) will be explored. Closer relationships between the regional technical institutions and USG sources of technical expertise are seen as beneficial and will be encouraged.

With the emphasis throughout the region on export promotion, private sector investment and taking advantage of the CBI, a link with the Department of Commerce and its information sources would be very useful. The regional venture capital company in particular would benefit from such a contact, and the project will consider how strong linkages could best be established.

C. Use of PVOs and Cooperatives

A limited role is seen for PVOs working in conjunction with national counterparts in the dissemination of information and technologies developed by the regional projects. This is already happening in Guatemala under the Fuelwood and Alternative Energy project and opportunities may exist in other projects during the planning period.

Cooperatives are important potential target groups for training and technology transfer activities planned by the regional projects. Demonstration activities, where all the members of a cooperative can observe the impact of using more appropriate technologies, can be particularly effective in such a setting. The regional projects will include cooperatives among the target groups.

D. Staffing Requirements, Monitoring and Evaluation

ROCAP staffing was reduced by five USDH personnel last year and the staff is currently composed of eight USDH on-board, including a Controller and Deputy Controller who serve USAID/Guatemala as well as ROCAP. One USDH position, the Program Officer, remains to be filled.

Given the nature of the program proposed, if significant financing is made available for DA or ESF projects with CABEI, and funding is made available, as planned, for assistance to the CACMF for revitalization of trade and grant funds provided for projects addressing the equity concerns in health and nutrition voiced in the CP, ROCAP would require three additional USDH positions: (1) an Assistant General Development Officer to aid in managing and monitoring the Oral Rehydration Therapy project, the improved food distribution systems grant and the CABEI portfolio; (2) design and monitoring of planned agricultural and agroindustry projects will require the addition of an Assistant Rural Development Officer, and (3) the design of DA and ESF loans to CABEI, the CACMF and the countries on policy reforms, the design of grant activities in fuelwood production, nutrition, supplemental feeding and export promotion and proposed future loans to BLADEX and LAAD will require the services of an Assistant Project Development Officer.

The addition of these new positions would bring the ROCAP USDH total staffing to twelve persons who would be managing a program of in excess of $150 million annually in 1985 and 1986. In the period FY 1987-1989, the funding level would drop to an average of slightly over $110 million annually. With twelve U.S. direct hire and carefully selected FSN professionals and contractors, we would be able to meet the design, implementation and evaluation requirements imposed by the program which we have described in this paper.

E. Project Resource Requirements

The following table, covering the period FY 1985-1989, provides a breakout of proposed allocations for the ROCAP program by functional account, loan-grant split and funding source for each year.

PROJECTED RESOURCE REQUIREMENTS
($000)

	85	86	87	88	89
I. DA					
- ARDN	19,405	16,750	30,000	18,800	14,650
Grants	4,405	6,750	10,000	8,800	4,650
Loans	15,000	10,000	20,000	10,000	10,000
- HE	7,000	1,500	-	-	750
Grants	7,000	1,500	-	-	750
Loans	-	-	-	-	-
- EHR	-	1,100	1,300	2,100	1,600
Grants	-	1,100	1,300	2,100	1,600
Loans	-	-	-	-	-
- SDA	23,195	32,650	18,700	33,100	45,000
Grants	3,195	2,650	3,700	3,100	5,000
Loans	20,000	30,000	15,000	30,000	40,000
Total DA Accounts	49,600	52,000	50,000	54,000	62,000
Grants	14,600	12,000	15,000	14,000	12,000
Loans	35,000	40,000	35,000	40,000	50,000
II. ESF	115,000	118,000	75,000	50,000	50,000
Grants	-	50,000	50,000	50,000	50,000
Loans	115,000	68,000	25,000	-	-
III. Total All Accounts	164,600	170,000	125,000	104,000	112,000
Grants	14,600	62,000	65,000	64,000	62,000
Loans	150,000	108,000	60,000	40,000	50,000