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Evaluation of the Central America Trade Credit Insurance Program

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PREFACE

This report was prepared under Macroeconomic IQC Contract No. PDC-0000-I-28-6135-00 and was managed by A.I.D.'s Bureau for Latin America and the Caribbean (LAC). The scope of work was jointly designed by LAC and the Export-Import Bank.

The research involved was carried out by an RRNA team during March and April, 1988, traveling to the four countries involved for basic data and interviews and drafting their report in the United States. Mr. Gustavo Gomez, RRNA Principal Associate, was team leader, while Dr. William Loehr served as macroeconomist. Dr. John Newton and Mr. Gerard Sequeira aided in briefing and report preparation in the United States.

The team would like to thank the Project Officer, Mr. Donald Boyd of LAC, and Mr. William Ryan and Mr. Charles Anderson of Eximbank for their active support during the course of this project.

LIST OF ACRONYMS AND ABBREVIATIONS

A.I.D.	U.S. Agency for International Development
BCCR	Banco Central de Costa Rica (Central Bank of Costa Rica)
BCR	Central Reserve Bank of El Salvador
BCG	Banco Central de Guatemala (Central Bank of Guatemala)
BCH	Banco Central de Honduras (Central Bank of Honduras)
BLADEX	Export Bank of Latin America in Panama
FEPROEXAH	Honduran Export Promotion Federation
FODEIN	El Salvadoran Organization for Export Promotion
FOPEX	Costa Rican Export Promotion Organization
GOCR	Government of Costa Rica
GOES	Government of El Salvador
GOG	Government of Guatemala
GOH	Government of Honduras
LIBOR	London Interbank Offer Rate
RRNA	Robert R. Nathan Associates, Inc.
TCIP	Trade Credit Insurance Program
USAID	An A.I.D. Country Mission

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I. INTRODUCTION AND EXECUTIVE SUMMARY

Objectives

The four chapters that follow this summary assess the markets for short-term import financing in each of the four Central American countries under study. Originally we had intended to aggregate the information obtained in Central America into one general statement about credit markets in the region. Our visit to the region changed our minds. We discovered that each country was unique, and that a discussion that pretended to be a general one would overlook a large number of factors that are essential to an understanding of the region's financing needs.

Our discussion will deal with each country separately. For each country we will discuss six dimensions of our research:

- Mechanisms, procedures, and institutional framework surrounding the TCIP
- The supply of financing comparable to financing available under the TCIP
- The demand for short-term financing of imports
- Terms at which TCIP financing is available compared with terms available for the same purpose from alternative sources
- TCIP impact on production, stabilization, and exports
- An overall assessment of the benefits, costs, and prospects for the TCIP

It is also important to keep in mind that the TCIP may have had an impact on the region if, because of the program, there was a change in the financing offered by either the Exim Bank or the U.S banks that are participating in the program. Thus, our country-by-country exposition will be followed, in Chapter VI, by an explanation of what we have found the influence of the program to be in these institutions. Finally, Chapter VII offers an overall assessment of the TCIP and makes recommendations for its future use.

Background to the Project

The Trade Credit Insurance Program (TCIP) was created by Congress to go into effect in FY 1985. Originally, the TCIP made available $300 million, to finance the import transactions of Central American importers. The premise of the TCIP was that short-term credit lines to the region had dried up and that renewing them was important to achieving economic stabilization.

The TCIP was implemented by A.I.D. and the Export-Import Bank (Eximbank). It is Eximbank's normal practice to offer guarantees for letters of credit and for credits offered by private banks, when the transactions involve exports from the United States. The TCIP was designed to use the normal Eximbank practices to minimize administrative cost. Eximbank's normal practice is to guarantee financial transactions where there is "reasonable assurance of repayment." Based upon this criterion, the Eximbank was reluctant to extend large amounts of guarantees to Central America in 1985. The TCIP authorized A.I.D. to reinsure the Eximbank's guarantees for Central America. If the Eximbank were to suffer losses in the region, A.I.D. would reimburse them. Criteria for participation in the program were few. First, all Central American imports of production inputs, used by the private sector, and originating substantially in the United States qualify for TCIP financing. Secondly, countries could participate only in so far as their governments were willing to guarantee that obligations would be met. This government guarantee normally implies a central bank guarantee, although it can be interpreted as any guarantee backed by the "full faith and credit" of the government in each country.

A.I.D.'s authority to offer TCIP guarantees was set at a maximum of $300 million in FY 1985, $250 million in FY 1986, $275 million in FY 1987, and $200 million for FY 1988. A.I.D. has allocated these amounts among each of the four participating Central American countries. Over the course of the program, the allocations to each country have changed from time to time. A chronology of major events occurring under the program, for each country, is found in Appendix B. Participants are Costa Rica, Honduras, Guatemala, and El Salvador.

By the end of 1987, use of the TCIP had been much less than originally anticipated by A.I.D. Outstanding commitments under the program were only a bit under $100 million. Commitments under the program were not expanding in El Salvador, although that country was the heaviest user of the program. Legal problems in Costa Rica had prevented the full extension of the program there, and problems with non-TCIP Eximbank loans in Honduras had caused the TCIP to be suspended there in September 1987. Use of the TCIP had expanded recently in Guatemala, but total use there remained small compared with that country's allocation.

This study was prompted by two factors. First, the legislation authorizing TCIP will be up for renewal in 1989, and an evaluation of the program's progress will be desirable. Secondly, the overall use of the program has not been as great as originally anticipated and A.I.D. wishes to know why.

Thus, Robert R. Nathan Associates, Inc. (RRNA) has been contracted by A.I.D. to analyze the extent to which the TCIP has

- Resulted in making available additional trade credits to Central America, or has improved the terms on which such credit is available
- Promoted increased industrial and agricultural production and economic stabilization in participating countries
- Achieved an increase in participating countries exports
- Had beneficial impacts within the financial system or private sector which were not originally intended

Also, RRNA is to identify any procedural, institutional, legal or other factors bearing on the functioning of the TCIP and make recommendations on the modification and continuation of the program.

Examples of Typical Transactions

Transactions under the TCIP can take a number of forms. There are two major features of the program:

- A.I.D./Eximbank guarantees can extend only to guaranteeing commitments to honor letters of credit. This feature of the TCIP does not involve credit *per se*, since a letter of credit is only a promise to pay and does not involve any lending.
- Letters of credit can be refinanced and the TCIP guarantees that the loans implied by refinancing will be serviced properly. When a letter of credit results in payment to a U.S. exporter, the U.S. bank may lend the Central American importer the amount paid to the exporter for a period of up to one year. The TCIP guarantees that when the term of the loan expires, the U.S. bank will be repaid. Under the TCIP, the participating U.S. banks may refinance letters of credit for up to 180 days for raw materials and up to one year for capital goods.

The reader should keep in mind that use of the TCIP does not imply that any credit has been extended. If importers are taking advantage of only the guarantees of letters of credit, without refinancing, no credit occurs. For this reason, throughout this report we use the term "financing" to refer to transactions under the TCIP. The "financing" can be the use of either the letter of credit guarantees or guarantees of refinancing. Only in the latter case is any credit being extended.

Some readers may be unfamiliar with all of the steps in financing imports in Central America. To help these readers better understand how and where the TCIP enters the system, we have provided Figure 1 to illustrate general

import transactions. In each country there may be some minor variation in the steps shown in the diagram, but in all countries the general procedure is the same.

Figure 1 shows the six entities involved in making an import/export transaction. All interactions between these six entities are shown and numbered in order of their occurrence. Most of these interactions are self explanatory; others are not. In step three, when the importer requests his commercial bank to open a letter of credit on his behalf the commercial bank may require the importer to provide a deposit. The amount of the deposit will depend upon deposit requirements of the central bank and the confidence that the commercial bank has in the client. In cases where the importer has anything but an outstanding credit record, deposits may exceed 100 percent of the face value of the letter of credit. In step 5, when the central bank approves the commitment to spend foreign exchange, it may do so contingent on the use of the TCIP if the goods to be imported qualify. When the commercial bank requests the foreign correspondent to open a letter of credit (step 6), it informs the correspondent that the TCIP is to be used. Step 9 is the most important part of the entire transaction. Once a letter of credit is negotiated (steps 7 and 8) and confirmed (step 9) all commitments under the letter of credit are irrevocable. Step 14 separates the two main features of the TCIP. If the importer is taking advantage of only the TCIP guarantee of the letter of credit, steps 13 through 16 occur simultaneously. Notice that no credit *per se* is involved. The letter of credit is simply a promise to pay. It is designed so that on the same day that the exporter claims payment, the importer pays. The banks are only intermediaries. The TCIP guarantees that all obligations made to the U.S. bank will be met. The U.S. bank can disburse funds to the exporter with the certainty that they will be reimbursed. If the importer chooses to refinance the letter of credit, the claim of the U.S. bank on the local commercial bank is only exercised at the end of the refinance period. Thus, step 14 may take place (for example) 180 days after step 13. Again, the TCIP guarantees that at the end of the refinance period, the amount of refinancing plus interest will be paid to the U.S. bank.

Figure 1 illustrates both a conventional import/export transaction and the original design of how the TCIP fits in. Since the central banks in each country must guarantee that the importers and banks under their jurisdiction comply with their obligations under letters of credit guaranteed by TCIP, a modification of the standard procedures of Figure 1 has evolved. Step 6 in a standard case has a local commercial bank opening a letter of credit with a U.S. bank on behalf of a local importer. In Costa Rica and Guatemala the local bank opens the letter of credit on behalf of the central bank. Thus,

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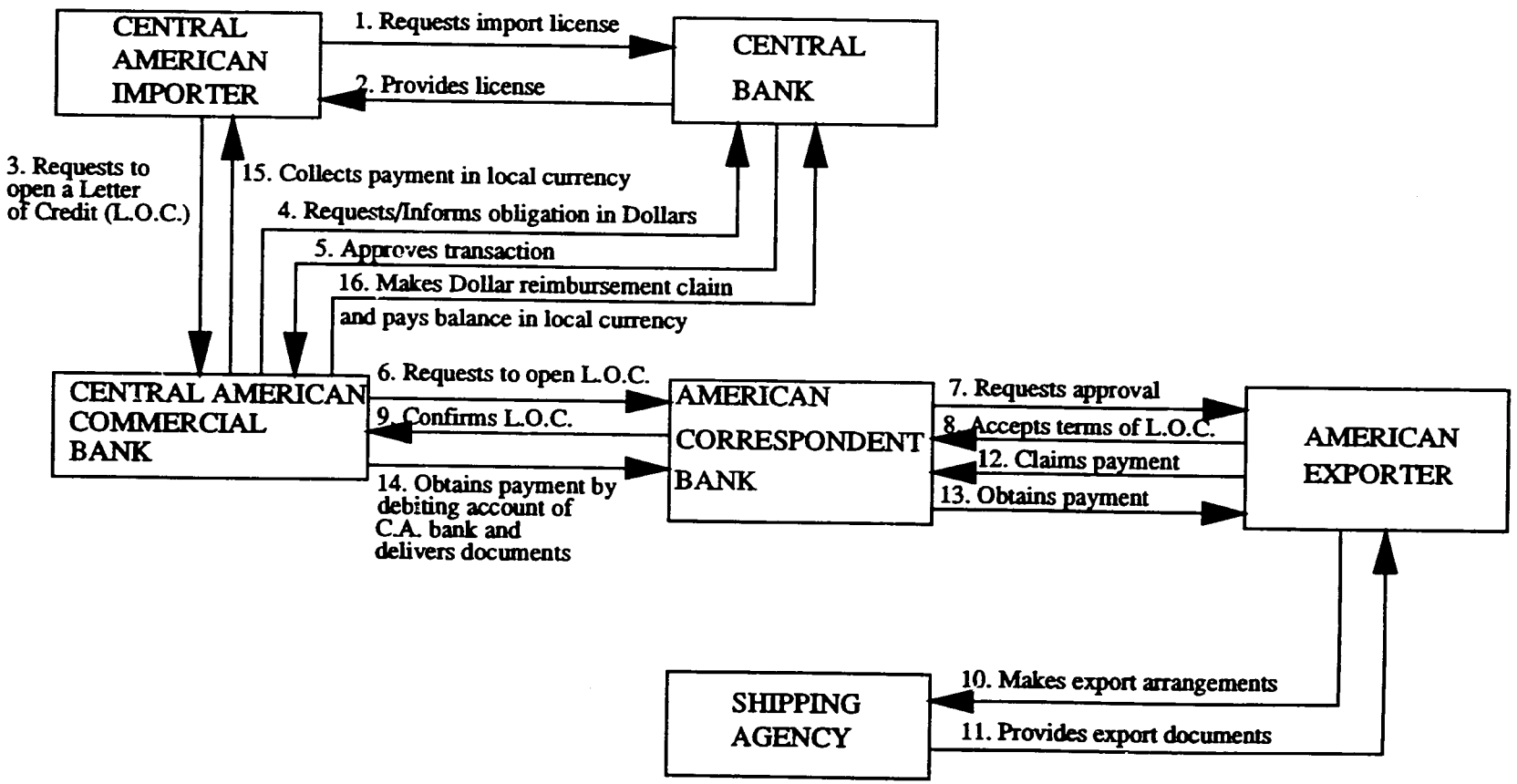
1. Deposits are normally in local currency. Some deposit in foreign exchange may be required in cases where the TCIP is not being used. In those cases local banks may have correspondent banks abroad. The correspondents will usually require that some deposits, in dollars, be made as collateral backing letters of credit. Deposits required of importers may exceed 100 percent of a letter of credit, for in the face of default, the local commercial bank will suffer penalties charged by its correspondent.

when step 14 occurs, the step is broken in two parts. First, in what could be called step 14.a, shipping documents are forwarded to the local commercial bank as they are in the standard step 14. Second and more important, a

Figure 1.

Illustration of import process under a Letter of Credit when the Central American Commercial Bank is the user of credit provided under the TCIP



new arrow representing a step 14.b could be drawn connecting the U.S. bank and the central bank, illustrating a debit to the account of the central bank, rather than to the account of the commercial bank, in compensation for the payment made to the exporter in step 13. The local bank still collects payment from the importer (step 15) and forwards that payment to the central bank. A step 16 could be drawn illustrating the forwarding of this payment to the central bank by the local bank. If refinancing occurs the party who is refinanced is the central bank, for it is the central bank's account that is debited in compensation for the U.S. bank's payment to the U.S. exporter.

Some of the main things to keep in mind when thinking about the effect of the TCIP are

- Use of the program does not imply that credit has been extended. Only where letters of credit are refinanced is credit actually involved.

- When credit occurs it need not be extended to importers. Credit may go to the central bank or to local commercial banks.

Methodology

Our assessment of the TCIP was carried out mainly through interviews with people associated with the program. In late March 1988 interviews were held with A.I.D. and Eximbank personnel who either are working or have worked on the program. During the first two weeks of April 1988, visits were made to the four participating Central American countries, Costa Rica, Honduras, Guatemala, and El Salvador, where interviews were conducted with A.I.D. personnel, central bank staffs, local bank administrators and importers who have participated in the program. Several participating banks in the United States (in Miami) were also visited. In our interviews we sought information on the following dimensions of the program:

- How does the program function in each country? What are the steps that must be taken by each importer, commercial bank, central bank, and correspondent bank, to effect each transaction? Are there any institutional constraints that are necessary to an understanding of how the program functions?

- What alternatives exist? Are there other means by which TCIP-like transactions can occur? If so what are the mechanics behind those transactions? In general, what are the supply alternatives?

- What is the demand for TCIP-like financing? What are the incentives to importers and commercial banks to use the program as opposed to its alternatives?

- What are the costs of using the program compared to the alternatives? What are costs to importers? To participating banks?

- Have there been major economic factors or events that have influenced the use, or lack of use of the program?

In addition to the main questions outlined above, the scope of work called for comments on the impact of the program on production, exports, and stabilization in the participating countries. Only qualitative statements are possible regarding these dimensions. To connect the program to production would be an enormous econometric task. To connect it to specific stabilization and export performance is almost impossible. However, some statements are possible. To help discuss any implications for production and exports, an examination was made of the kinds of goods imported and who they were imported by. In this way we were able to ask in each country whether the importers were also exporters and whether the imports could reasonably be considered to be an input into an export item. We could also discover whether or not the goods imported seemed to be important to production in general as opposed to being imports of goods commonly available without using the program. Our information came from a detailed examination of all transactions occurring under the program over the period September through December, 1987. Participating U.S. banks report monthly to Eximbank. These reports include information on all transactions completed during the month, including all goods that were imported, the name of the importer and local bank. All transactions over $40,000 were noted to limit the number of transactions to a reasonable number. These transactions became the basis for discussions with relevant people in each country.

TCIP impacts on stabilization were inferred from the apparent effect of the program on the availability of foreign exchange, inflation, and interest rates in each country. Statements about stabilization are our subjective judgment.

Summary of Results

The Trade Credit Insurance Program (TCIP) offers guarantees to importers in four Central American countries for two kinds of transactions:

- Guarantees to participating U.S. banks that letters of credit opened on behalf of Central American importers will be honored

- Guarantees that when participating U.S. banks refinance letters of credit for Central American importers, those debts will be honored

The TCIP applies, with few exceptions, to any imports of production inputs by the private sector in Costa Rica, Honduras, Guatemala, and El Salvador. All financing covered is short term: letters of credit can be refinanced for up to 180 days for raw materials and up to one year for capital

goods. The program was created by Congress in 1985, to be administered by A.I.D. in cooperation with the Eximbank. All guarantees are offered by Eximbank through its normal procedures, and Eximbank is in turn guaranteed by A.I.D. Current FY 1987 authorization allows up to $275 million in guarantees outstanding, which currently total about $100 million.

The TCIP is organized differently in each country. In Costa Rica and Guatemala importers' commercial banks open letters of credit with participating U.S. banks in the name of their central banks. Any refinancing of letters of credit is done by the central banks. In Honduras the TCIP is currently suspended. However, before its suspension it was organized to function as originally intended, although the program was little used. In El Salvador importers can take advantage of only the letter of credit guarantees, not the refinancing facility.

Specific conclusions and observations for each country are contained in the body of the report. General conclusions include the following:

- There is considerable demand for the TCIP letter of credit guarantees. There is a preference for very short-term letters of credit.

- There is very little demand for the refinancing facility of the TCIP.

- Shortages of foreign exchange and perceptions of foreign exchange risk are the main deterrent to the use of the program. Foreign exchange risk is the main reason for lack of demand for the refinancing facility.

- Alternative mechanisms for financing imports are available in Costa Rica and Guatemala, and probably could be for El Salvador. Few alternatives are available in Honduras.

- Despite alternatives, the TCIP is the preferred mechanism for financing imports in all countries, with the possible exception of Honduras.

- TCIP has improved the terms for import transactions. The main beneficial impact of the TCIP has been that it allows for a more efficient management of the flow of foreign exchange. Guatemala and Costa Rica are taking advantage of this aspect of the TCIP. El Salvador and Honduras could redesign their use of the program to improve foreign exchange management.

- The cost of the TCIP is extremely low in comparison with its benefits.

- The FY 1988 level of authorization ($200 million) is probably adequate for the foreseeable future.

II. COSTA RICA

Mechanisms, Procedures, and Institutional Surroundings

The original TCIP allocations (January 1985) included $25 million for Costa Rica. In April 1985, the central bank (BCCR) agreed to act as borrower and agreed that all Costa Rican financial institutions would be able to open letters of credit on behalf of the BCCR with the only U.S. bank participating at the time, First Palm Beach International Bank (FPBIB). This is the single most important thing to keep in mind in understanding the functioning of the TCIP in Costa Rica. The borrower who is being guaranteed is the BCCR, not the commercial banks or the importers.

Each transaction in Costa Rica involves two commitments. The first is between the importers/commercial banks and the central bank. The second is between the BCCR and the participating U.S. bank. The terms of the two commitments need not be the same, and in practice are rarely the same. Generally, the BCCR refinances the letter of credit with the U.S. bank for the maximum that the TCIP allows, that is, 180 days for raw materials and one year for capital goods. The first commitment between the importer/commercial bank and the BCCR is usually of very short duration. Typically, the importer and his commercial bank do not want credit *per se*, but wish to use only the letter of credit guarantee that the TCIP provides and to take advantage of some of the cost reductions associated with the program. They may therefore open a 60-day letter of credit (for example) on behalf of the BCCR with the U.S. bank. The obligation of the Costa Rican importer and his commercial bank is, upon payment by the U.S. bank to the U.S exporter, to provide payment to the BCCR. The BCCR in turn receives a loan for the amount due to the U.S. bank for 180 days. It is the obligation of the BCCR to pay the U.S. bank, in dollars, at the end of the 180-day period (one year for capital goods). Thus the credit is normally to the BCCR, not to the Costa Rican importer or his bank.

There are cost advantages to Costa Rican importers associated with the program. There are other means to finance imports (which are discussed below) but they cost more. If the TCIP is not used the BCCR requires that 50 percent of the face value of a letter of credit be deposited (in colones) before a letter of credit is negotiated. The deposit is required at the point where the importer applies for foreign exchange. Once the foreign exchange

application is approved, the importer may negotiate a letter of credit. Approval of a foreign exchange application requires about 20-25 days, and a letter of credit can be negotiated in a very short time thereafter. The deposit is retained by the BCCR until the letter of credit matures or results in payment to a foreign supplier. Also, the foreign correspondent bank that is opening the letter of credit will require a deposit in hard currency of from 15 to 50 percent of its face value. Thus, the importer must come up with at least 65 percent, but more typically, 100 percent of the money needed to finance the transaction (50 percent in colones; the remainder in dollars), plus whatever security is demanded by his commercial bank. This money may be borrowed from his commercial bank or come from his own resources. In either case the importer bears interest charges or opportunity costs of the amounts placed on deposit.

If the TCIP is used, the importer avoids most of the costs of prior deposits. A 50 percent deposit is still required by the BCCR, but only until the letter of credit has been negotiated. When the TCIP is being used, the approval of foreign exchange occurs within a 10-12 day period, rather than about twice that long under normal conditions. Upon the letter of credit's confirmation, the deposit is no longer needed. Because of the Eximbank guarantee, no deposit is required by participating U.S. banks. If the Costa Rican importer also needs hard currency financing for the transaction, interest charges by the U.S. bank are also likely to be lower when the TCIP is used than when it is not.

Attempts have been made since the TCIP's beginning to expand the program in Costa Rica. In August 1985, the BCCR requested an expansion of the program to $100 million, and this was quickly approved by A.I.D. and Eximbank. Problems occurred in implementing this change. The plan was for the increase in the TCIP to be channeled through Costa Rica's state-owned banks and through private banks. However, Costa Rican law does not permit the BCCR to guarantee loans made to either kind of bank. The BCCR did agree to provide the foreign exchange needed by the state-owned banks to honor their commitments under the TCIP. A.I.D. agreed (in August 1986) that this promise of foreign exchange to the state-owned banks constituted the "full faith and credit" of the Costa Rican government, but wanted some participation by private banks too, before the TCIP was extended to state-owned banks. In September 1986, the TCIP was renewed at a total level of $70 million, with $25 million to be available to the BCCR. How the remaining $45 million was to be split between state-owned and private banks was delayed while A.I.D. sought some way to allow participation of private banks. Most recently, in September 1987, it was determined to allocate $25 million to the state-owned banks, reserving $15 million for private banks. Since the question of how private banks were to participate without guarantees of the Costa Rican

government has never been settled, the private banks are not yet participants in the program.[2]

Supply of Financing

All commercial banks in Costa Rica have lines of credit available to them to cover import financing. All have access to public or quasi-public sources, such as FOPEX, FODEIN, and BLADEX, for financing exporters. FOPEX is the primary institution serving the financing needs of exporters in Costa Rica and banks report that currently they are able to serve all requests for financing exporters needs through FOPEX. However, FOPEX is a creation of the BCCR, and commercial banks are limited in their ability to indebt themselves to the BCCR, and therefore to FOPEX.[3] Should commercial banks reach their FOPEX borrowing limits, TCIP may be their next best alternative for serving exporters. All commercial banks that we had contact with disclosed that they had established lines of credit, usually with several foreign correspondent banks, and that they could finance imports out of their own resources. Suppliers credits are also available to some importers, but are reported to be only a fraction of what they were prior to 1980.

Demand for Financing

The demand for import financing is relatively great in Costa Rica, although most demand is for very short terms. Despite a great improvement in exchange rate management in recent years, Costa Ricans are reluctant to take on financial obligations denominated in hard currency. Thus, banks receive most requests for short-term transactions, typically involving payment by sight drafts (cobranzas) or letters of credit of up to 60 days, without refinancing. Banks report that the fear of exchange risk is great enough that they rarely receive a request for as long as a 180-day transaction. Importers who want credit prefer to take financing denominated in colones, even though the cost of that is roughly 30-35 percent per annum, rather than a loan in dollars at a much lower interest rate (about 10 percent).

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2. There had been a proposal to allow private banks to participate with guarantees provided by the state-owned banks. However, this involved a guarantee fee chargeable by the state-owned banks. This would make the private banks uncompetitive with the state-owned banks, since identical service is available to importers through the state-owned banks without the guarantee charge.

3. Commercial banks can indebt themselves to the central bank only up to a fixed proportion of their "qualifying assets." Thus, they can fill their implicit quota with FOPEX. None that we contacted had done so.

Some of the fear of exchange risk seems irrational. The colon devalued by about 12 percent in nominal terms in 1987 and the exchange rate is managed to prevent significant divergences between nominal and real value from occurring. Unfortunately, despite assurances from the BCCR that "mini-devaluations" would be continued, a devaluation of more than 6 percent was declared in mid-January 1988. This served to undermine confidence that the BCCR was managing the exchange rate properly, and fueled the notion that more extensive devaluations were in the offing. Costa Ricans are particularly sensitive to any signs of devaluation. The devaluation experience of the early 1980s, when many businessmen were financially ruined, is still a vivid memory. Thus, in the early part of 1988, fears of exchange risk are probably higher than they had been toward the end of 1987. This fear tends to skew the demand for credit in favor of shorter term obligations.

There is considerable demand for the TCIP by the central bank. The BCCR uses the program to stretch out payments, and the TCIP is therefore a valuable tool for foreign exchange management. The BCCR therefore requires that any transaction that qualifies must be financed through the TCIP. The BCCR is currently under IMF restrictions limiting the overall amount of short-term credit that the public sector can commit itself to. If it were not for the TCIP, the BCCR would undoubtedly find other lines of credit that allowed it to stretch out payments, but none are likely to be as flexible or to come at such low cost.

The total demand for financing of imports of goods that qualify under TCIP is probably reflected by the currently outstanding balances. In October 1987, the BCCR established a requirement that whenever an import qualifies for financing under the TCIP, it must be financed under the program. The outstanding TCIP balances probably do not reflect an increment in financing for imports, since some of the imports would have been financed using other means. The central bank requirement almost guarantees that there is some substitution of TCIP financing for other forms of finance.

Terms

If importers in Costa Rica use the TCIP, including the refinancing facility, the savings can be considerable compared with the alternatives. Costa Rican importers have a preference for short-term letters of credit with no refinancing. The main advantage that they receive in using the TCIP is that the 50 percent prior deposit normally required by the central bank is dropped. The importer saves the opportunity cost of the funds that are normally tied up at the BCCR.

We have created a numerical example to illustrate and quantify the savings available to importers who use the TCIP. The example was created with the help of personnel at the Banco Nacional, one of the state-owned banks in Costa Rica, and illustrates what for them is a fairly typical

transaction. We assume that an importer wishes to import $25,000 of goods from the United States and that the Banco Nacional is arranging TCIP financing with Citizen's and Southern Bank of Miami. We divide the costs associated into those occurring locally and those that occur in the United States. We assume initially that the $25,000 transaction is financed through a 90-day letter of credit. Then we show the costs associated with refinancing the amount over an additional 90-day period:

Example:

Amount: $25,000

Correspondent bank: Citizen's and Southern, Miami

Costa Rican bank: Banco Nacional

Case 1: Open 90-day Letter of Credit Using TCIP

Local costs:

Local opening of L.C.	$125	
Telex	30	
Total local costs		$155

Costs in U.S.:

Open L.C.	$ 40	
Confirmation	25	
Acceptance	375	
Negotiation	50111*6	
Advise	10	
Eximbank insurance	177	
Total U.S. costs		$677
Total costs		$832

Cost as percent of import value = 3.3 percent

Case 2: Local Financing Without TCIP

Using the same correspondent bank and performing the same transaction without the TCIP involves two changes. First, the importer need not pay for the Eximbank insurance. Second, the BCCR requires that the importer

maintain 50 percent on deposit until the letter of credit expires, i.e., for 90 days. If we assume that the opportunity cost of money in Costa Rica is represented by the rate at which the importer can borrow money, the costs of the transaction are

Local and U.S. costs (case 1 minus $177)	$ 655
Opportunity cost ($12,555 for 90 days @ 31.5 percent)	984
Total cost	$1639

Cost as percent of import value = 6.5 percent

Case 3: L.C. From Case 1 is Refinanced Through TCIP

Refinancing through the TCIP could be available to Costa Rican banks at LIBOR plus 2 3/8 points. Currently LIBOR is about 7 percent so the Costa Rican importer can refinance at about 9.375 percent. If the transaction is refinanced for 90 days, the refinance charges are $586. Thus, the total cost of financing the letter of credit and refinancing it through the TCIP is

Local and U.S. costs	$ 832
Refinancing costs	586
Total cost	$1418

Cost as percent of import value = 5.7 percent

Case 4: Refinancing the L.C. Locally

If the importer does not use the TCIP to finance the letter of credit (case 2) and refinances the $25,000 for 90 days after the letter of credit expires, he incurs the following costs:

Local and U.S. costs (costs of case 2)	$1639
Refinance costs ($25,000 @ 31.5 percent for 90 days)	1969
Total	$3608

Cost as percent of import value = 14.4 percent

Case 5: Use TCIP for Letter of Credit, with Local Financing

Importers can use a combination of the above. They can use the TCIP to guarantee their letters of credit, then refinance it in local currency. Costs are

Letter of credit from Case 1	$ 832
Financing from Case 4	1969
Total	$2801

Cost as percent of import value = 14.4 percent

On the basis of the costs shown above, the preferences of Costa Rican importers should be clear. Assuming for the moment that there is no fear of foreign exchange risk, importers would always choose to use the TCIP both for guaranteeing letters of credit (case 1) and for refinancing (case 3). In so doing they raise the cost of the $25,000 transaction by 3.3 percent for guaranteeing the letter of credit and by 5.7 percent if they refinance the letter of credit too. Equivalent transactions would cost them 6.5 percent and 14.4 percent respectively if they were to use local financing.[4] In fact in Costa Rica, importers do not have access to the refinancing facility, since all letters of credit are refinanced by the BCCR. Importers would still have a preference for opening their letters of credit under the TCIP. Those that need refinancing would do it in local currency. The costs of Case 5 would therefore prevail, raising the cost of the transaction to 11.2 percent of the import's value.

There is some doubt whether Costa Rican importers would take advantage of the refinancing facility if it were available to them. Refinancing under the TCIP implies that the importer takes on an obligation in dollars. Many would avoid doing so because of their fear of devaluation. They would prefer to pay a higher rate of interest to have the loan specified in local currency. The difference in the cost of the refinancing under TCIP (Case 3) and refinancing locally (Case 5) is 5.5 percent of the cost of the imports. The importer who willingly pays 5.5 percent more to finance locally for 90 days,

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4. In fact we have made local financing of a letter of credit seem a bit less costly than it really is under most circumstances. Costa Rican banks must normally make a deposit in dollars with their correspondent bank when they open a letter of credit. The deposit is normally between 15 and 50 percent. If the opportunity cost of dollars is 9.375 percent as we have assumed in Case 3, the additional deposit requirements would carry an implicit additional cost of between $88 and $292.

rather than finance for the same period in dollars, expects devaluation to occur at an annual rate of at least 22 percent.[5] That investor would rather hold colon-denominated debt at the higher interest rate than dollar-denominated debt at the lower interest rate. In general, any expectation of devaluation causes the real interest rate differential to be smaller than the nominal interest rate differential. Since there is considerable fear of devaluation in Costa Rica, nominal interest rate differentials may not be enough to convince importers to take on dollar-denominated debt.

Production, Stabilization, and Exports

It is likely that the TCIP has had a favorable impact on production and exports in Costa Rica. An examination of the list of imported items reveals that they reflect items that are important to the basic production processes of the country. Chemicals, materials for making packing cartons, agricultural inputs, and plastics are the most common kinds of items imported under the TCIP. Few of the inputs financed under the program seem to be the kinds of items that would simply go into the production of import-substituting consumer goods. Furthermore, in Costa Rica there seems to be less of a concentration of financing going toward large transactions than in the other countries. That implies that the benefits of TCIP are being spread among a large number of users. Sources in Costa Rica also indicate that the importers using the program usually include those that are producing for both domestic and export markets.

The kind of help that the TCIP has provided for production and exports should be made clear. Without TCIP, financing would probably have been available for the inputs imported under the program. However, under the TCIP terms are better. Thus, the TCIP has provided users with a cost advantage that they would not otherwise have had. It is probable that the BCCR has been able to use the TCIP to make foreign exchange more readily available to importers, whether they are users of the program or not. Thus, the TCIP may have allowed some goods to be imported that otherwise would not have been. This latter effect is likely to have been very small.

It is likely that the TCIP has contributed to economic stabilization in Costa Rica. TCIP credits go primarily to the BCCR. The BCCR is under pressure to increase the amount of foreign exchange available to the economy while minimizing the short-term indebtedness of the public sector. Indeed, the latter is constrained by Costa Rica's standby agreement with the IMF. The fact that the BCCR keeps its share of the TCIP fully occupied indicates that TCIP is either less costly or more flexible than alternative sources of short-term foreign exchange. If it were not, the BCCR would choose to draw upon

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5. 5.5 percent for one-quarter of a year implies a yearly rate of 22 percent or four times 5.5 percent. These are approximations.

other sources of short-term financing. Drawing upon other sources would require cutting back on the use of TCIP, since the IMF constraint is currently binding. Thus, the TCIP probably does not increase the amount of financing available to the BCCR, but probably does improve the terms.

Benefits, Costs, and Prospects

From an importer's viewpoint the main advantages in using the TCIP include

- The authorization period for use of foreign exchange is much shorter. Without TCIP participation, an importer faces a typical wait of about 25 days. With TCIP participation, the wait is about 10-12 days.

- There is always some uncertainty as to whether the BCCR will approve foreign exchange applications. Users who qualify for TCIP financing are almost assured that foreign exchange will be available.

- Costs are lower using the TCIP than they are using alternative sources of financing. As we have illustrated, the costs associated with a $25,000 letter of credit with a refinancing period of 90 days would typically involve costs totalling $1,418 using the TCIP and $3,608 under other arrangements. Most of the savings from the TCIP are due to the reduced deposit requirements with the BCCR and foreign correspondent bank.

Commercial banks benefit from the TCIP in that it gives them much greater flexibility in the financial services offered to their clients. Since deposits with foreign correspondents are not required when TCIP is being used, foreign exchange is freed up for other uses. Also, the TCIP has probably helped commercial banks establish some correspondent relationships that did not exist before the program began.

Prospects for the TCIP in Costa Rica seem good. The volume of Costa Rican trade is expanding rapidly, and exports in particular are growing. Thus, one would expect continually increasing use of the TCIP. Also, to the extent that prudent management by the BCCR reduces the expectation of a devaluation, Costa Rican importers may begin to use more credit to finance their transactions, rather than relying heavily upon short-term letters of credit without refinancing. However, A.I.D. should keep in mind that demand for additional use of the TCIP will develop only over time. Since the BCCR now requires that qualifying imports use the TCIP, the current use of the program is probably near the maximum use. The state-owned banks have just had $25 million in TCIP allocations made available to them. Use of this amount will

only expand as trade expands, so the $25 million will probably not be fully occupied immediately.

It is unfortunate that the private banks in Costa Rica cannot use the TCIP in competition with the state-owned banks. Requiring the private banks to obtain a guarantee from the state-owned banks will not allow them to compete. The state-owned banks would have to charge a fee for that service and would therefore put the private banks at a disadvantage. The concept of encouraging state-owned banks to provide guarantees to private banks should be discouraged.

A small amount of access to the TCIP by private banks operating without a central bank guarantee would probably be feasible in Costa Rica. Reasons for this judgment include

- Most private banks already have foreign correspondents and experience in working with them.

- If the same access to foreign exchange could be arranged at the central bank for private banks as exists for state-owned banks, the means of settlement of debt would be assured.

- Most demand for use of the TCIP by private banks is for guarantees of short-term letters of credit. Not much demand exists for the refinancing feature of the program. A modified version of the TCIP could be offered to private banks which does not include any refinancing, or refinancing for only short periods (for example 90 days).

- Costa Rica maintains a system for classifying private banks. Banks classified as "A" banks are the soundest. A.I.D. should examine the basis for this classification and consider offering access to the TCIP to only "A" banks.

III. HONDURAS

Mechanisms, Procedures, and Institutional Surroundings

Honduras has to be the most frustrating case of under utilization of the TCIP in Central America. Honduras's original allocation of $25 million (January 1985) was quickly increased to $50 million (September 1985) based upon requests by the central bank. The bank reasoned that Honduras was starved for credit at the time and that demand for financing of the TCIP type would quickly occupy the original $25 million. It must be noted that the central bank made the request for additional financing (on March 19, 1985) before any use was made of the original line. In any event, by late 1986 it became evident that relatively little use of the line was being made in Honduras, and the country's allocation was reduced to $35 million. The allocation was further reduced in late 1987 to $25 million.

Problems with arrears caused the suspension of the TCIP in Honduras at the end of September 1987, and the suspension remains in effect to this date. The arrearage problem causing suspension did not originate within the TCIP. In the early 1980s, Eximbank made several loans to the Honduran public sector, and by about 1984 these had fallen into arrears; they remain in arrears. After repeated attempts to collect on these loans, Eximbank decided to suspend its own lines of credit to Honduras in February 1987, until adequate settlement is made. A.I.D. also decided to suspend the TCIP, until the arrears are made current. Through late 1987, there have been a few cases of arrears associated with credits within the TCIP, but they have been of short duration and have all been made current.

Honduras suffers from an extreme and chronic shortage of foreign exchange. Importers must have all external transactions approved by the central bank. Although commercial banks can retain a portion of the foreign exchange that their business generates,[6] they are required to obtain the

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6. Banks can retain 50 percent of the foreign exchange that their business generates. Normally, they are allowed to retain 70 percent, but the proportion has been reduced "temporarily" to provide greater amounts to the central bank. The central bank can also limit the total amount of accumulated foreign exchange. The normal limit is $500,000 on uncommitted cash balances.

normal permission from the central bank for its use. The waiting period for foreign exchange can vary, depending upon the time of year and upon the importer's position in the foreign exchange queue. Currently, waiting periods of about three to four months seem typical.

The extreme shortage of foreign exchange brings about several problems for the financing of imports.

- The exchange shortage creates an expectation of an official devaluation. Thus, to avoid exchange risk, businesses avoid financial obligations denominated in hard currency.

- The central bank may approve an application for foreign exchange and issue the appropriate permits to an importer, but when the importer presents his documents to his bank he may have to wait until foreign exchange is available. Many cases were cited of importers unable to obtain foreign exchange that had been authorized, because of a general shortage of foreign exchange. If the importer needs the foreign exchange at a specific time, to service an external obligation, and if he cannot get it then, he must either fall into arrears or obtain the exchange he needs in the black market. In the case of arrears, the importer will suffer whatever penalties are charged by his foreign creditor for non-performance and a weakened credit rating. Covering a transaction with foreign exchange obtained in the black market is equivalent to a devaluation by the amount of the premium paid in that market.

- To avoid the exchange risks and extra costs cited above, Honduran importers prefer to use either short-term means of settlement (e.g., cobranzas) or to make payments in advance.

- Foreign correspondent banks recognize the difficulties that Honduran banks may have securing foreign exchange at the time that their obligations mature. Thus, correspondents require very high prior deposits, often 100 percent, giving the Honduran bank little advantage over payments in advance.

- Honduran banks have an incentive to avoid transactions which commit them to external payments where the foreign exchange required is to be obtained from the central bank. This is in defense of the relationship they have developed with foreign correspondent banks.

There is some indication that the TCIP is not fully understood by all Honduran banks. Some banks apparently think of the program as one which has provided credit to the central bank to finance imports, rather than a program of loan guarantees. Some banks have financed transactions under

the program, thinking that the central bank was under the obligation to provide the foreign exchange that was needed to settle accounts when loans matured. However, it is the central bank's understanding (correctly) that its role is to permit the banks to use their own foreign exchange to service their debts. Thus, several banks have fallen into arrears when they expected the central bank to provide the foreign exchange when loans matured. When the central bank has not had foreign exchange available, those banks have not been able to meet their obligations immediately out of their own resources and have had to pay penalties and suffer damaged relationships with their correspondent bank. It is for this reason that the TCIP has experienced some arrears for brief periods.[7]

Many importers, and their banks, prefer to make payments in advance for imports. Banks may prefer this because their inflow of foreign exchange is irregular. Banks have little assurance that they will have the foreign exchange available to settle their obligations unless they already have it before a transaction is arranged. If banks commit to payment in the future, they must ensure that when the due date occurs, they have sufficient foreign exchange available. Because of the irregular inflow of exchange earnings they often cannot ensure that their means of payment will be available, even if on the average they have adequate foreign exchange balances.[8] Thus, a typical transaction is one where the importer and his bank accumulate the foreign exchange needed to effect a transaction. It is either paid directly to a supplier when the goods are ordered or a very short-term (e.g., 30 days) prepaid letter of credit is opened at a foreign correspondent bank in favor of the foreign supplier.

Supply of Financing

There are very few sources of import financing that are similar to what would be available under the TCIP. The European Community offers a program that is similar to the TCIP, but Hondurans have had similar problems in using it. There are lines of financing available for imports from Mexico, Brazil, Colombia, and Venezuela, but imports from these countries are small and the lines are little used. Complaints were heard about the poor quality of

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7. All the arrears problems involved only one Honduran bank, Banco de Occidente. Meetings with officials of that bank revealed a disagreement about how the TCIP was supposed to function.

8. The problem for many Honduran banks is one of a lack of portfolio diversification. There are not enough clients at any given bank to provide a smooth flow of foreign exchange to the bank. Many foreign exchange earners who are clients have businesses that are seasonal or that receive payment in foreign exchange at irregular and unpredictable intervals. Thus, for Honduran banks, the proportional variation in the flow of foreign exchange is much greater than in larger banks with diversified portfolios.

the imports available from these sources. Export-oriented firms have access to funds established by A.I.D. and channeled through FEPROEXAH ($10 million along with 38 million lempiras) which can be used for working capital with terms up to two years, but the dollar side of these funds have been used very little.[9]

Imports are normally financed in one of two ways. First, an importer may simply request foreign exchange from the central bank, wait until the request is approved, and then use the foreign exchange permit as a basis for placing an order abroad. Second, an importer may use a commercial bank to provide the foreign exchange out of its own resources. That is, instead of having to wait in the normal queue at the central bank, the importer may be able to get the foreign exchange from the dollar reserves of the commercial bank. With that as a base, the importer could enter into normal transactions employing letters of credit and so forth.

Commercial banks have little incentive to work with any clients who are not exporters. Since the hard currency reserves of the banks originate from their retained share of the foreign exchange that they generate, they would be reluctant to provide exchange to clients who were not exporters, since that may deplete their exchange balances. Furthermore, since there is much more demand for foreign exchange in Honduras than any commercial bank can satisfy, they are likely to be willing to finance only their traditional customers. There is no need to risk the foreign exchange that they have been able to accumulate by lending it to new clients who are not exporters.

Given the severe exchange shortage in Honduras, the use of the TCIP would not be great if the program were reestablished. Honduran importers prefer to pay in advance or to use sight drafts, neither of which plays a role in the TCIP. The main problem for trade is one of a general and persistent lack of foreign exchange, not one of financing *per se*. However, the TCIP could permit the commercial banks to use what foreign exchange they do have more efficiently. Most banks either pay in advance or use very short-term instruments with high prior deposit requirements. Use of the TCIP would make advance payment unnecessary and would eliminate the need to pay high prior deposits. Therefore, one would normally reason that the TCIP would greatly expand trade financing. Unfortunately, banks and their clients are so concerned about exchange risk that demand for TCIP-like financing is currently low.

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9. The low level of use of the dollar line available through FEPROEXAH is another indicator of the fear of foreign exchange risk.

Demand for Financing

The demand for financing of the TCIP type is not great in Honduras. Those banks that incorrectly view the TCIP as having provided a pool of foreign exchange out of which the central bank can provide additional amounts of foreign exchange, express a wish to use the program. However, these banks do not express much interest in the program when it is (correctly) understood as providing only a guarantee that they will meet their obligations out of their own foreign exchange resources.

There is a great excess demand for foreign exchange in Honduras, but that should not be confused with a demand for credit. Importers need foreign exchange and are willing and even anxious to borrow to get it. However, importers and banks are reluctant to commit themselves to debts denominated in dollars for fear of devaluation. In this regard, the TCIP could only expect to attract minimal use, as has also been the case with A.I.D.'s dollar credit lines available through FEPROEXAH. Banks are also unwilling to seek TCIP credits because of the need to divert their own dollar resources to cover obligations under the program rather than simply using those resources for their traditional purposes. They generally do not view the TCIP as expanding their ability to finance imports. This is something of a misimpression on their part, for the program would allow them to free some of their resources from being tied up in advance deposits, and would permit the financing of a larger volume of transactions from their rather fixed pool of foreign exchange.

There may be limited demand for some parts of the TCIP. Import transactions tend to be of very short duration. Letters of credit opened for 30 days are common, but those of even 60 days are not. Thus, there may be demand for TCIP guarantees on short-term letters of credit, but little demand for longer ones and almost no demand for the credits extending to one year. Very short-term guarantees for letters of credit would not occupy a very large portion of the $25 million that A.I.D. has allocated for use in Honduras. That sum would support a maximum total of $300 million in imports if it were used to guarantee instruments that averaged 30 days to maturity! If the program were reinstated as it existed before, only a small part of the $25 million could be expected to be occupied guaranteeing the kinds of transactions that are in demand in Honduras.

Terms

There are few advantages to a Honduran importer in using the TCIP. The central bank requires a 100 percent deposit in lempiras before an application for foreign exchange can be filed. The deposit is the same when the TCIP is being used as it is for any other transaction. Commissions and fees paid to the central bank and commercial banks are the same (1 percent each) for all transactions. An importer who has access to foreign exchange

would not normally want to refinance a letter of credit, since in addition to the refinancing, the 100 percent deposit would remain at the central bank until the obligation was liquidated. Rather than pay the opportunity cost of the lempiras tied up at the central bank plus the cost of credit in dollars associated with refinancing, the importer is better off using a short-term letter of credit without refinancing. Importers could borrow the amounts they need from overseas banks. Their costs would be about 10 percent but their commitment would be in dollars. Since local lempira loans are available at 13 percent (the legal maximum), it behooves most importers to borrow locally, paying 3 percent more, but avoiding any exchange risk.

For importers who do not have access to dollars at the time payment to a U.S. exporter is due, but who are confident that they will be earning dollars in a short time, there may be some attraction to using the refinancing feature of the TCIP. Credit received through the refinancing of letters of credit costs Honduran importers about prime plus two to three points. Today that would put their costs at around 9-10 percent. Clearly this would have been much more attractive when Honduran legal interest rates were set at 17 percent. Recently, 13 percent was established as the maximum legal interest rate in Honduras, so much of the incentive to use the TCIP's refinancing facility has been removed. Only those with very low perceptions of exchange risk would be willing to take on a dollar-denominated debt at 10 percent rather than lempira-denominated debt at 13 percent.

Production, Stabilization, and Exports

Obviously, since the TCIP has been suspended since October 1987, there has been no recent impact on production, stabilization or exports. Prior to last October, major items imported under the program seem to have included items which were clearly basic inputs to the production process. Such items included poultry feed, agricultural chemicals (fertilizer inputs, herbicides, insecticides), synthetic resins and plastics, and paper and packing materials. Since the volume of imports under the program Was small, the impact on total production must have been very small indeed. However, given that the TCIP financing was not large, and given the potential that the program has for mobilizing resources that would otherwise be tied up, the impact of the program relative to its size could have been substantial. The impact on exports was probably insignificant. Most of the inputs imported go into industries which do not export (plastics, poultry). Those which did enter export industries (fertilizers, pesticides, insecticides) are products that are very high on the central bank's queue for foreign exchange. It is likely that they would have been imported in any event.

It is unlikely that the program, as it existed, contributed much to economic stabilization in Honduras. The central bank did not appear to use the program to enhance the resources available to itself or to importers, or to provide better foreign exchange management. Furthermore, some confusion

about the program, probably originating with some commercial banks, caused a deterioration in the relationship between the commercial banks and the central bank. Because of uncertainty about foreign exchange availability, there may have been some deterioration in the correspondent relationship between Honduran and foreign banks as well. Any impact upon economic stabilization in Honduras due to the TCIP is sure to have been very small. Furthermore, most problems seem to be associated more with the poor relationships between the central and commercial banks than with the TCIP.

Benefits, Costs, and Prospects

The benefits and costs for Honduras associated with the TCIP have to be small. The program has been little used, and when used it has generally not been in ways which enhance the efficiency with which foreign exchange is used. Given the extreme shortage of foreign exchange in the country, prospects for the program as originally envisaged do not seem bright. Exchange risk will keep demand for trade credit low. Shrinking foreign exchange available to commercial banks will cause them to retrench, financing only traditional clients who are also exporters. For these banks, use of the TCIP line will simply divert funds from one use to another. Given the system established by the central bank, the TCIP is not very marketable among Honduran banks. The structure of the system is not compatible with the banks' interests or needs under present banking regulations and the country's economic circumstances.

To have its greatest positive effect in Honduras, the TCIP should be used to allow banks to use their hard currency resources more fully. Use of TCIP could allow banks to avoid prior payment or high prior deposits. However, switching over from prior payments to use of the TCIP will require greater management skill on the part of the commercial banks. Use of the TCIP requires that when a commitment for payment comes due, the bank has the foreign exchange needed, even if it did not have the foreign exchange when the commitment was made. To work with the program the banks must manage the flow of their reserves more carefully to ensure that commitments are met. This is somewhat difficult for them to do since their inflow of foreign exchange is rather erratic. Late payments can cause a great amount of difficulty in meeting their TCIP commitments. Nevertheless, use of prior payment can be reduced, thereby increasing the productivity of their limited resources.

Willingness of banks to use TCIP is limited mainly by their fear of devaluation, but also by the limits on the interest rates that they can charge on their loans. When banks commit themselves to borrowing from their correspondent banks, they commit themselves to an obligation denominated in dollars, and to interest charges of about 10 percent. Interest rate controls in Honduras limit the interest rate that can be charged to the banks' clients to 13 percent. The difference, 3 percent, is not enough to compensate the banks

for the foreign exchange risk that they perceive. Thus, they are unwilling to enter into transactions of this kind.

In determining the future of the TCIP in Honduras, A.I.D. should consider the following:

- There are benefits to Honduras if the TCIP is used, but almost no cost if it is not.

- There is almost no current demand for the part of the TCIP that offers credit. There may be significant demand for the part of the program that offers guarantees (without credit) on letters of credit of short duration (e.g., 30 days). Thus, there is probably not sufficient current demand to occupy the full $25 million allocated to Honduras.

- Arrears within the TCIP have been few, of short duration, and caused by the severe shortage of foreign exchange in the country, rather than by bad loans. The discontinuation of the TCIP is a penalty on the Honduran private sector for arrears on loans whose proceeds were used by public or quasi-public entities. Also, it is reasonable to assume that in the long run, the government would be in a better position to overcome delinquent loan problems if growth of the private sector were stimulated in an orderly way. Thus, reinstatement of the TCIP could probably be done safely and with some positive effect on the economy.

- A.I.D. must recognize that the main problem for Honduran trade is not credit. It is a severe shortage of foreign exchange and a relatively unsophisticated banking system.

- A.I.D. should consider making arrangements with the central bank that help commercial banks manage their flow of foreign exchange. Recall that commercial banks can retain part of the foreign exchange that their business generates, and that the central bank has control over how those exchange reserves are used. Recall also that commercial banks must honor their commitments in foreign exchange out of their own reserves, but that this is difficult to manage since their inflow of foreign exchange is erratic. It is the timing of foreign exchange inflow and service of commitments that presents a major obstacle in maximizing the use of the foreign exchange that is available. The central bank could help in this timing problem by being willing to fill the foreign exchange gap when commercial banks have a temporary shortage of foreign exchange at the time when commitments are due.

The following suggests a framework that could be considered for enhancing the usefulness of the TCIP in Honduras.

- In the course of normal transactions, commercial banks should not be put in a position where they bear any foreign exchange risk. Banks do not have much pricing flexibility that would allow them to be compensated for bearing exchange risk.

- Importers faced by a shortage of foreign exchange may be willing to bear exchange risk for a short period of time. Also, it is they who benefit from the imports and they should bear the risk associated with import transactions. Importers could reasonably be expected to assume exchange risk from the time that letters of credit are confirmed to the time that payment is due, normally 30 to 90 days later. Unlike the banks, importers do have some pricing flexibility to compensate themselves for bearing risk.

- Commercial banks could be provided with some flexibility for overcoming the problem of falling into arrears when letters of credit become due at a time when they are short of foreign exchange.

- The central bank could use the TCIP as a "bridge financing" facility, to provide the commercial banks with the dollars they need at the time obligations under the TCIP are due. The central bank could use the TCIP refinancing facility to provide the commercial banks with a dollar loan of 30 or 60 days when the banks cannot meet the payment for a letter of credit at the time that payment is due. The central bank could make this arrangement available only to banks that can demonstrate that they cannot meet their obligations because of a <u>timing</u> problem, and not because of any fundamental inability to pay. Under these arrangements the central bank would be the debtor of the U.S. correspondent bank and the creditor of the Honduran commercial bank. The commercial banks should bear the exchange risk when they become debtors of the central bank under these circumstances[10] and the central bank should pass on to them all interest charges. Commercial banks should

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10. When these steps are being taken it is the commercial bank that benefits. Inability to honor obligations under a letter of credit is due to an inability of the bank to manage its foreign exchange flow efficiently (sometimes for reasons beyond its control). The suggestions being made would allow the bank to finance a larger flow of transactions from a given flow of foreign exchange, thus benefiting the bank. If the bank is the primary beneficiary, the bank should bear the exchange risk.

be required to service the debt to the central bank in dollars and to give that debt service priority.

- An efficient system should be put in place to monitor and control TCIP contingent or real obligations under the program.

These measures should be understood by A.I.D., the central bank, and the commercial banks as measures that help commercial banks smooth out the flow of their resources and not an arrangement to increase the total amount of foreign exchange available. These suggestions are based upon the already existing right of the central bank to direct the use of foreign exchange owned by commercial banks.

IV. GUATEMALA

Mechanisms, Procedures, and Institutional Surroundings

Use of the TCIP in Guatemala did not begin as rapidly as it did in the other Central American countries. A.I.D. authorized Eximbank to issue guarantees up to $25 million in early 1985, but the program remained largely unused until July 1987. Despite the lack of use, the amount of guarantees under the program was raised to $70 million in mid-1986, which is the current level of authorization.

One must recognize that the conditions facing Guatemala for all of 1985 and part of 1986 did not lend themselves to the use of the program. Extreme foreign exchange shortages existed at the end of 1984, and the country faced a greatly overvalued currency. In late 1984, parallel markets began to be used to bring about a gradual devaluation, but for a time (during most of 1985) exchange markets were out of control, and exchange rates fluctuated widely. Exchange volatility of this magnitude is very destructive of trade, and it would not be reasonable to expect that the TCIP would be heavily used under the circumstances existing in 1985 and early 1986.

In early 1986 the central bank, the Banco de Guatemala (BG) began to regain control of exchange markets. In June 1986, new legislation allowed a liberalization of trade and payments, and an orderly transition to a more stable and devalued quetzal was begun. Payments were shifted from an overvalued official market, which was accompanied by a very disorderly black market, to a regulated market where foreign exchange was bought and sold at about market rates. This effort, combined with very favorable coffee prices in 1986, allowed the full transition to the regulated market by April 1987. Overall confidence in the BG and the economy in general improved. Whereas importers were required to wait months for foreign exchange in 1985, with no assurance of getting it, by mid-1987 importers could confidently expect delivery of foreign exchange within a few days. The BG retains control over all foreign exchange earned by Guatemalans, but has managed their situation so as to minimize exchange shortages.

In July 1987, the BG instituted a rule requiring that any transaction that qualifies must use TCIP. Basically, any transaction involving qualifying items, where the purchaser requires a letter of credit to effect payment, must use

the TCIP. Imports purchased using supplier credit, sight drafts or prepaid accounts need not use the TCIP (indeed, have no relevance to TCIP). It is not surprising therefore that outstanding TCIP guarantees, which averaged only about $3 million before July 1987, quickly rose to around $19 million by the end of January 1988.

In Guatemala, as in Costa Rica, it is the central bank that receives credit under the TCIP, not the local commercial banks or importers. For example, if an importer needs a 60-day letter of credit to effect payment to a supplier in the United States, the importer applies for an import permit and for foreign exchange at the BG. If the import qualifies under TCIP, the foreign exchange permit can be issued almost immediately. The importer's commercial bank then opens a letter of credit in favor of the U.S. supplier, on behalf of the central bank at one of the participating U.S. banks. At the time the letter of credit is confirmed, the exchange rate is fixed for the Guatemalan importer. When payment is made to the U.S. exporter, the Guatemalan importer pays the BG at the predetermined exchange rate.[11] The BG may then seek refinancing of the letter of credit in accordance with the rules of the TCIP. As in the Costa Rican case, it is the central bank that receives the credit, not the Guatemalan importer or his commercial bank. The main difference between the Guatemalan and Costa Rican cases is that in Guatemala the importer and his bank bear no foreign exchange risk. The exchange rate is fixed at the beginning of the transaction. In Costa Rica by contrast, the exchange rate used to settle accounts is the one existing at the time payment is made to the U.S. supplier.

Supply of Financing

Although when the TCIP was begun there was little credit available to Guatemala, conditions have improved greatly. Banks and importers can now obtain foreign exchange relatively easily, although neither is permitted to own foreign exchange reserves. Nevertheless, the BG makes working capital in foreign exchange available to banks, and on this basis they are able to open up normal correspondent relationships with foreign banks. Most banks have lines of credit available to them, and supplier credits have expanded of late. One indicator of a substantial supply of non-TCIP financing is the fact that before July 1987 there was very little use of the TCIP, despite an apparently much larger volume of transactions that would have qualified. Also, when we questioned bankers about whether they would be able to serve all the import

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11. The same procedure governs transactions that do not go through the TCIP. Application and approval procedures are identical, although approval of foreign exchange requests may occur a bit more quickly if the TCIP is used. Most important, however, is that the central bank guarantees the exchange rate at which settlement will occur whether or not the TCIP is used.

needs of their clients if the TCIP did not exist, all responded that they could.

Demand for Financing

The demand for the TCIP in primarily a demand by the central bank. As in Costa Rica, the BG is able to use the program to gain control over the use of foreign exchange in a very flexible and low cost manner. Although TCIP credits are short term, since the BG is the only borrower, and the borrowing is done using a large number of loans with varying maturities, the program is equivalent to one that has lent the BG the amount outstanding ($19 million) at long term. This borrowing by the BG is available to them at low cost (LIBOR + 1/4) and is therefore one of their preferred sources of credit. Without TCIP credits, the BG reports that similar credit would come at a cost of about LIBOR plus 1/2 to 1 point.

The data would make it appear that demand for TCIP financing has expanded greatly among importers. However, since they have been required to use TCIP since July 1987, the increase in use does not reflect an increase in demand (except by the BG) but rather a diversion from the use of other means of finance to the TCIP. Despite great improvements in foreign exchange availability and stability, Guatemalan banks and importers are somewhat fearful of foreign exchange risk. They generally prefer to avoid committing themselves to future payments in dollars. However, one banker reported to us that he has experienced a small but increasing demand for the refinancing of letters of credit, even if the refinancing is denominated in dollars. If this turns out to be generally true it would reflect both confidence in the quetzal and a source of future demand for TCIP credit. Still, as in the other Central American countries, Guatemalans prefer to pay for imports using very short-term instruments or prepayment. Since the foreign exchange delivery period is now rather short, importers could (in the absence of a requirement to use TCIP) effect payment in the form that they prefer without TCIP.

Terms

Guatemalan importers and their commercial banks are totally unaffected by the terms associated with the TCIP. The commissions paid for opening letters of credit are the same whether or not the TCIP is being used. Since it is the central bank that receives any credit from the TCIP, it is the central bank that pays for the Eximbank fees. As already mentioned, there is an advantage to the central bank in that it can borrow at about 1/2 percent less than it would be charged without TCIP.

Production, Exports, and Stabilization

It is not likely that the TCIP has improved either Guatemala's production or export performance. Particularly since significant use of the program only began about eight months ago, one could not expect much impact to have been felt. Also, since use of the program is required, it is likely that the items being imported would have been imported anyway. There may be an important but indirect impact on Guatemala's production and exports in that the central bank has been able to secure the use of more foreign exchange by borrowing under the program. Thus, there is more foreign exchange available for all purposes, some of which would be productive ones. To the extent that the BG has more foreign exchange available to it in a very flexible, low-cost form, the central bank is surely helped in managing its stabilization program. This is the main effect of the TCIP in Guatemala.

Benefits, Costs, and Prospects

There are no significant costs or benefits to Guatemalan importers from the TCIP. Indeed, when an importer applies to the Banco de Guatemala for an import and foreign exchange permit, the BG assigns the importer to a line of financing. If they qualify, they are assigned to the TCIP. Three of the four banks that we visited noted that the importers probably are unaware of the line that has been assigned to them. Commercial banks report no cost advantages to them when they use the TCIP, although all report that the central bank and the correspondent banks in the United States make it easy for them. They also comment that the existence of the TCIP may have helped them develop healthier correspondent relationships than would have existed otherwise. An indirect benefit from the TCIP, for importers of all kinds and for the commercial banks, is that foreign exchange is more readily available and the central bank is more efficient in meeting their needs.

Our observations on prospects for the TCIP in Guatemala are

- Use of the TCIP is likely to grow more rapidly than the economy in general, but not as fast as may be implied by the growth since July 1987.

- An operational rule change contemplated at the central bank will probably reduce the popularity of the program. Currently the BG guarantees the exchange rate for a transaction from the date of approval of the import permit. The change would remove this guarantee, and an importer would bear exchange risk up until the date of settlement under a letter of credit. Thus, an importer will be bearing an exchange risk for about 60 to 90 days, whereas now he bears no exchange risk. If confidence in the stability of exchange rates continues to improve, this risk will be perceived to be minimal.

- Given continued exchange stability and efficient central bank management, demand will expand for the letter of credit refinancing feature of the program, or substitute financing in quetzales.

- The currently authorized level of TCIP for Guatemala ($70 million) should be adequate for the foreseeable future. Currently there is about $20 million in credit outstanding under the program.

V. EL SALVADOR

Mechanisms, Procedures, and Institutional Surroundings

The initial TCIP allocation for El Salvador of $75 million (February 1985) was expanded to $100 million in September 1987. But, during 1987 the outstanding balances under TCIP were generally in the $44-49 million range.

The extent to which the TCIP is used depends in an important way on the central and commercial banks' access to other financial facilities for obtaining foreign exchange such as USAID grants and lines of credit from other sources, and the condition agreed upon with the donors for using the facilities they provide.

The Salvadoran importers interviewed by the consultant team were pleased with the import opportunities opened up by the TCIP, but complained about the Central Bank requirement under which the U.S. suppliers have to provide a 90-day credit after the shipment of goods to the Salvadoran importers.

The BCR's rules do not permit importers to take credit from the participating U.S. banks in the way it was originally conceived in the TCIP. Importers cannot refinance their letters of credit with participating banks in the United States.

The requirements for use of 90-day letters of credit and for suppliers to agree to be paid 90 days after the shipment of goods are important for an understanding of how the TCIP works in El Salvador. An example may best illustrate the mechanics of import financing. First, the importer must open a letter of credit with the foreign correspondent for a period of 90 days. During that 90 days, the U.S. exporter will ship his goods and present documents for payment to the U.S. correspondent bank. Assume that these documents are presented on day 60. The exporter will then be paid with a note maturing 90 days later. (This would probably be in the form of a banker's acceptance drawn on the participating U.S. bank.) The Salvadoran importer will therefore be required to pay in full on the 150th day after the letter of credit is opened. On the surface, from the Salvadoran importer's point of view, the transaction appears to be one that does not involve refinancing. The amount paid by the Salvadoran importer is the amount of the

invoice presented by the U.S. exporter. However, hidden in this is the implicit interest paid to the U.S. supplier to induce him to accept payment 90 days after the conventional date. In effect, what occurs is that the U.S. exporter charges more for the goods and discounts the note received in payment. Thus, the Salvadoran importer pays an interest charge hidden in the cost of the goods imported.

Supply of Financing

The TCIP opens a way of financing imports that may not otherwise be open to Salvadoran importers. The total available under the program, $100 million, is very large compared with other sources of financing. The BCR revealed that, other than the TCIP, only $105 million is available in a number of other lines for financing transactions with the rest of the world and with the United States for non-qualifying goods. Thus, the amount of financing under the TCIP is a relatively large portion of the total, and without the TCIP it would probably prove difficult for Salvadorans to import efficiently.

It is likely that other lines of TCIP-like financing would have been opened up had the TCIP not existed. A.I.D.'s ESF disbursements, which totaled about $200 million in 1987, are tied to the purchase of production inputs from the United States. Thus, the same kinds of goods that can be financed under the TCIP are the object of purchases using ESF funds. Currently, when ESF funds are placed in the special accounts set up to handle them, the funds are used as a source of foreign exchange to pay for goods brought into El Salvador. The TCIP is one mechanism under which these goods could be brought into El Salvador.

Most of the alternative sources of import financing have been established by the BCR, although several Salvadoran commercial banks have maintained their own lines of finance with foreign banks. Since the commercial banking system in El Salvador is nationalized, distinctions between lines of financing open to commercial banks as opposed to the BCR are sometimes blurred. Very little true supplier credit is available. Before 1979, supplier credits were the main source of import financing, but that source has almost entirely dried up.

Demand for Financing

The demand for import financing in El Salvador is a demand for guarantees of letters of credit of relatively short duration. It is not a demand for the refinancing facility contained in the TCIP. Importers bear the foreign exchange risk associated with their transactions in El Salvador, and most prefer to have less exchange exposure than they are now forced to take. Since all letters of credit are for 90 days, and supplier "credits" are required for an additional 90 days, an importer is exposed for as long as 180 days. Most would prefer to avoid this risk. Currently, liquidity in the local banking

system is such that importers can acquire local credit for import transactions should credit be desired.

When questioned about the financing terms that would best suit them, both banks and importers had a preference for short-term, sight letters of credit. All were of the opinion that the requirement that foreign suppliers offer "credit" was injurious to importers. The opinion was that the supplier "credit" requirement put importers in a weak position to bargain for the best prices and, in any event, leads to prices that reflect the discount costs to foreign suppliers. All prefer that the supplier "credit" requirement be dropped. Importers with a good liquidity position have good reason for opposing the supplier credit requirement because it increases their costs with no corresponding benefit. However, importers who would otherwise have to obtain local credit for financing their imports might find that the supplier's credit is cheaper than their alternatives. The ideal would be a system that put central bank pressure on foreign suppliers to offer credit, but that did not make it mandatory for Salvadoran importers.

Despite the problems associated with the terms of financing under TCIP, importers and their banks think the program has been valuable to them as a facilitator of transactions. All believe that without the program, obtaining foreign exchange in a timely manner would be difficult.

Terms

Most transactions in El Salvador occur under the same circumstances, and one cannot identify any important differences in terms associated with the TCIP. All other transactions have the same terms associated with letters of credit and supplier "credits." All are subject to similar prior deposits[12] and commissions. A disadvantage of the TCIP is that only in this case do importers have to pay an insurance premium, although in fact we heard little complaint about this requirement.

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12. Prior deposit requirements in El Salvador are small compared with most other countries. Upon opening a letter of credit an importer must offer a deposit of 20 percent of its face value. However, the deposit can be in the form of a note. Since the note is not cashed until the letter of credit is liquidated, there is little financial cost associated with it. When deposits are in cash, interest is paid until the date of liquidation.

Production, Stabilization, and Exports

One cannot build a case that the TCIP has been particularly important for production or exports. Indeed, given that the ESF monies must be spent on the kinds of goods qualifying for TCIP coverage, it is likely that in the absence of TCIP, the same goods would have been imported in any event. The list of goods imported and the firms importing them does not reveal any pronounced concentration among export activities. Also, since El Salvador has not been particularly successful at promoting exports, most goods imported under the program enter production for the local market. Unfortunately, the costs of all producers, including exporters, are likely to have been unnecessarily raised by BCR rules. Requiring 90-day letters of credit when shorter terms are preferred and compulsory supplier "credit" whether or not the importer wants it are measures that surely raise production costs. To this extent, Salvadoran exporters will be at a competitive disadvantage compared with producers elsewhere, who have greater flexibility to arrange terms that suit their business interests. The TCIP may have been of marginal benefit to production in that it probably makes import transactions a bit easier than they would otherwise be.

Stabilization is not likely to have been helped by the TCIP. The BCR is not using the program to help itself manage foreign exchange resources as central banks are doing in Costa Rica or Guatemala. or is the BCR allowing the private sector to manage its own resources.

Benefits, Costs, and Prospects

In El Salvador, it is likely that costs of the TCIP have exceeded benefits. Benefits of the program have been mainly that transactions have been facilitated. However, considering the size of the ESF program and the way ESF funds are tied to purchases from the United States, if the TCIP had not existed over the past several years other means by which ESF funds could be spent would have to have been found. Costs of the program could be substantial. Most of these costs result from the way the BCR regulates the use of the program. Main costs are

- High transaction costs. The BCR requires importers to use 90-day letters of credit when most importers prefer shorter terms. Shorter term letters of credit carry lower commissions and insurance fees.

- Implicit finance charges. The BCR requires suppliers to finance Salvadoran importers for 90 days. Suppliers pass on the costs of this "credit" in higher prices for their goods.

- The bargaining position of Salvadoran importers is weakened when foreign suppliers learn that they are required to offer 90-day supplier "credit." Many foreign suppliers simply do not transact business in this way. Salvadoran importers can only deal with the limited set of suppliers who are willing to take delayed payment. Base prices, to which suppliers add a premium to cover their implicit interest charges, would probably be lower if Salvadoran importers were able to bargain with all potential suppliers.

- Foreign exchange risk for importers is higher than it could be. Importers bear exchange risk from the date at which they commit themselves to a transaction to the date of settlement. The BCR regulations cause importers to bear the exchange risk for as long as 180 days, whereas most have a preference for shortening the risk-bearing period (to about 30-60 days). Bearers of risk normally protect themselves by charging higher prices than they would in the absence of risk.

- High production costs resulting from these costs imply higher prices for final products. Exporters particularly are at a competitive disadvantage.

Prospects for the TCIP are good in El Salvador in that minor changes in the way the program is used could yield significant benefits. First, the BCR could manage the TCIP to gain more flexibility in its own access to foreign exchange. As in the cases of Costa Rica and Guatemala, the BCR could use its ability to borrow on a short term to smooth out its foreign exchange flow. This would not imply that credit is withdrawn from importers, for importers do not demand this kind of credit. Measures to accomplish this would require the BCR to examine the options available to it, design a system to fit the TCIP into the other exchange management measures used by the BCR and devise a way to monitor the outstanding and pending commitments under the TCIP.[13] Secondly, the requirements that importers use 90-day (or any other predetermined length) letters of credit and that foreign suppliers must defer payment for 90 days should be dropped.

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13. The BCR should be able to program the expiration of commitments that have been made through letters of credit and the flow of new commitments implied by the approval of new applications for foreign exchange. Currently, the BCR can tell only what the total commitments outstanding are and the total foreign exchange applications approved but not yet acted upon. They cannot now tell the rates at which current commitments expire nor how new commitments are scheduled to come on stream.

Under the present circumstances, it does not appear likely that additional allocations of TCIP coverage need to be extended to El Salvador. Data from U.S. banks reveal an average outstanding balance of about $44-49 million during 1987. Furthermore, the average level of use does not appear to be growing.

VI. TCIP IMPACT OUTSIDE CENTRAL AMERICA

The TCIP could have had an effect on trade in Central America if it induced either the Eximbank or U.S. commercial banks to increase financing or improve terms for the region. Thus, conversations were held with Eximbank and commercial bank officials to determine whether or not financing had changed because of the program.

The TCIP would have had little effect if it simply replaced lines of financing that the Eximbank would have provided anyway. Fortunately, this did not occur. When the TCIP was begun in 1985, the Eximbank was offering coverage for short-term import financing of $25 million in Guatemala, $10 million in El Salvador and $10 million in Honduras. Since then Guatemala's coverage has remained at $25 million. There has been some talk of increasing that amount to $50 million, but in the presence of the TCIP there is no great pressure to do so. Also, demand for the regular Eximbank line in Guatemala does not appear to be great. Only about $12 million of the $25 million authorized is currently outstanding. In El Salvador, the Eximbank has retained an authorization of $10 million for short-term financing, while increasing its allocation for medium-term financing from $10 million to $20 million. The Eximbank has faced very little demand for the medium-term facility.

No regular Eximbank facilities are currently available for Honduras or Costa Rica. The $10 million line available for Honduras was suspended in February 1987, because of arrears. As we have mentioned in Chapter III, the TCIP was also suspended in Honduras until problems with the regular Eximbank line have been resolved. Eximbank coverage of short-term guarantees in Costa Rica were suspended in 1982 and remain suspended. Costa Rica's debt rescheduling, its difficulties in honoring the rescheduled obligations, and IMF constraints on short-term debt for the public sector, imply that the Eximbank would not be extending its normal short-term coverage under current conditions. The Eximbank did open up a program of medium-term financing in April 1987, but there has been no demand for the facility.

It is interesting to note that the Eximbank has had little or no demand for the medium-term facilities that it has opened in Central America. The facility in El Salvador is little used and the one in Costa Rica is unused. This is consistent with our observations in all countries that there is a fear of

foreign exchange risk that drives importers away from credit denominated in dollars. We found little demand for the part of the TCIP that guarantees refinancing of letters of credit because that would commit importers to a future payment in dollars. For the same reason, other dollar lines of credit established by A.I.D. in the region are only lightly used.

Participating banks in the United States have probably improved their relationships with Central America because of the TCIP. They report that because of the program they are opening letters of credit that they would probably not be inclined to open without the TCIP. Also, the terms that they can offer are more favorable. Commissions and fees associated with letters of credit are minimal and deposit requirements nil. Without the TCIP guarantee, deposits of about 50 percent would be required. Finally, Central American commercial banks have used the program to open up relationships with U.S. banks that they may have had greater difficulty opening without the program.

In summary, the effect of the TCIP outside Central America has been pretty much as the program's designers intended. The Eximbank has not simply replaced its own lines with the TCIP, and their terms are better because of the program. U.S. commercial banks are also able to deal with Central American countries at terms which are much more favorable than they would otherwise be.

VII. CONCLUSIONS AND RECOMMENDATIONS

In Chapters II through V of this report, we have made observations about the effect of the TCIP on each of the participating countries. In most cases country-specific conditions determine how one views the usefulness and prospects for the TCIP. Nevertheless, some region-wide observations can be made. Most important among them are the following:

- The TCIP has facilitated imports of production inputs into Central America. Without the program all countries would have had difficulty in finding a facility through which imports could flow.

- The TCIP has improved the terms for import financing. Importers are relieved of high deposits and commissions, and fees are minimal (except in Honduras).

- The TCIP can be used as a valuable tool for managing foreign exchange. Indeed, this is probably the primary beneficial impact of the program. Central bank use of the letter of credit refinancing feature of the program helps them smooth out the flow of foreign exchange and the import activity implied by it. Central banks in Guatemala and Costa Rica are taking advantage of this feature. Those in El Salvador and Honduras are not.

- There is a direct relationship between the availability of foreign exchange and a country's ability to benefit from the TCIP. When foreign exchange is scarce, trade breaks down because of that scarcity, not from a lack of credit or letter of credit guarantees. As foreign exchange becomes more available, the TCIP becomes more useful, and can function more like it was originally designed to function.

- There is little demand among importers for the feature of the TCIP that guarantees the refinancing of letters of credit. Most importers prefer to finance their imports with short-term letters of credit, without financing in dollars. Thus, there is

only demand for the part of the TCIP that provides guarantees of letters of credit.

- Almost no credit is being extended directly to importers because of the TCIP.

- Total demand for the TCIP is probably accurately represented by the currently outstanding commitments of about $100 million. In the three major countries, Costa Rica, Guatemala, and El Salvador, the central banks require that all qualifying transactions must use the TCIP. Thus, in these countries, there are no qualifying transactions that could be shifted to the program. Growth in the use of the program will only occur as trade in these countries expands. The TCIP is currently suspended in Honduras, but even if reinstated, its use in Honduras would be very low.

- Given the very low costs associated with the program, the benefits from it are certain to far outweigh costs. The TCIP has very low administrative costs. Since it is only a guarantee program (as opposed to a loan program) it only suffers major costs when there are defaults. To date, no defaults have occurred.

The observations that we have made about the applicability and use of the TCIP in each country lead us to the following recommendations for future management of the program.

- The program should be renewed at about the FY 1988 level, which authorizes $200 million. Although current outstanding use, $100 million, represents almost all demand for the program, trade and demand for the program will expand more rapidly than overall growth in participating countries. Also, as countries create improved expectations for exchange rate stability, growth in demand for the refinancing feature of the program will grow.

- An attempt to extend part of the program to private Costa Rican banks should be made. This extension may be to offer only the letter of credit guarantees. Currently the program in Costa Rica puts private banks at a disadvantage when compared with state-owned banks.

- TCIP should be reinstated in Honduras, even if at a limited level. Although demand for the program there is limited, it is of some use to some importers.

- El Salvador could be making much greater use of the program than it is. The way the TCIP (and other means of financing) is being managed by the central bank imposes significant costs on importers. Alternative management could relieve these costs. Also, the central bank could take advantage of the program to manage better its own flow of foreign exchange.

APPENDIX A. LIST OF PERSONS INTERVIEWED

APPENDIX A: PERSONS INTERVIEWED

COSTA RICA:

- Vincenz Schmack, AID
- Jorge Zamora, Jefe Seccion Extranjera, Banco Nacional de Costa Rica
- Cesar Arie S., Jefe Seccion Cobranzas, Banco Nacional de Costa Rica
- Jose Rivera, Banco Nacional de Costa Rica
- Carlos Wong, Sub-gerente, Banco Nacional de Costa Rica
- Tobias Celdas, Banco Central
- Rodolfo Ulloa, Gerente General, Banco de Costa Rica
- Eduardo Madriz, Sub-gerente, Banco Interfin
- Carlos Morales, Sub-gerente, BANCOOP
- Jorge Dengo, BANEX
- Jorge di Palma, BANEX

HONDURAS

- Guillermo Bolanos, AID
- Kermit Moh, AID
- James Grossmann, AID
- Joel Cassman, Econ Section, U.S. Embassy

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- Ranulfo Lizardo, Jefe, Programa de Reactivacion Industrial, Central Bank
- Mario Suazo, Jefe, Dpto. Regulador del Financiamiento Externo, Banco Central
- Armando San Martin, Gerente General, Banco de las Fuerzas Armadas
- Rafael Guillen, Banco de Occidente
- Roberto Agurcia, Banco de Occidente
- Manuel Bueso, Gerente General, Banco de Occidente
- Evyven Corrales, Banco de Occidente
- Salvador Gomez, Primir Vice-Presidente, Banco Atlantida
- Marcio Suazo, Coalpalma, Ltda., Tegucigalpa

GUATEMALA:

- Guillermo Matta, AID
- Sergio A. Gonzalez, subgerente, Banco de Guatemala
- Luis H. Soria, subgerente, Dpto. Internacional, Banco de Guatemala
- Enrique Lima, subgerente, Banco Industrial
- Arturo Magana, jefe Dpto. Internacional, Banco de Occidente
- Roberto Pena, jefe Dpto. Extranjero,Banco Agricola Mercantil
- Carlos Rosales, sub-jefe Dpto. Extranjero

EL SALVADOR:

- J. Stephenson, AID
- P. Bojorquez, AID
- Nicholas Apostol, Tucker and Associates

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- Cesar Valladares, Jefe, Dpto. de Fomento de Exportaciones, Banco Central de la Reserva
- Fausto Betancourt, Former head, dpto. de Contro de Cambios, Banco Central de la Reserva
- Rafael Barrera, Jefe, Dpto del Exterior, Banco Central de la Reserva
- Dimas Ramirez, Jefe, Dpto de Control de Cambios, Bco Central de la Reserva
- Alvarado Ramirez, Dpto. de Control de Cambios, BCR
- Julio Alvaarenga, Dpto. de Control de Cambios, BCR
- Blanca Estela Benevides de Hernandez, Jefe Dpto. Exterior, Banco de Desarrollo e Inversion.
- Leonor de Prieto, Bco. Capitalizador.
- Antonio Trejo, Sub-gerente General, Corcho y Lata, S.A.
- Luis Garcia, Contador General, Corcho y Lata, S.A.
- Ricardo A. Molina, Jefe de Inventario y Compras, La Constancia, S.A.
- Jose Gomez, Director Financiero, ADOC, S.A.

UTSIDE CENTRAL AMERICA:

- Don Boyd, AID
- Irving Levy, AID
- David Dettner, Eximbank
- William Arnold, Eximbank
- Marcello Figuerola, Costa Rica desk, IMF
- Manuel Varela, Senior Vicepresident, Citizen's and Southern Bank, Miami
- Cecilia Norrman, Assistant Treasurer, Barclay's Bank, Miami

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APPENDIX B. PROGRAM CHRONOLOGY BY COUNTRY

Trade Credit Insurance Program

Chronology for Costa Rica

- O/A 1-20-85	A.I.D. authorizes Eximbank to issue insurance coverage up to $25 million for Costa Rica.
- 2-8-85	A.I.D. mission in Costa Rica signs T.C.I.P. agreement with the Banco Central de Costa Rica ("BCCR").
- 3-13-85	BCCR telexes Eximbank to request an allocation of $25 million. BCCR advises that it has selected First Palm Beach International Bank ("FPBIB"), Coral Gables, Florida, to provide financing.
- 3-21-85	Eximbank's Board authorizes an initial allocation of $25 million.
- 4-30-85	FPBIB signs loan agreement with BCCR. BCCR will act as borrower and essentially all Costa Rican financial institutions will be able to open L/C's on behalf of BCCR.
- 5-8-85	FCIA issues insurance coverage to FPBIB.
- 8-19-85	The first L/C's and direct payment orders are issued this week.
- 9-6-85	BCCR requests an additional allocation of $75 million.
- 9-13-85	A.I.D. authorizes Eximbank to issue insurance up to an additional $75 million.
- 9-26-85	Eximbank's Board authorizes a second allocation of $75 million.
- 10-31-85	BCCR allocates the additional $75 million to five U.S. banks: Bankers Trust, Irving Trust, Bank of America, Security Pacific and Banco Internacional de Costa Rica.
- 11-15-85	In response to a 11-7-85 telex from Eximbank, BCCR advises that it will act as borrower as is the case with the initial $25 million.
- 12-3-85	BCCR advises that it may act as guarantor rather than borrower and will telex again when it has made a decision.
- 4-25-86	Rodrigo Bolanos, general manager of BCCR, meets with A.I.D. and Eximbank in Washington to discuss reasons for delay in implementing the supplemental $75 million. Mr. Bolanos reports that by law BCCR cannot guarantee short-term borrowings of the four state-owned banks or any borrowings of privately owned financial institutions. Mr. Bolanos proposes that the four state banks act as borrowers with BCCR providing A.I.D. with a written assurance that foreign exchange will be provided to the four banks to repay T.C.I.P. obligations. Mr. Bolanos will also investigate the possibility of having the state banks reallocate a portion of the lines to private banks. 1/

1/ The four state banks are Banco de Costa Rica, Banco Nacional de Costa Rica, Banco Anglo Costarricense and Banco Credito Agricola de Cartago.

6-6-86	FPBIB ceases its international banking activities. Its $25 million allocation is taken over by Barclays Bank.
-o/a 8-15-86	A.I.D. determines that obligations of the four state banks are backed by the full faith and credit of the Government of Costa Rica. These banks will be allowed to act as borrowers under the T.C.I.P. without the guarantee of BCCR. However, since it controls access to foreign exchange, BCCR will provide A.I.D. with an assurance in writing that it will provide dollars for T.C.I.P. obligations.
9-25-86	Eximbank's Board of Directors authorizes a renewal from 9-30-86 to 9-30-87 and a reduction from $100 million to $70 million.
9-30-86	BCCR advises that it wishes Barclays Bank to continue operating [illegible]
5-6-87	BCCR advises that on 4-14-87 it allocated $5.5 million to Banco Anglo Costarricense and $9.0 million to Banco de Costa Rica. Four U.S. banks were selected by these two state banks to provide financing. They are Citibank, Barclays Bank, C&S International Bank and Banco Atlantico. The operating mechanism will be as described in the 8-15-86 caption above.
9-17-87	BCCR advises that on 9-9-87 it allocated $9.0 million to Banco Nacional de Costa Rica. The same four banks as in the 5-6-87 caption were selected by Banco Nacional to provide financing.
9-29-87	Eximbank's Board authorizes a one-year renewal through 9-30-88 at a reduced level of $65 million. A.I.D. desires that $15 million be reserved for private sector Costa Rican banks.
2-9-88	BCCR allocates $3.5 million to Banco Anglo Costarricense. Financing will be provided by C&S International Bank.
2-15-88	BCCR advises that on 1-22-88 it transferred $6 million from Barclays Bank to C&S International Bank on the $25 million line under which BCCR acts as borrower.
3-4-88	BCCR suspends at least temporarily the $3.5 million allocation for Banco Anglo Costarricense with Banco Atlantico (see 5-6-87 caption).
3-11-88	BCCR advises that on 3-2-88 it allocated $1.5 million to Banco Credito Agricola de Cartago. Financing will be provided by Banco Atlantico.

Expiration Date: 9-30-88

Note: The latter portion of the above chronology is obviously diffficult to follow. In summary, BCCR acts as borrower on $25 million with financing provided by Barclays Bank ($19 million) and C&S International Bank ($6 million). Another $25 million has been assigned to the four government-owned commercial banks. Four U.S. banks, including Barclays, provide financing. A.I.D. hopes to involve private sector banks in the remaining $15 million. This will probably not work out because A.I.D. wants a government guarantee on the T.C.I.P. The four government state banks, but not BCCR, could issue such a guarantee, but they would charge the private banks a fee which would make the latter uncompetitive.

David V. Dettner
March 29, 1988

Trade Credit Insurance Program

Chronology for El Salvador

- O/A 1-20-85	A.I.D. authorizes Eximbank to issue insurance coverage of up to $25 million for El Salvador.
- 2-5-85	The A.I.D. mission in El Salvador signs a T.C.I.P. agreement with the Banco Central de Reserva de El Salvador ("BCR").
- 2-13-85	A.I.D. increases El Salvador's allocation to $75 million.
- 3-13-85	BCR telexes Eximbank to request an initial allocation of $75 million. It also advises that it has allocated the $75 million among eight U.S. banks and ten Salvadoran banks. BCR will act as guarantor.
- 3-21-85	Eximbank's Board approves an initial allocation of $75 million.
- 5-22-86	Eximbank's Board renews the T.C.I.P. for El Salvador through 9-30-87 at the existing $75 million level.
- 9-29-87	Eximbank's Board renews the T.C.I.P. through 9-30-88 at an increased level of $100 million.
- 10-30-87	BCR advises that two additional Salvadoran banks will open L/C's under the T.C.I.P. Because certain of the Salvadoran banks were not fully using the amount of credit available to them, BCR advises that the twelve Salvadoran banks will no longer have specific dollar allocations with designated U.S. banks. The U.S. banks will each have a portion of the $100 million and in theory will be able to work with any or all of the Salvadoran commercial banks.
Expiration Date:	9-30-88

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Trade Credit Insurance Program

Chronology for Guatemala

- O/A 1-20-85	A.I.D. authorizes Eximbank to issue insurance coverage up to $25 million.
- 3-11-85	A.I.D. mission in Guatemala signs T.C.I.P. agreement with Banco de Guatemala ("BG"), the central bank.
- 4-3-85	BG telexes Eximbank to request an allocation of $25 million. BG advises that it will act as borrower and eighteen financial institutions will be authorized to open L/C's on its behalf.
- 8-29-85	Eximbank's Board approves an initial allocation of $25 million. Eximbank had deferred action on BG's request because of unrecovered transfer risk claims that reached $2.3 million at one point. These claims were largely cleared up by 8-19-85.
- 11-18-85	BG telexes Eximbank to advise it has allocated $5 million each to Banco Atlantico, Irving Trust, Bank of Boston, Philadelphia National Bank and First Palm Beach International Bank.
- 6-5-86	Eximbank's Board authorizes an increase from $25 million to $75 million. At A.I.D's request, the expiration date of the initial $25 million is left unchanged at 8-31-86, while the expiration date of the incremental $50 million is set at 9-30-87.
- 6-27-86	BG allocates the $70 million to C&S International Bank, Manufacturers Hanover Trust Co., Banco Atlantico, Irving Trust, Philadelphia National Bank and Bank of Boston.
- 9-25-86	Eximbank's Board authorizes an extension from 8-31-86 to 9-30-87 and a decrease from $25 million to $20 million in the initial allocation originally approved on 8-29-85. Consequently, Guatemala's total allocation is now $70 million with an expiration date of 9-30-87. All twenty private and government-owned commercial banks will be eligible to open L/C's on behalf of BG.
- 1-2-87	Philadelphia National Bank is replaced by Barclays.
- 9-29-87	Eximbank's Board authorizes a one-year renewal through 9-30-88 at the existing $70 million level.
- 10-2-87	BG advises that Bank of Boston and Banco Atlantico will be eliminated from the T.C.I.P. and First American International Bank will be added.

Expiration Date: 9-30-88

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Trade Credit Insurance Program

Chronology for Honduras

- O/A 1-20-85	A.I.D. authorizes Eximbank to issue insurance coverage up to $25 million for Honduras.
- 2-4-85	A.I.D. mission in Honduras signs T.C.I.P. agreement with the Banco Central de Honduras ("BCH").
- 3-19-85	BCH telexes Eximbank to request an initial allocation of $25 million. BCH advises that it has allocated the $25 million among eight U.S. banks and fifteen Honduran commercial banks.
- 3-21-85	Eximbank's Board approves an initial allocation of $25 million.
- 8-16-85	A.I.D. increases Honduras' allocation to $50 million.
- 9-12-85	Eximbank's Board approves an increase from $25 million to $50 million in Honduras' allocation.
- 5-20-86	BCH allocates the second $25 million among Honduran and U.S. commercial banks.
- 9-25-86	Eximbank's Board authorizes an extension from 9-30-86 to 9-30-87 and a decrease from $50 million to $35 million.
- 10-15-86	BCH allocates the $35 million among eleven Honduran and six U.S. Banks.
- 9-29-87	Eximbank's Board authorizes a one-year extension to 9-30-88 at a reduced level of $25 million. A.I.D.'s continuing guarantee, however, will be subject to Eximbank's reinstatement of its own $10 million short-term, general purpose, bank-to-bank facility which expired on 2-28-87 and was not renewed because of arrears and claims involving the Honduran public sector. As of 3-29-88 neither of the two facilities had been reinstated.

Expiration Date: 9-30-88

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