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

EL SALVADOR

PROJECT PAPER

INDUSTRIAL STABILIZATION AND RECOVERY  
ADMENDMENT NUMBER 2

AID/LAC/P-644  
CR-198, 351

PROJECT NUMBER: 519-0287

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AGENCY FOR INTERNATIONAL DEVELOPMENT  
**PROJECT DATA SHEET**

1. TRANSACTION CODE:  A (Add),  C (Change),  D (Delete). Amendment Number: 2. DOCUMENT CODE: 3

COUNTRY/ENTITY: EL SALVADOR. 3. PROJECT NUMBER: 519-0287

4. BUREAU/OFFICE: LAC. 05. 5. PROJECT TITLE: Industrial Stabilization and Recovery

6. PROJECT ASSISTANCE COMPLETION DATE (PACD): MM DD YY 09/30/94. 7. ESTIMATED DATE OF OBLIGATION (Under 'B' below; enter 1, 2, 3, or 4):  
A. Initial FY: 84. B. Quarter: 4. C. Final FY: 93

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

A. FUNDING SOURCE	FIRST FY 85			LIFE OF PROJECT		
	B. FX	C. L/C	D. Total	E. FX	F. L/C	G. Total
AID Appropriated Total						
(Grant)	(1,850)	( 712 )	( 2,562 )	(36,655)	(13,805)	(50,460)
(Loan)	( -- )	( -- )	( -- )	( -- )	( -- )	( -- )
Other: 1. U.S. 2.						
Host Country (ESF Counterpart)		870	870		10,677	
Other Donors (Part. Inst.)		147	147		8,465	
<b>TOTALS</b>	<b>1,850</b>	<b>1,729</b>	<b>3,579</b>	<b>36,655</b>	<b>32,947</b>	<b>69,602</b>

9. SCHEDULE OF AID FUNDING (\$000)

A. APPROXIMATE RELATION/PURPOSE CODE	B. PRIMARY TECH. CODE	C. PRIMARY TECH. CODE		D. OBLIGATIONS TO DATE		E. AMOUNT APPROVED THIS ACTION		F. LIFE OF PROJECT	
		1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan
(1) ESF	730	840		29,460		16,000		45,460	
(2) PSEF						5,000		5,000	
(3)									
(4)									
<b>TOTALS</b>				<b>29,460</b>		<b>21,000</b>		<b>50,460</b>	

10. SECONDARY TECHNICAL CODES (maximum 6 codes of 3 positions each): 831, 874, 920

11. SECONDARY PURPOSE CODE

12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each):  
A. Code: DEL, PVON. B. Amount:

13. PROJECT PURPOSE (maximum 480 characters):  
To stimulate growth in the non-traditional export sectors of El Salvador, resulting in increased levels of employment, income, investment, and foreign exchange earnings.

14. SCHEDULED EVALUATIONS: Interim MM YY 10/9/2, Final MM YY 08/9/4

15. SOURCE/ORIGIN OF GOODS AND SERVICES:  000,  941,  Local,  Other (Specify) CACM

16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a \_\_\_\_\_ page TP Amendment):  
INCREASE FUNDING AND EXTEND LIFE OF PROJECT.  
"Methods of implementation and financing are hereby concurred with."  
*Giorgio L. Franklin*  
CONTROLLER

17. APPROVED BY: *Henry H. Bassford*  
Title: HENRY H. BASSFORD, Mission Director. Date Signed: MM DD YY 03/22/91

18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION: MM DD YY

AGENCY FOR INTERNATIONAL DEVELOPMENT  
UNITED STATES OF AMERICA A. I. D. MISSION  
TO EL SALVADOR  
C/O AMERICAN EMBASSY.  
SAN SALVADOR, EL SALVADOR, C. A.

PROJECT AUTHORIZATION AMENDMENT No. 2

Name of Country/Entity: El Salvador  
Government of El Salvador  
Salvadoran Foundation for Economic and Social Development (FUSADES)

Name of Project: Industrial Stabilization and Recovery

Number of Project: 519-0287

1. Sections 1 and 2 of the Authorization, as amended, are hereby deleted in their entirety and the following Sections 1 and 2 substituted therefor:

- A. Pursuant to Sections 531 and 106 of the Foreign Assistance Act of 1961, as amended, I hereby authorize the Industrial Stabilization and Recovery Project for El Salvador, encompassing a grant to the Salvadoran Foundation for Economic and Social Development (FUSADES) and a grant to the Government of El Salvador (GOES), and involving planned obligations not to exceed Fifty Million Four Hundred Sixty Thousand United States Dollars (\$50,460,000) in grant funds over a period of ten years from date of original obligation, subject to the availability of funds in accordance with the A.I.D. OYB/Allotment process, to help in financing foreign exchange and local currency costs of the project.
- B. The Project consists of technical and financial support to private and public sector efforts to stimulate growth in the country's non-traditional export sectors, resulting in increased levels of employment, income, investment, and foreign exchange earnings.
- B. The following provisions will be included in the Agreement Amendments:
  - A. Conditions Precedent to Disbursement for Special Activities
    1. FUSADES
      - a. Prior to disbursement of additional A.I.D. resources for the industrial credit activity, FUSADES will present, in form and substance satisfactory to A.I.D., the timetable, organizational chart, and charter for FIDEX, S.A., unless A.I.D. otherwise agrees in writing.
      - b. Prior to disbursement of additional A.I.D. resources for the industrial credit activity in excess of \$3.5 million, FUSADES will present documentation, in form and substance satisfactory to A.I.D., which demonstrates that FIDEX, S.A. has been legally established, and that FUSADES has contributed five million colones from its resources for its capitalization, unless A.I.D. otherwise agrees in writing.

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c. Prior to disbursement of A.I.D. resources to be channeled through FIDEX, S.A., FUSADES will present, in form and substance satisfactory to A.I.D., for A.I.D.'s review, the funds management agreement(s) for A.I.D. funds to be managed by FIDEX, S.A., unless A.I.D. otherwise agrees in writing.

2. GOES

a. Prior to disbursement of A.I.D. resources for the National Export and Investment Commission (CONAEXI), the GOES will present documentation in form and substance satisfactory to A.I.D., which details the staffing, organizational structure, and functions of CONAEXI.

b. Prior to disbursement of A.I.D. resources for CONAEXI, the GOES will present an Action Plan for 1991 which contains the individuals, salaries, and list of equipment proposed for the technical unit, the activities from the National Export Strategy to be implemented in 1991, and a procurement and implementation schedule.

c. Prior to disbursement of A.I.D. resources for CONAEXI, the GOES will provide A.I.D. with the names and signatures of those individuals empowered to act for the GOES on behalf of the Project.

B. Covenants

a. FUSADES and A.I.D. will annually review the feasibility of moving the offshore trust onshore.

b. FUSADES covenants that it will reduce its participation in FIDEX, S.A. to 25%, or the maximum allowable under Salvadoran banking law, over the life of this Project.

Except as expressly amended or modified herein, the Authorization, as amended, remains in full force and effect.

  
Henry H. Bassford  
Director  
USAID/El Salvador  
Date 3/27/91

Drafted by: MSDugan, PRJ, 0078B, p.2  
Cleared by: DKKennedy, PRJ, MS/My, Date 3-14-91  
JStephenson, PRE, Date 3-14-91  
TMcKee, DPP, Date 3/15/91  
DSFranklin, CONT, Date 3/15/91  
LKMCGhee, CO, Date 3/15/91  
ISmyer, RLA, Date 2/1  
JHeard, AMDO, Date 3/22/91  
JLlovaas, DDIR, Date

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## ACRONYMS

AID	Agency for International Development
BCR	Central Reserve Bank
CACM	Central American Common Market
CBI	Caribbean Basin Initiative
CENTREX	One-Stop Export Documentation Center
CEPA	Autonomous Executive Port Commission
CODEXI	Export and Investment Development Committee
COEXPORT	Corporation of Exporters
CONAEXI	National Commission for Exports and Investment
CPA	Certified Public Accountant
DA	Development Assistance (A.I.D. funding account)
DEES	Economic and Social Studies Department (FUSADES)
DIVAGRO	Agricultural Diversification Program (FUSADES)
EIRR	Economic Internal Rate of Return
ESF	Economic Support Funds (A.I.D. funding account)
FEDEPRICAP	Private Sector Federation for Central America and Panama
FIDEX	Investment Fund for Export Development (FUSADES)
FIDEX, S.A.	Private Development Finance Institution
FISS	Salvadoran Social Investment Fund
FMLN	Farabundo Marti National Liberation Front
FOB	Free on Board
FORTAS	Association Strengthening Activities Program
FUSADES	Salvadoran Foundation for Economic and Social Development
FX	Foreign Exchange
GAO	U.S. General Accounting Office
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GOES	Government of El Salvador
IDB	Interamerican Development Bank
IBRD	International Bank for Reconstruction and Development (World Bank)
IFC	International Finance Corporation
IMF	International Monetary Fund
LC	Local Currency
LICOA	Law for the Credit Institutions and Auxiliary Organizations
LOP	Life of Project
MICE	Ministry of Foreign Trade (now merged with Ministry of Economy)
MINEC	Ministry of Economy
NES	National Export Strategy
NTAE	Non-traditional Agricultural Exports
NTE	Non-traditional exports
PACD	Project Assistance Completion Date
PP	Project Paper
PRIDEX	Export and Investment Promotion Program (FUSADES)
PSEE	Private Sector, Energy, and Environment (A.I.D. funding account)
PROPEMI	Small and Micro Enterprise Program (FUSADES)
PROMISAM	PROPEMI Program in San Miguel (financed by the IDB)
SAL	Structural Adjustment Loan (World Bank)
SAR	Semi-Annual Review
SBFZ	San Bartolo Free Zone
SDR	Special Drawing Rights
TIPS	Trade and Investment Promotion Services
U.S.	United States
USAID	United States Agency for International Development
USG	United States Government

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<u>PROJECT NAME</u>	<u>NUMBER</u>
Industrial Stabilization and Recovery	519-0287
Water Management	519-0303
Small and Microenterprise Program	519-0304
Training for Productivity and Competitiveness	519-0315
Association Strengthening Activities	519-0316
Free Zone Development	519-0323
Agribusiness Development	519-0327
Private Sector Initiatives	519-0336

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**INDUSTRIAL STABILIZATION AND RECOVERY**  
**PROJECT NO. 519-0287**  
**PP SUPPLEMENT NO. 2 OUTLINE**

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- I. Institutional Analysis
- J. Procurement Waiver

0078B Text           0282B Supercopy  
 0088B Annexes       0283B Supercopy

USAID/El Salvador PP Supplement Design Committee

Maureen S. Dugan, Deputy, Office of Projects, Chairperson  
James Stephenson, Chief, Private Enterprise Office  
Ana de Aguilar, Private Enterprise Office  
Beatriz Peralta, Private Enterprise Office  
Claudia Maza, Private Enterprise Office  
Kenneth Ellis, Chief, Rural Development Office  
Julian C. Heriot, Jr., Chief, Office of Economic Planning and Analysis  
Edward Landau, Deputy, Development Planning and Program Office  
Martin Schultz, Controller's Office  
Laura McGhee, Contracts Office  
Eduardo Tugendhat, Carlos Torres, Robert Bond, Bruce Heatly, Siegfried  
Marks, William Phelps; Consultants

USAID/El Salvador PP Supplement Review Committee

John Lovaas, Deputy Director  
John Heard, Associate Mission Director for Operations  
Deborah Kennedy, Chief, Office of Projects  
Thomas McKee, Chief, Development Planning and Program Office  
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Kenneth Ellis, Chief, Rural Development Office  
Douglas Franklin, Mission Controller  
James Leo, Executive Officer

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## I. SUMMARY AND RECOMMENDATIONS

The proposed Amendment to the Industrial Stabilization and Recovery Project is consistent with the Mission's and the Government of El Salvador's efforts to promote private sector-led economic growth with equity. The Project is one of the Mission's key initiatives to generate employment and higher incomes by increasing non-traditional exports and investment in El Salvador. The Project is designed to help El Salvador achieve broadly based, sustainable growth and to encourage a vigorous response by the private sector to an improved policy environment. This Project Paper Supplement proposes an increase in the life of Project funding of \$21.0 million in Economic Support Funds and Development Assistance grant monies, for a total A.I.D. contribution to the Project of \$50,460,000. The local currency equivalent of \$8,465,000 (for a total of \$19,142,000) will be provided in-kind and in cash counterpart by the two grantees: the Salvadoran Foundation for Economic and Social Development (FUSADES), a Salvadoran private voluntary organization, and the Government of El Salvador (GOES). The implementing entity for the GOES will be CONAEXI, the National Export and Investment Commission. The total cost of the Project is \$69,602,000. This Amendment also includes a three and one-half year extension of the Project, i.e. extending the Project Assistance Completion Date from March 31, 1991 to September 30, 1994.

The goal of the ongoing Project is to accelerate economic growth and diversify the economy to attain higher levels of economic well being. The purpose is to stimulate growth in the non-traditional export sectors of El Salvador, resulting in increased levels of employment, investment and foreign exchange earnings.

The problem which the Project will continue to address is that El Salvador has inadequate resources to support the country's efforts to expand non-traditional exports as a means of promoting economic growth and diversifying the economy.

The resources added herein are expected to result in 23,500 new jobs, \$110 million in new investment in export-oriented industries, and \$94 million in additional foreign exchange earnings, bringing life of Project totals to 40,000 jobs, \$155 million in investment, \$139 million in foreign exchange earnings.

The Project is designed to take advantage of two of El Salvador's best resources: a skilled, well-educated and aggressive entrepreneurial class; and a plentiful pool of low-cost, productive labor. By utilizing these resources more effectively, the Project addresses the serious problems of underemployment and low incomes. For both the entrepreneur and the worker, the higher incomes will be generated by Project activities. Project beneficiaries include the persons gaining employment and income as a result of increased investment in productive sectors.

Project activities are designed to provide the technical, financial, and operational support needed to advance public and private sector efforts to promote and facilitate non-traditional exports and investment in export-oriented industries. The first component, Private Sector Activities, provides support for FUSADES' export and investment promotion efforts (PRIDEX)

in El Salvador and abroad; credit to facilitate investment in non-traditional industrial and "maquila" export operations (FIDEX); and support for FUSADES' economic and social research activities (DEES). Under the extended Project, PRIDEX will place greater emphasis on foreign investment and more selective, targeted technical assistance to domestic firms. The Amendment also provides limited operational support for FIDEX, while assisting it to become a private, for-profit development finance institution. Support for the DEES will enable it to continue to perform high quality research, analysis, and dissemination thereof in support of private sector solutions to the country's development.

The second component, Public Sector Activities, provides support for the National Export and Investment Commission, which is tasked by the GOES with the implementation of the National Export Strategy. No additional A.I.D. funds are needed for this component.

Other costs associated with the implementation of the Project include: \$309,000 for A.I.D. Project management expenses (FSN Project Manager, FSN Assistant Project Manager, etc.); and \$340,000 for audit and evaluation.

SUMMARY PROJECT BUDGET  
(U.S. \$000s)

<u>COMPONENT</u>	<u>PREVIOUS TOTAL</u>	<u>TEIS AMDT</u>	<u>NEW PROJECT TOTAL</u>
<b>1. <u>PRIVATE SECTOR ACTIVITIES</u></b>			
a. PRIDEX	10,500	10,701	21,201
b. FIDEX	9,470	6,909	16,379**
c. DEES	555	2,741	3,296
d. FORTAS	575	---	575
e. Administration	5,000	---	5,000***
f. FUSADES building	<u>800</u>	<u>---</u>	<u>800</u>
	26,900	20,351	47,251
<b>2. <u>PUBLIC SECTOR ACTIVITIES</u></b>	2,225	---	2,225
<b>3. <u>OTHER PROJECT COSTS</u></b>	<u>335</u>	<u>649</u>	<u>984</u>
<b>TOTAL A.I.D.</b>	<b>29,460</b>	<b>21,000</b>	<b>50,460</b>
<b>COUNTERPART*</b>	<b><u>10,677</u></b>	<b><u>8,465</u></b>	<b><u>19,142</u></b>
<b>TOTAL PROJECT</b>	<b>40,137</b>	<b>29,465</b>	<b>69,602</b>

\* Includes in-kind and cash, and based on an exchange rate of 8 colones/U.S.\$.

\*\* Includes \$15 million in credit.

\*\*\* 9% overhead charge included in individual program budgets herein.

Based on the Project's contribution to the Mission's development efforts, USAID/El Salvador recommends AID/W provide an ad hoc redelegation of authority to the Mission Director, USAID/El Salvador, to approve this Project Paper Supplement, which provides \$21,000,000 in additional A.I.D. funding and a three and one half year extension of the PACD, through September 30, 1994.

## II. BACKGROUND AND RATIONALE

### A. Country Setting

During the 1980s, civil conflict, global recession, a devastating earthquake, and sharp drops in productive investment battered the economic and social fabric of El Salvador. The violent civil war, which began in 1979, has claimed over 75,000 lives, damaged the country's infrastructure, and drained economic resources, through both necessary military expenditures and capital flight. Concomitant with the outbreak of the war, exogenous factors, primarily higher prices for imports, lower prices for commodity exports, and the international debt crisis, further dampened El Salvador's economic prospects. The result was economic decline; in 1988, GDP and GDP per capita stood at 84% and 73%, respectively, of their 1978 levels. Gross domestic investment fell from 23.8% of GDP in 1978 to 12.8% in 1988. This situation was exacerbated by the 1986 earthquake, which left more than 1,500 dead, over 20,000 injured, 300,000 homeless, and extensive damage to social and economic infrastructure.

In June 1989, a new democratically elected government assumed office. The new government of President Cristiani initiated a broad program of structural adjustment designed to achieve sustainable, private sector led growth. The structural adjustment program includes: (1) measures to improve the profitability of the export sector, including the introduction of a flexible exchange rate, import tariff reductions, and the elimination of non-tariff barriers to imports; (2) measures to reduce the fiscal deficit, primarily through a streamlining of the tax rate structure and the elimination of exonerations to indirect taxes; (3) measures to strengthen the financial system, including the adoption of a flexible interest rate structure, and legal and institutional reforms to privatize the banking system; and (4) measures to remove price distortions, including eliminating price controls on all but a few essential items. However, as positive results were being achieved from the adjustment measures, conditions took a turn for the worse. Although coffee production rose sharply in 1989 and 1990, world coffee prices collapsed. In addition, the November 1989 guerrilla offensive damaged public and private infrastructure, and led to increased public spending. The offensive and its aftermath led to a 16% decline in the volume of production, a 43% decline in construction activity, and a 24% drop in commercial sales in the final quarter of 1989, according to January 1990 surveys of the private sector. Nevertheless, the GOES remained committed to the adjustment program as the only means of achieving sustained increases in GDP per capita and improve the material well being of Salvadorans.

The economic reforms enacted in 1989 are now having their intended effect. The removal of price controls on basic grains and other crops sharply increased plantings in 1990. The resulting increase in agricultural and commercial output produced an estimated GDP growth rate of 2.8% in 1990, as compared to 1.1% in 1989. The Central Reserve Bank battled inflation through tight monetary policy and succeeded in reducing inflation from about 23.5% in 1989 to 19.3% in 1990, despite petroleum price shocks late in 1990.

The GOES reform efforts are being recognized. The government has signed an upper tranche agreement with the International Monetary Fund, and is negotiating a Structural Adjustment Loan with the World Bank, both for the purpose of supporting its macroeconomic and financial sector reform efforts.

In terms of political development, the 1980's also witnessed a return to democracy in El Salvador. Nascent democratic institutions are functioning in this small country, in spite of the guerrilla insurgency. In 1989, for the first time since 1931, a freely elected government transferred power peacefully to the elected government of the opposition political party. A series of negotiations are taking place between the GOES and the FMLN guerrillas under the auspices of the United Nations.

#### B. The Export Sector

During the 1960's and 1970's, El Salvador experienced healthy annual growth rates which averaged approximately five percent of GDP. This growth was based on traditional commodity exports such as coffee, cotton and sugar, and non-traditional industrial exports to the Central American Common Market (CACM). El Salvador had the first free zone in Central America, and by 1978 had begun to develop a healthy extra-regional export industry with significant foreign investment. The political events of 1979 precipitated a climate of disinvestment which, when combined with the worldwide recession of the early 80's, price fluctuations and loss of market for traditional exports, the failure of the CACM, poor economic policy, and civil war, sent the country into an economic tailspin. Although the economic slide was stabilized in 1983-84, unfavorable GOES economic policy impeded economic recovery. Lack of investment in the coffee sector resulted in reduced productivity which, combined with weak world prices, halved foreign exchange earnings from El Salvador's primary earner by the end of the decade. Cotton and sugar, which had fallen to fractions of previous performance, failed to revive.

Beginning in 1984, the private sector began to recognize the potential of extra-regional, non-traditional industrial and agricultural exports (NTE), and organizations such as FUSADES actively promoted this sector. Unfortunately, until the election of the current Government in 1989, economic policy continued to be a disincentive to investment. Although there was modest growth in the NTE sector, it did not receive the investment necessary for the dramatic growth seen in other countries in the region.

This situation changed significantly in June 1989, when the Cristiani government took office. As an integral part of its economic program, the Cristiani government adopted an export-led growth strategy which relies on the private sector as the engine of development. At the same time, it adopted a free market economic model that had been advocated by FUSADES. A fundamental aim of this model was the establishment of policies conducive to investment and the removal of protectionist tariff and non-tariff barriers which discouraged exports and encouraged poor investment choices. These new policies, combined with a disciplined monetary regime policy, led to reduced inflation and increased earnings for exporters in 1990.

TABLE II  
EL SALVADOR: MERCHANDISE EXPORTS BY PRINCIPAL GROUPS  
(million of U.S. dollars)

	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989(1)	1990(2)
TOTAL EXPORTS (DB)	1075.4	797.9	699.6	758.1	726.4	695.1	754.9	590.9	608.8	496.5	547.0
Additional ports	726.0	537.0	481.9	550.2	505.2	525.7	593.6	386.4	393.5	251.8	272.0
Coffee	615.2	452.6	402.6	443.0	450.0	463.7	546.8	351.5	358.0	227.5	240.7
Cotton	84.6	53.6	45.2	55.4	9.1	29.0	4.5	2.3	0.3	0.8	0.8
Sugar	13.4	14.8	15.9	40.1	25.9	23.2	25.3	12.1	19.2	13.5	18.5
Wheat	12.8	16.0	18.2	11.7	20.2	9.8	17.0	20.5	16.0	10.0	12.0
Non-Traditional ports	349.3	260.9	217.7	207.9	221.2	169.4	161.3	204.5	215.3	244.7	275.0
COM	295.8	206.5	174.2	164.9	157.2	95.7	91.0	119.6	139.8	160.6	170.0
Extra Reg. Mkts.	53.5	54.4	43.5	43.0	64.0	73.7	70.3	84.9	75.5	84.1	105.0

(1) preliminary BCR data.

(2) BCR estimates.

Sources: for 1980-1981, El Salvador, Recent Economic Developments 1984, IMF.  
for 1982-1984, El Salvador, Recent Economic Developments 1986, IMF.  
for 1985, 1990, 1990 Monetary Program of the BCR (2nd. review)

In early 1990, the GOES, with A.I.D. financed technical assistance, initiated a series of high level working sessions which produced a National Export Strategy. The premise of the Strategy is that sustained economic growth can only be achieved through investment in those export-oriented industries which offer maximum opportunity for El Salvador. The Strategy, which is discussed in Section II.D.2., details quantitative goals, inputs, outputs, priority sectors, critical constraints and the roles to be played by both governmental and private sector entities.

As can be seen in Table II, export performance in eighties was largely determined by the volume of and price for coffee exports, which accounted for between 40 and 50 percent of total exports. Non-traditional exports outside the region grew steadily (96%) during the decade, while non-traditional exports to the CACM, after falling

drastically in the early eighties, have grown by more than 78% since 1985. These figures do not include drawback, which is reported by the GOES under services. Although data on drawback is unreliable because of the difficulty in measuring value-added, the data suggests that apparel drawback earnings, while highly erratic, have grown at an average annual rate of 34% from 1983 through 1990 (Department of Commerce data, July 1990).

The implementation since mid-1989 of sound economic policy had a profound impact on export performance in 1990. Preliminary data collected by the Central Reserve Bank and FUSADES indicate growth rates for non-traditional exports (including drawback) of over 65 percent in 1990. (The San Bartolo Free Zone alone exported \$69.4 million FOB with a value added of \$24.2 million.) FUSADES-assisted investment in non-traditional exports in 1989 in 1990 totaled \$31.3 million. These increases occurred in spite of the guerrilla offensive and a tight monetary policy that restricted both investment and working capital credit. Barring a major recession in the U.S. and a softening of demand for non-traditional products, continued growth in the export sector can be expected.

### C. Project Results to Date

The Project was authorized in September 1984, for a LOP total of \$9.46 million in grant funding for a three year period. The original goal was to generate employment, income, and foreign exchange earnings for El Salvador. The original purpose was to develop the capacity of the private and public sectors to provide policy support and technical assistance, technology transfer, and training services to exporters of non-traditional products.

The public sector component, implemented by the Ministry of Economy (formerly by the Ministry of Foreign Trade - MICE), consists of a \$2.56 million grant to finance activities designed to improve the legal, policy, and institutional framework in support of private sector efforts to increase non-traditional exports to non-CACM markets, and to improve facilities and operations at the GOES Free Zone at San Bartolo. A five month PACD extension through February 28, 1988 was granted to give the Mission and the GOES time to review the Project, which had achieved little to date. The Grant Agreement for this component was then amended to provide a two-year extension of the Project through September 1989. Although it was recognized that progress on the public sector side had been minimal, it was A.I.D.'s judgement that it was better to keep working with MICE to try to effect some change. Both the public and private sector components were amended again in 1989 and in 1990, ultimately extending the Project through March 1991, to allow the FUSADES credit component to be utilized and the GOES to implement planned activities.

The Project's private sector component is implemented by the Salvadoran Foundation for Economic and Social Development, FUSADES. FUSADES is a non-profit, apolitical Salvadoran private voluntary organization. The FUSADES component, originally funded at \$6.9 million, has provided support for export and investment promotion, economic and social research, association strengthening, and general FUSADES administration. The Project Paper foresaw the need for credit for exporters, but did not initially include any because of the need to dialogue with the GOES on credit policies and regulations, such

as foreign debt obligations of exporters, capital repatriation, etc. The Project Paper was amended in August 1986, to add a credit activity in response to the lack of long-term financing and access to dollars for light industrial/assembly export operations.

The 1986 Project Paper Supplement and related Cooperative Agreement Amendment increased planned LOP funding from \$6.9 million to \$26.9 million for the FUSADES component, bringing the new LOP for the entire Project to \$29.46 million. No funds were added or modifications made to the public sector activities. This Amendment provided greater support for the development of export-oriented, light manufacturing/assembly operations in El Salvador. Of the \$20.0 million added, \$15.0 million was for dollar denominated investment credit; the remainder was primarily for PRIDEX activities. Primary users of the credit were expected to be "maquila" (assembly/drawback) or light manufacturing operations, one of the more promising sectors in terms of generating employment and foreign exchange earnings for the country. During the PP Supplement process, the Project purpose was revised to emphasize quantitative results: to stimulate growth in the non-traditional export sectors of El Salvador, resulting in increased levels of employment, income, investment, and foreign exchange earnings. The Project goal was amended to reflect greater consistency with overall A.I.D. strategy: to accelerate economic growth and diversify the economy to obtain higher levels of economic well being. At this time, the Project was extended for two years through September 30, 1989. As noted above, the PACD was extended again in 1989 and 1990 to give FUSADES sufficient time to utilize the credit program, and the Mission adequate time to judge the effectiveness of the Project, prior to proceeding with a planned Project Amendment.

This Project has labored for most of its life in a policy and political environment that was not conducive to increased investment or export. Because of the civil war and the poor investment environment in El Salvador, the country has had a difficult time attracting investment. At the time of the 1986 PP Supplement, the Institutional Investor ranked El Salvador 106 of 109 countries in terms of credit standing; Euromoney ranked El Salvador 119 out of 119 countries for financial risk, and 111 of 119 for economic risk; and the Frost and Sullivan World Political Risk Forecast ranked El Salvador "very high" in political risk -- its most severe categorization. In spite of this, FUSADES managed to establish an export facilitation and investment promotion service which has been directly responsible for sustained growth in investments and earnings from non-traditional exports. Its research program has had significant impact as well; the structural adjustment program of the current GOES administration was heavily influenced by research carried out by FUSADES. Although the GOES portion of the Project was characterized largely by indifference until mid-1989, it has recently achieved success in the development of the National Export Strategy, acceptance of El Salvador into the GATT, and in advances in the negotiation of a bilateral agreement on investment, and a Tax Information Exchange Agreement. Given the improvements in the policy framework which have made the country more attractive and competitive and the advent of a government committed to the development of non-traditional exports, the Project is now positioned to facilitate real opportunities for growth. The significant foreign involvement in new investments and the substantial increase in non-traditional exports in 1990

are strong indicators that the Project's efforts to date have been effective and merit continued support.

### 1. Private Sector Component

FUSADES was established in 1983 by a group of Salvadoran entrepreneurs concerned about the country's development. Its mission is to formulate, promote, and implement private sector related economic development strategies to assist the nation in responding to its economic and social crises. FUSADES received its first A.I.D. support in 1984, a small grant to finance research and dissemination activities related to the newly introduced Caribbean Basin Initiative. FUSADES engages in a variety of activities (e.g., economic and social research, export and investment promotion, small and microenterprise development, agricultural diversification, and agricultural and industrial lending). A.I.D. is the principal supporter of FUSADES, having authorized \$95 million in financing under various grants, one of which is this Project. A 1988 evaluation by Development Associates, Inc. concluded that "in light of the present political, social, and economic environment, the results achieved by FUSADES are phenomenal."

Under this Project, financing was provided for the following FUSADES programs: the Trade and Investment Promotion Services (later renamed the Export and Investment Promotion Program - PRIDEX); the Association Strengthening Program - FORTAS; and the Department of Economic and Social Studies - DEES. In addition, the majority of the Foundation's overhead to date has been covered by this Project. As of December 31, 1990, total expenditures of the FUSADES portion of the Project amounted to \$21,860,100, or 81% of the total amount obligated with FUSADES. The following is a description of the programs financed to date under the Project:

FORTAS. The Association Strengthening Activities program delivered information and training to potential exporters through business associations. This program was designed to provide short-term technical assistance and training materials to Salvadoran business associations to improve the associations' ability to offer their members services to upgrade management and production skills and establish bases for future exportation of their products. It subsequently became apparent that the associations needed considerable organization, managerial, and administrative strengthening prior to actively engaging them in export related activities. Therefore, this program has been financed since 1985 under separate Projects--the Association Strengthening Activities Project and later the Private Sector Initiatives Project. FORTAS has not received funding under the subject Project since July 1985. FORTAS has succeeded in accomplishing its objectives and as of December 31, 1990, is no longer financed by A.I.D.

PRIDEX. The Industrial Stabilization and Recovery Project Paper prepared in September 1984 provided for the creation of a Trade and Investment Promotion Service (TIPS) within FUSADES, to provide "technical assistance at the enterprise level to specific export projects..." TIPS was designed to "link Salvadoran firms interested in exports to necessary information, technical assistance and possible foreign partners", and to emphasize licensing, production sharing, subcontracting and technical relationships.

The 1986 Project Paper Supplement stressed the need to accelerate the development of light manufacturing and assembly industry in El Salvador. This was to be accomplished with an expansion of the trade and investment promotion service, now known as PRIDEX, and the creation of a credit fund. PRIDEX was expected to focus its efforts on apparel/textiles, electronics, medical supplies, light manufacturing and handicrafts. Through its linkage with the credit fund, FUSADES was expected to create 14,000 jobs, \$45 million in foreign exchange and \$25 million in investment over the 1984-1989 period.

By learning from experiences and adjusting to changing circumstances in El Salvador, PRIDEX has evolved through two distinct phases and is now entering a third.

TIPS, the first phase, lasted until August 1987. This phase involved the promotion of direct U.S. investment, with heavy reliance on an outside contractor to carry out studies of opportunities and to promote follow-up. The contractor was also responsible for institutional development in El Salvador and the operation of a promotion office in New York. Support for export development by Salvadoran firms was given secondary priority. However, because of the political situation (including the civil war and GOES policies), results in terms of jobs, dollars, and foreign exchange, were disappointing. Thus, it was decided to reorient the program.

The second phase can be characterized by a focus on promoting exports from existing companies, with considerably less emphasis on promoting direct foreign investment. The second phase also stressed the institutional development and upgrading of PRIDEX staff to reduce dependence on outside contractors.

This phase involved the following elements:

- Sector studies to analyze export market potential, the country's overall competitiveness, and the export prospects/limitations of specific firms. These studies were used to select twelve "priority" sectors,\* and identify firms with export potential. Firms are placed into four categories: (1) idea stage; (2) has product; (3) has export capacity; and (4) exports and seeks to expand.
- Orientation, education and information services, especially for firms in categories (1) and (2). This involved seminars, support for travel to trade fairs, visits by PRIDEX staff, and assistance in preparing export plans to help companies reach category (3).

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\* The "priority" sectors were: garment drawback, textiles, wood products (furniture), metal/mechanics, footwear, handicrafts, electronic drawback, plastics, data entry, pharmaceuticals, minerals, and ornaments.

- Intensive planning, marketing and production services for companies in category (3). This entailed technical assistance and marketing assistance and travel. Clients pay 35% of the cost of the technical assistance and 50% of the cost of the travel.
- Facilitation of export expansion for companies already exporting in category (4). This involved support for travel (50%) to assist in exploring new markets and marketing assistance (65%).
- An office in Miami with one promoter, aimed at interesting U.S. companies in contract production, direct investment or joint ventures in El Salvador.
- Promotion of private free zones, as one of the implementing institutions for the Free Zone Development Project. This activity, which mainly involves financing feasibility studies and seminars, is financed under the Free Zone Development Project.
- A different approach to the use of outside contractors. While one U.S. firm had full responsibility for the PRIDEX program during the first phase, the Director, now a Salvadoran, is responsible for the overall management and institutional development of PRIDEX. A range of specialized contractors have been utilized for various tasks as required by PRIDEX management.

PRIDEX results have been measured in terms of jobs, foreign exchange and investment. The results to date, as reported by PRIDEX, are summarized below:

TABLE III  
PROJECT RESULTS TO DATE

<u>Output/Year</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>TOTAL</u>	<u>LOP TARGET</u>
Jobs	1,281	587	1,466	3,221	4,200	5,478	16,233	14,000
Foreign Exchange (\$000)	2,241	3,317	5,024	12,734	19,355	29,185	72,056	45,000
Investment (\$000)	401	560	937	3,834	7,930	9,971	23,633	25,000

Results have been very positive, especially in light of the external investment community's perception of El Salvador, which is greatly influenced by the continuing civil war.

**FIDEX.** Primary funding for FIDEX, the credit delivery unit for FUSADES, was approved in the 1986 PP Supplement. This provided \$15 million for an Investment Fund to be established by FUSADES in an offshore financial institution. (Due to legal requirements, such as reserve requirements, as well as the lack of access on the part of entrepreneurs to foreign exchange at the time, it was not considered prudent to establish an onshore dollar credit facility.) In addition to \$15 million available in dollars under this Project, FIDEX is engaged in lending activities under two other A.I.D. Projects: the Water Management Project, with \$10.8 million in local currency for irrigation and related horticultural projects; and the Agribusiness Development Project, with \$10 million available in dollars for the importation of equipment, and dollars or local currency for working capital purposes.

As presently structured, FIDEX is functioning as a financial intermediary, channeling dollars and local currency for investment and working capital credit funds through other financial institutions acting as disbursement agents. New project proposals are generated primarily through PRIDEX or DIVAGRO. Potential clients approaching FIDEX directly are referred to PRIDEX or DIVAGRO for technical analysis. If approved on a technical basis, loan proposals are submitted to FIDEX for financial analysis. Once determined to be both technically and financially viable, project loans are submitted to the FUSADES Credit Committee for consideration.

The disbursement agent for U.S. dollar financing is the Investment Fund established as a trust account with Cititrust/Bahamas. Project loans, as recommended by FIDEX and approved by FUSADES, are disbursed by the trust as the nominal lender. When dollars are to be utilized for the importation of equipment, Citibank/San Salvador opens a letter of credit in favor of the foreign supplier. Upon receipt of instructions agreed upon by FIDEX, Citibank/San Salvador and the borrower, Cititrust transfer dollars to the account of Citibank/El Salvador at Citibank/Miami. This serves as cash collateral for the letter of credit, which is then opened in favor of the supplier.

Loans under this Project are restricted to non-traditional industrial/assembly export activities that generate hard currency as the source for loan repayment. Principal repayments are returned to the Trust and placed in short-term investments until such time as all A.I.D. grant funds are disbursed. At that point, accumulated reflows may be reloaned for Project purposes. Reflows of principal and accumulated interest in excess of FUSADES administrative costs are considered to be FUSADES capital.

Although approval of the first PP Supplement was secured in late 1986, the first project loan was not approved by FUSADES until April 1989. This was due in part to considerable delays encountered in establishing the offshore trust. Other reasons for the lapse of time between A.I.D. Project approval and the first loan include: the availability from the nationalized banking system of credit at highly subsidized rates; the poor investment climate; excessive lending restrictions imposed by A.I.D. (prohibitions on working capital lending in conjunction with long-term loans; ineligibility of firms exporting services, e.g., data processing, and of firms supporting

non-traditional exports, have since been waived). In addition, FIDEX was initially quite conservative in its lending practices. This situation has changed, however, as the unit has gained experience in development lending and as the economic situation and business climate improved, which led to increased demand for term credit.

Fifteen loans under the subject Project totalling \$7.236 million have been approved, and twelve loans for a total \$6.236 million disbursed as of December 31, 1990. In addition, FIDEX is considering additional loan applications for approximately \$ 2.1 million. This will fully utilize the \$8.549 million currently available to FIDEX, after reprogrammings to cover other FUSADES programs in 1989 and 1990.

In-depth evaluations in 1989 and 1990 of FIDEX's loan portfolio completed by outside contractors with recognized expertise in development banking found that procedures, files, and follow-up were uniformly good. However, in an effort to maximize the impact of the Project, the Mission and FUSADES considered various alternatives to enable FIDEX to become a more effective development finance institution. FUSADES and A.I.D. are now assisting FIDEX to become an independent development finance institution.

DEES. Originally, FUSADES consisted only of the DEES, which was created to analyze economic and social issues, advocate free market approaches to development, and publicize private sector views on national issues. The main activities of the DEES are: (1) to report on economic and social trends in El Salvador, and (2) to analyze economic policies and advocate reforms consistent with free market concepts. The DEES presents its analysis in publications, seminars, and public and private discussions. DEES' primary focus has been on economic policy issues, attempting to influence the government to reform El Salvador's policy framework along free market lines. Secondarily, the DEES has started to analyze social issues (e.g., housing, education, health care) and to develop proposals for attacking these problems.

The DEES conducts an active program of seminars on economic and business issues. Seminars are open to the general public on broad economic and social issues, and workshops are held on specific topics such as social security, tailored to individuals with a special interest in the topic. The main objective of these workshops is to mobilize action on a specific issue, in part through the participation of high level government officials. Regular briefings are also held for FUSADES' members about Salvadoran economic trends and current government policy issues.

The DEES has a library of more than 1,800 volumes and technical papers on diverse economic topics. Access to this library is available free of charge to businessmen, government officials, students, and others.

The DEES publishes frequently and regularly. Pamphlets are published on topics relating to free market reforms or the Salvadoran economy. There is an emphasis on presenting free market theory in clear, simple terms. Analyses by foreign authors, such as Arnold Harberger from the University of Chicago and the Chilean Fundación Miguel Kast, are sometimes published.

The DEES also publishes the following regular publications:

- "Informe Económico Semanal" (Weekly Economic Report)
- "Polémica Económica Semanal" (Weekly Economic Discussion)
- "Boletín Económico y Social" (Monthly Economic and Social Bulletin)
- "Informe Trimestral de Coyuntura" (Quarterly Situation Report)
- "Informe Sobre Clima de Negocios" (Quarterly Business Climate Report)
- "Como Está Nuestra Economía" (Annual State of the Economy Report)

The above are among the best economic publications produced in El Salvador. Although the publications had been offered free of charge to government, business, universities, the press, and other organizations, initial results of a marketing effort to sell subscriptions to some of these publications have been positive.

In sum, the DEES is a high quality "think tank" researching, analyzing, and publishing studies on important economic, and social issues. It has made significant progress in mobilizing the Salvadoran government to adopt free market economic reforms. Former DEES personnel have been appointed to the highest policy-making positions in the present administration. Government ministers attend meetings on economic policy issues organized by the DEES, and DEES staff maintain frequent direct communication with government officials. The DEES has significantly improved the availability and analysis of economic statistics of El Salvador, and is in the process of doing the same with social statistics to support recommendations for reforms in social areas.

## 2. Public Sector Component

The public sector component was designed to support the formulation of a strategy for non-traditional exports and investment promotion and the development and implementation of related activities. The Project Grant to the GOES totalled \$2,560,000, of which \$1,233,680 or 48% had been expended as of December 31, 1990. The GOES grant financed activities in three interrelated areas: Export and Investment Strategy Formulation and Policy Analysis, Strategy Support Mechanisms, and Free Zone Development.

In the Export and Investment Strategy Formulation and Policy Analysis area, the Project supported CODEXI, the Export and Investment Development Committee. CODEXI was a high level committee formed of public and private sector leaders whose purpose was to promote increased exports and investment. During the period 1986-1989, CODEXI itself was a significant achievement given the tense relationship between the public and private sectors. CODEXI meetings provided a forum for dialogue between the private and public sectors, and led to the solution of several problems which at the time affected exporters. For example, CODEXI contributed to the passage/adoption of the Export Promotion Law and its six implementing regulations, and the Foreign Investment Guarantee Law.

In general, activities in this area included: (a) the elimination of obstacles that inhibited new export and investment activities; (b) the

development of productive and institutional infrastructure needed to facilitate investment and exports; and (c) specific activities that complemented the export promotion efforts of PRIDEX, such as the collection of data relevant to foreign investors, and dissemination of information on laws and regulations related to exports and investment.

In the Strategy Support Mechanisms area, support was provided to design CENTREX, the one-stop export documentation center. Assistance was also provided for an automation needs assessment of MICE which was used to acquire the software and hardware necessary to improve the Ministry's activities and services to the public. Training and technical assistance was provided to MICE personnel in foreign trade-related areas to upgrade the Ministry's capabilities and services.

In the Free Zone Development area, assistance has been provided to conduct studies of the San Bartolo Free Zone (the country's only free zone, which is a public sector one) which have led to improved administration and the decision by the GOES to privatize (divest) San Bartolo. GOES counterpart resources under the Project have been utilized to finance, among other things, the construction of an additional 24,000 square meters of under-roof industrial space at the San Bartolo Free Zone (SBFZ), which is now fully leased out to exporting companies. Complementary works at the SBFZ that were also financed with counterpart ESF-local currency generations include: leveling of terrain for future construction of approximately 23,000 square meters of industrial space, construction of two new internal roads, and construction of additional space for administration/security quarters, the main gate, and the entrance control post.

The public sector component of the Project has shown less than dynamic progress. The reasons for initial implementation delays included: the political nature of the Ministry, frequent changes of Ministers, the general managerial and technical weaknesses of Ministry staff, and the pronounced lack of commitment on the part of the GOES to support export and investment initiatives. During the last two years of the previous administration (1988-1990), some changes were noticed. There was increased awareness on the part of the government of the need to: establish a coherent legal framework for exports and foreign investment (the Export Promotion law and implementing regulations, the Free Zone law and implementing regulations, and the Foreign Investment Guarantee law); improve the services and documentation procedures for exporters (CENTREX); and to create basic infrastructure for exporting firms.

In June of 1989, this component underwent additional changes when the new administration absorbed the functions of MICE within the Ministry of Economy. During this transition period, activities slowed again. However, the following accomplishments can be attributed to the current GOES administration: further improvements in CENTREX to make it fully operational; concrete steps towards the privatization of the San Bartolo Free Zone; and, most important, the development of a National Export Strategy.

In March of 1990, a group of key private and public sector representatives, assisted by project-financed technical assistance, began to

work on the development of the National Export Strategy. The process evolved, and ultimately a national private-public consensus was achieved on export development as the primary vehicle for economic revitalization and growth. The first phase of the Strategy's development focused on the identification of the key sectors that contribute the most to the total exports of the country; on the establishment of realistic targets for the 1990-1994 period by sector; and on identification of key constraints (financing, infrastructure, legal environment, etc.) to achieving the five-year targets. (Section III.C. of this PP Supplement provides further detail on the identified constraints.)

In a second phase, the roles and capabilities of the public and private sectors in export promotion were debated, discussed, and defined. Finally, specific responsibilities were assigned to key institutions and individuals, and timetables for actions were developed. The process itself brought about a commitment from the private sector to achieve the Strategy's goals, and to work with the public sector in fulfillment of the strategy.

The process also led to the conclusion that CODEXI, as an ad hoc group, was not the appropriate vehicle to aggressively coordinate and monitor the implementation of the Strategy. An alternative was recommended: a top level commission, chaired by an influential person appointed by the President and reporting directly to him. As a result, the National Commission for Exports and Investment (CONAEXI) is being created.

In spite of the advances made in 1990 under the public sector component of the Project, there is still work to be done. CONAEXI will need to coordinate and ensure follow-up on the part of the public and private sector entities to make the National Export Strategy a reality.

#### D. Relationship to GOES and USG Strategy

##### 1. Overall Development Strategy

Both the GOES and A.I.D. realize that the El Salvador's social and economic development is contingent upon export-led economic growth and diversification of the economy. The present GOES administration has embarked on a structural adjustment program to facilitate sustainable economic and social development. This program includes key policy and institutional reforms which form the basis for a free market economy. The GOES recognizes that much remains to be done, and that outside assistance is required to stimulate a vigorous private sector response to the improved policy environment. The public sector component under the Project has played an important role in overcoming strained public and private sector relationships, and in re-orienting the public sector's mentality in support of private sector led growth. These efforts have an impact on the entire private sector portfolio of the Mission.

This Project is the cornerstone of USG efforts to support private sector development, to re-orient the economy, and to spur economic growth and social development in El Salvador. The Project facilitates A.I.D.'s

objective, as articulated in the 1990-1994 CDSS, of broad based sustainable economic growth by encouraging a strong private sector response to a favorable policy environment. Successful Project implementation will result in increased investment, expanded job opportunities and increased non-traditional exports and foreign exchange earnings, all of which are key A.I.D. and LAC Bureau performance indicators. Finally, this Project illustrates the Mission's commitment to the goals of free trade and increased investment established in President Bush's Enterprise for the Americas Initiative.

## 2. National Export Strategy

The National Export Strategy presents the consensus reached by the public and private sectors on what is necessary in the short, medium and long-term to develop and expand Salvadoran exports. The objectives of the Strategy are fourfold: (1) to create jobs in order to help absorb new entrants to the labor force each year and to reduce unemployment and underemployment; (2) to generate foreign exchange to overcome the trade deficit and finance needed imports to stimulate economic growth; (3) to stimulate local and foreign investment in export capacity; and (4) to diversify the country's export base, significantly reducing its reliance on coffee. The basic agreements reached during the Strategy's development are:

- export development is the primary vehicle for achieving sustained economic growth, the basis for economic and social development in El Salvador;
- taking into account world markets and comparative advantages, the sub-sectors with greatest potential in the short-term are "maquila" (mainly of garments), coffee, textiles and apparel (non-drawback), products for the CACM, and non-traditional agricultural products and agroindustry;
- high levels of private investment in new capacity and in industrial reconversion are required to significantly increase exports and to meet international standards;
- the role of the government is to establish clear, stable, competitive rules of the game, to eliminate anti-export and investment biases, and to develop the required infrastructure; and
- the role of the private sector is to invest, as well as to carry out an aggressive promotion campaign, both internally and abroad, and to actively collaborate with the GOES in training the labor force.

The following tables show the magnitude of the task ahead. Table IV shows exports per year. Table V shows the results to be achieved by 1994 in terms of exports, net foreign exchange, and jobs.

**TABLE IV**  
**NATIONAL EXPORT STRATEGY TARGETS**  
(Millions of U.S. Dollars)  
(FOB or equivalent)

<u>CATEGORY</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>
Drawback (1)	87	134	208	323	500
Coffee (2)	230	270	309	396	483
CACM	160	179	200	220	251
Textiles (3)	72	96	109	134	164
Non-Trad. Ag. & Agroind.	44	56	75	94	120
-shrimp, fish, aquacul.	20	23	28	34	44
-agroindustry	7	11	16	20	25
-fresh products	6	8	14	21	29
-sesame, others	11	14	17	19	22
Other Industry	24	32	40	50	60
Sugar and by-products	34	41	45	50	55
Cotton	<u>1</u>	<u>3</u>	<u>6</u>	<u>9</u>	<u>12</u>
<b>TOTAL</b>	<b>652</b>	<b>811</b>	<b>992</b>	<b>1,276</b>	<b>1,645</b>

- (1) Mainly garments. Other types of maquila (electronics, pharmaceuticals, data entry, etc.,) not considered.  
(2) An annual average increase in prices of 6.4% is assumed.  
(3) Includes yarn and apparel non-drawback.

**TABLE V**  
**NATIONAL EXPORT STRATEGY**  
**DETAILED 1994 TARGETS**

<u>CATEGORY</u>	<u>EXPORTS</u>		<u>NET FOREIGN EXCHANGE</u>		<u>JOBS</u>	
	<u>(U.S. \$ millions)</u>		<u>(U.S. \$ millions)</u>		<u>(000)</u>	
	<u>TOTAL</u>	<u>net increase</u>	<u>TOTAL</u>	<u>net increase</u>	<u>TOTAL</u>	<u>net incre</u>
	<u>1994</u>	<u>over 1990</u>	<u>1994</u>	<u>over 1990</u>	<u>1994</u>	<u>over 1990</u>
Drawback	500	413	225	186	50.0	42.0
Coffee	483	253	386	202	20.5	4.5
CACM	251	91	126	46	25.0	9.0
Textiles	164	92	98	55	11.0	1.9
Non-Trad. Ag. & Agroind.	120	76	90	56	16.4	9.6
Other Industry	60	36	30	18	6.0	3.6
Sugar and by-products	55	21	43	17	13.9	1.6
Cotton	<u>12</u>	<u>11</u>	<u>8</u>	<u>8</u>	<u>N.A.</u>	<u>N.A.</u>
<b>TOTAL</b>	<b>1,645</b>	<b>993</b>	<b>1,006</b>	<b>588</b>	<b>142.8</b>	<b>72.2</b>

NOTE: Projections based on 1989 levels.

- (1) Annual cost of \$3,000/employee assumed and a nominal value added ratio of

The main actions/activities required to achieve the proposed targets in the priority sub-sectors are the following:

**"Maquila:"** (a) maintain a regionally competitive exchange rate; (b) develop under-roof industrial space and related infrastructure (water, electricity, communications); (c) carry out aggressive promotion campaigns to attract local and foreign investment; and (d) train the labor force (workers, technicians, and mid-management).

**Coffee:** (a) make financing available for the reforestation of the coffee plantations and to introduce new coffee varieties; (b) develop, evaluate and disseminate new coffee varieties; and (c) develop coherent policies to expand the export markets for Salvadoran coffee.

**Textiles:** (a) modernize existing capacity (through financing and technical assistance); (b) liberalize the cotton trade, and (c) develop the capacity to negotiate international agreements.

**CACM:** (a) adopt a common low tariff; and (b) develop mechanisms and procedures that facilitate the free trade of goods (e.g. payment system, transportation, etc.)

**Non-Traditional Agriculture and Agroindustry:** (a) identify market niches; (b) develop varieties and utilize appropriate technologies in growing and handling products; (c) develop specialized infrastructure (e.g. refrigerated transportation and rooms at Customs); and (d) introduce new technologies and train small farmers (including cooperatives).

The National Export Strategy also outlines a proposed institutional framework to monitor/follow-up and facilitate the implementation of the Strategy: the National Commission for Exports and Investment (CONAEXI). A copy of the Strategy is available in the Mission's and LAC/DR's bulk files.

#### E. Relationship to Mission Projects and Programs

The A.I.D. Mission in El Salvador is assisting the country in its efforts to achieve broad based sustainable economic growth, and to support the evolution of a stable, democratic society. With the support of A.I.D.'s ESF balance of payments assistance, the GOES has dramatically improved its macroeconomic policy framework, i.e., flexible exchange rate, reduced import tariffs, reduced fiscal deficit, etc., to improve the environment for increased investment and export production. Through PL 480 Title I self-help and other institutional reform measures, i.e., price bands, reduced coffee taxes, privatization, etc., the GOES has created a policy framework conducive to increasing investment, production, and exports in the agricultural sector. The Mission has undertaken major efforts in basic education, primary health services, family planning, and infrastructure to help facilitate the participation of the disadvantaged and to create a more healthy and better educated work force. The Mission is also implementing efforts to strengthen civilian government institutions, to encourage pluralism, and to promote decentralization in government and services. Projects focusing on judicial reform, legislative assembly strengthening, free and fair elections, municipal

development, and labor union strengthening will have a long-term impact on stabilizing society and solidifying democracy. A stable society, meriting the confidence of its people and institutions, will provide more secure ground for investment and economic growth.

The Project has been and will continue to be the Mission's lead vehicle for facilitating non-traditional exports and investment. Through FUSADES, this Project works in tandem with efforts to improve agricultural production and exports. The Water Management Project and the Agribusiness Development Project support activities which not only complement industrial production, but also strengthen the capabilities of FUSADES to sustain export promotion activities over the long-term. Other complementary Projects include: (1) Free Zone Development, which promotes the development of private free zones, and works hand-in-hand with the subject Project in promoting investment in private free zones; (2) the Private Sector Initiatives Project, which finances the activities of the Department of Economic and Social Studies at FUSADES through CY 1991; and (3) Training for Productivity and Competitiveness, which provides vocational and technical training for internal and export-oriented industries.

#### F. Relationship to Other Donors

During the past decade, other donors have been characterized primarily by their absence. However, largely as a result of GOES policy reforms adopted since 1989, the International Monetary Fund, the World Bank, and the Interamerican Development Bank have become fully engaged in El Salvador. These institutions are building upon and reinforcing A.I.D.'s policy dialogue efforts in the areas of macroeconomic and financial sector reform and are providing substantial resources which directly support or reinforce the efforts of this Project.

The IMF Stand-By Arrangement, signed August 31, 1990, enabled El Salvador to reschedule \$135 million in bilateral debt via the Paris Club mechanism. Although the IMF Stand-By provides SDR 35 million for El Salvador, the GOES has not as yet made any drawdowns due to a strong balance of payments position, largely the result of improved macroeconomic policies.

In December 1990, the GOES and the IBRD signed a \$75 million Structural Adjustment Loan (SAL). The SAL will support GOES efforts to maintain sound macroeconomic policies, accelerate privatization and reform of the financial sector, and further liberalize agricultural trade.

In December 1990, the IDB approved a \$60 million loan to support GOES efforts to reactivate domestic production. Disbursements will be based on satisfactory progress in financial sector reform and on maintenance of sound macroeconomic policies. The loan will fund a multi-sectoral credit program promoting private sector investment in the installation, expansion, modernization and diversification of production operations. The program is designed to reduce credit market segmentation and will finance projects with high economic rates of return.

With technical assistance from A.I.D. and the IDB, the GOES established the Salvadoran Social Investment Fund (FISS). The Fund will channel an estimated 300 million colones (\$37.5 million) annually in donor resources to activities primarily designed to protect vulnerable groups over the next four years. The activities will be implemented by local public and private organizations and will support domestic production through investments in infrastructure, occupational training, and working capital for small and microenterprises. The FISS will also seek to help the poor meet their basic education, health, nutrition and housing needs. The initial injection of IDB monies to fund FISS projects is expected in June, 1991.

Both the IDB and International Finance Corporation (IFC) have expressed interest in investing in a private development finance institution. FUSADES reports that it has received an expression of interest from the IDB to purchase an interest in FIDEX, S.A., (the proposed spin-off of FUSADES' credit program). FUSADES is presently negotiating with the Central Reserve Bank permission to sell 25% of the FIDEX, S.A. authorized shares to the IDB.

The above mentioned activities are directly related to the economic and other policy reforms undertaken by the GOES. As the economy continues to improve, there is every expectation that additional other donor efforts will be undertaken in policy reform, privatization, industrial modernization, and capital formation. All of these areas complement the Project activities and will facilitate accomplishment of the Project's goal and purpose.

### III. PROJECT SUPPLEMENT DESCRIPTION

#### A. Problem Statement

The problem which the Project will continue to address is that El Salvador has inadequate resources to effectively support the country's efforts to expand non-traditional exports as a means of promoting economic growth and diversifying the economy.

#### B. Project Goal and Purpose

The goal and purpose of the Industrial Stabilization and Recovery Project, as articulated in the August 1986 Project Amendment, are still valid:

Goal: to accelerate economic growth and diversify the economy to attain higher levels of economic well being.

Purpose: to stimulate growth in the non-traditional export sectors of El Salvador, resulting in increased levels of employment, income, investment, and foreign exchange earnings.

#### C. Constraints and Opportunities for Export Development

In spite of what has been accomplished to date under this Project and under the GOES structural adjustment program, serious constraints to private sector, export-led growth remain. The remaining constraints include:

Financial Constraints. The National Export Strategy estimates the need for over \$300 million in investment capital (above and beyond projected credit levels from the Salvadoran banking system) for non-traditional export activities over the next five years. Most of this will have to come from private sources, given the GOES' current fiscal situation and the need for continuing outlays for the war effort, infrastructure, and social programs. The inability of the nationalized banks to adequately service the capital and credit needs of non-traditional export projects points to the need to create a development finance institution. Currently, most term lending is provided by international donor lines of credit or rediscount facilities, for which the banking system has not proved to be an effective intermediary. While this situation may improve in the medium to long-term with the privatization of the banking system, it will not adequately address the financial constraint over the life of this Project.

As with other A.I.D. assisted countries, El Salvador lacks the financial resources to support its export and investment promotion efforts itself. On the public sector side, the GOES' fiscal situation precludes full financing of CONAEXI. On the private sector side, FUSADES/PRIDEX has, over the Life of the Project, increased the cost sharing required of its clients. However, at the present time, neither FUSADES nor the private sector have the resources to fully fund the PRIDEX program without donor support.

Attitudinal Constraint. Although the Salvadoran business climate has improved significantly, international perceptions of the business and commercial risk of investment in El Salvador remain high. There is a need to promote the country as a good site for direct investment and a reliable source of contract production and to continue to educate Salvadorans on the need to export. Assuming that the war continues at current levels, or decreases somewhat, aggressive external investment promotion could generate significant dividends in terms of jobs, foreign exchange, and investment. This will require that both PRIDEX and GOES activities be restructured to play complementary roles in attracting investors and providing local follow-up services, and that the DEES continue its analysis and dissemination efforts.

Institutional Constraints. PRIDEX has re-oriented its strategic focus to place greater emphasis on external promotion and investor follow-up services. It is in the process of restructuring its internal organization, hiring and training staff, developing data bases and information services, and opening overseas promotion offices. The National Export Strategy highlighted the need for a single, full-time entity to coordinate public and private sector export and investment promotion efforts. Therefore, CONAEXI is being established to coordinate the implementation of the Strategy. Its activities will include: monitoring government policies affecting investment and exports and identifying obstacles to achieving the Strategy's objectives; coordinating the efforts of the public and private sectors in support of priority investment promotion and export development activities; and developing a data base and information system to measure progress under the Strategy.

Infrastructure Constraints. The Strategy also identified investment and export-related infrastructural problems. These included the need to: improve and upgrade the maritime transport system; reconstruct and maintain the highway system, and consider developing a feeder road program; improve the cargo handling capacity and build refrigeration facilities at the airport; promote the private construction of an additional 260,000 square meters of under-roof industrial space; assure the supply of electricity to industry; and modernize the telecommunication systems. In the short-term, and given the emphasis on promoting drawback industry, priority attention needs to be paid to constructing industrial space and providing necessary services (electricity, water, telecommunications), and to improving airport and maritime facilities. While this Project does not provide financing per se for addressing these infrastructure constraints, CONAEXI will coordinate public and private sector efforts to overcome them as resources permit.

Policy and Legal/Regulatory Constraints. Significant progress has already been made in this area under the Project and especially under the GOES adjustment program. There are no significant remaining policy or legal/regulatory constraints. However, CONAEXI will monitor and address any that are identified over the LOP.

In summary, while El Salvador still suffers from a number of difficulties (most notably the war and its associated economic disruptions), substantial progress has been made in the investment and export climate over the life of the Project to date. The current GOES administration is implementing a structural adjustment program, which has already led to increased business

confidence and new investment. Private sector-government relations have changed from open mistrust and hostility to active collaboration, as exemplified by the development of the National Export Strategy. The significant legal and regulatory constraints to investment and exports have been removed. Initiatives are being taken to provide more industrial space. Under the Free Zone Development Project, two different groups of private investors are in the final stages of negotiations with financial institutions to obtain financing under the Project's credit facility. If fully developed, the two zones would provide approximately 125,000 square meters of under-roof space. In addition, the GOES has decided to privatize the San Bartolo Free Zone. The Salvadoran business community is poised to take advantage of new export investment opportunities, in part because of the assistance provided under this Project. There is increasing interest being expressed in El Salvador by U.S. companies as a source for direct investment and contract production to take advantage of CBI benefits, quick access to U.S. markets, and a low cost, trainable, and potentially very productive labor force. The institutional framework supportive of investment and exports has improved substantially, particularly in terms of the specialized programs of FUSADES. In summary, El Salvador is at a threshold in its drive to achieve sustained, export-led growth and increased economic well being for the population.

#### D. Project Supplement Strategy

The key assumptions which formed the strategy for the Project when it was originally developed in 1984 are still valid today:

- The GOES is committed to maintaining an appropriate policy environment for export development; and

- The political, economic and social situation of El Salvador will not deteriorate in the near term, and will improve over the long-term.

In light of the political and economic environment in which the Project has operated, considerable success has been achieved. However, much remains to be done. It became exceedingly clear in the development of the National Export Strategy and the review of the Project's results to date that further mutually supportive interventions were needed to enable the non-traditional export sector to play a key role in the country's economic growth. This Project will continue to follow an integrated approach, utilizing Project funds for credit, technical assistance and training, export and investment promotion, and economic and social research. Both the public and private sectors are involved, although the private sector has the lead role in increasing exports and investment. This approach and mix of inputs has been used successfully around the world and can be found, to some degree, in the other A.I.D.-assisted CBI countries.

The PP Supplement strategy entails: (1) support for the program activities of PRIDEX, with greater emphasis on investment promotion and export facilitation; (2) support for FIDEX in 1991, while assisting it to become a private development finance institution; (3) support for the economic policy and social research and analysis of DEES; and (4) support for CONAEXI. This PP Supplement includes a PACD extension of three and one half years

(from March 31, 1991 thru September 30, 1994). Project activities are grouped by two principal components: Private Sector Activities, which includes support for PRIDEX, FIDEX, and the DEES, and Public Sector Activities, which provides support for the CONAEXI.

The PRIDEX sub-component will support investment promotion, both local and foreign. PRIDEX reviewed its program and determined that its strategic direction needed modification to respond to a more favorable policy environment. The main thrusts of the strategy for the PRIDEX sub-component are: (1) development of an aggressive external promotion capacity complemented by local investor information and follow-up support services to generate direct foreign investment, production contracts, and joint venture partners; and (2) refinement of PRIDEX' current efforts to develop local export capacity, with greater emphasis on those industries and firms that can become attractive contractors and joint venture partners.

The FIDEX sub-component will support the conversion of FIDEX to a private, diversified financial institution, with FUSADES eventually maintaining a minority shareholder interest. This arrangement will put FIDEX in a better position to be more responsive to financing requirements of non-traditional exporters during the LOP and beyond.

The DEES sub-component will continue to finance high quality economic and social research and analysis. With respect to export and investment per se, the DEES will endeavor to improve the policy and regulatory framework affecting export-oriented industries. The DEES will serve as a catalyst, providing studies and policy recommendations to promote productive investment; highlighting government policies which adversely affect investment decisions (pricing policy, exchange rate, etc.); and supporting foreign investment promotion and export diversification efforts.

Direct support for FUSADES central administrative and management costs is also ending, to be replaced by a negotiated overhead rate for carrying out Project activities. The Mission recognizes that there will be a need for the FUSADES programs supported under this PP Supplement to continue beyond the LOP. Therefore, activities are designed to assist FUSADES in its efforts to achieve financial self-sufficiency by 1994.

The public sector component will continue, but no additional funding is required. Existing resources will support CONAEXI, the organization responsible for the coordination of the National Export Strategy.

#### E. Expected Achievements/Accomplishments

It is expected that by the end of the Project in 1994, the additional Project resources will have contributed to the following EOPS:

- increased non-traditional exports to extra-regional markets.
- increased employment in the non-traditional export sector.

- FUSADES will be self-sufficient, enabling it to continue to contribute significantly to the development of El Salvador without additional support from A.I.D. Through DIVAGRO, FUSADES will support a core program in agricultural diversification, providing assistance to develop non-traditional agricultural exports. Through PRIDEX, it will support a program of non-traditional export facilitation and overseas investment promotion. Through DEES, it will maintain its capacity for economic and social research; and through PROPEMI, it will maintain a self-sustaining credit and technical assistance program to small and microenterprises.

- FIDEX, S.A. will be a self-sufficient diversified financial institution. It will cover operating costs from the fees paid for the management of the FUSADES credit portfolio, and will generate earnings from its own portfolio of loans, financial services, investments, and the rediscounting of loans from the BCR and other international institutions. Diversified in assets and liabilities, it will engage in developmental lending with FUSADES funds as well as its own.

Expected LOP outputs under this Project Amendment include:

- An estimated 23,500 new jobs created for skilled and unskilled labor in export oriented enterprises.
- An estimated \$110,000,000 in new direct investment in export oriented enterprises as a result of project activities.
- Net foreign exchange earnings of \$94,000,000 as a result of the export activities supported by the Project.

#### F. Project Components

The following description refers to the additional funding and corresponding activities for the extended period authorized under this PP Supplement, April 1, 1991 - September 30, 1994.

##### 1. Private Sector Activities

(\$20,351,000 A.I.D., \$7,215,000 FUSADES, total of \$27,566,000)

This component supports private sector export and investment promotion efforts, credit, and support for economic and social research.

##### a. Export and Investment Program (PRIDEX)

(\$10,701,208 A.I.D., \$2,115,000 FUSADES, \$12,816,208 total)

A.I.D. will, under this sub-component, provide operational and program support for the export and investment promotion efforts of the PRIDEX program at FUSADES. While PRIDEX will maintain its efforts to support domestic firms with export potential, it will now focus on a fewer number of industrial sectors, selected on the basis of their potential for increased exports and job creation. The sectors to be stressed are: garment drawback, electronics drawback, textiles, wood products (furniture), footwear, and metal/mechanics. (It should be noted, however, that these sectors may change over the LOP or beyond as conditions warrant.)

PRIDEX will aggressively promote El Salvador abroad, seeking direct foreign investment, co-investment and long-term subcontracting opportunities through the use of overseas promoters. The overseas promoters will be supported by local investment officials trained to assist and support the visits of potential foreign investors. PRIDEX will also provide specific technical assistance (marketing, production, etc.) to local businesses seeking to take advantage of export opportunities. This will be supported by the efforts of PRIDEX' external promotion, and by technical assistance that PRIDEX may contract specifically for a local client.

A major part of the new organization will be the establishment of two overseas promotional offices (in addition to the Miami office) which will act as marketing arms for the PRIDEX' efforts. PRIDEX plans to open its second office in New York in 1991, and a third office on the West Coast of the U.S. later on. The Mission will carefully assess the cost effectiveness of any additional overseas offices prior to committing funds for such purposes. An overseas office, which consists of a senior Salvadoran promoter and an assistant/secretary, will carry out targeting and sales calling activities in order to interest potential investors in contract production or in making a direct investment in El Salvador. The local investment division of PRIDEX will support the overseas offices by providing these offices with the information that they require in their selling efforts, and by managing the investor itineraries when they travel to El Salvador.

PRIDEX' technical assistance, training, and travel for beneficiaries are partially financed by clients. It is estimated that the colón equivalent of \$1,970,000 will be generated in PRIDEX beneficiary contributions. This counterpart will be utilized to finance additional program activities. In addition, the estimated in-kind contribution (volunteer time of Commission members and Directors) is \$145,000.

It is expected that as a result of the technical assistance, seminars and conferences, communications/dissemination, travel/training, supplies and equipment, personnel, and overseas promotion that collectively make up the program, PRIDEX will emerge as a well established, successful export and investment program funded by FUSADES at the end of the Project.

TABLE VI  
PRIDEX BUDGET: 1991-1994  
(U.S. \$000s)

<u>Activity</u>	<u>A.I.D.</u>	<u>FUSADES</u>	<u>Total</u>
- Technical Assistance	2,865	1,600	4,465
- Seminars and Conferences	286	--	286
- Communications, Dissemination	874	--	874
- Travel and Training	740	370	1,110
- Equipment and Supplies	923	--	923
- Personnel	1,717	--	1,717
- Overseas Offices	1,921	--	1,921
- Contingencies	462	--	462
- Overhead	913	--	913
- In-kind Counterpart	--	145	145
<b>TOTAL</b>	<b>10,701</b>	<b>2,115</b>	<b>12,816</b>

b. Export Investment Fund (FIDEX)

(\$6,909,000 A.I.D., \$4,895,000 FUSADES, \$11,804,000 total)

Under this sub-component, A.I.D. will provide \$6,500,000 for industrial export credit and \$409,000 for operating costs of FIDEX over the remaining LOP in response to continuing financial constraints facing investors and exporters. FUSADES counterpart consists of \$625,000 in cash, \$4,125,000 in beneficiary contributions, and \$145,000 in in-kind contributions. The cash is FUSADES' paid-in capital for the new development finance institution. Beneficiary contributions are cost sharing by FIDEX borrowers, while the in-kind contribution is the volunteer time of the FIDEX Commission and FUSADES Board of Directors.

FIDEX acts as a financial intermediary for several A.I.D. Projects. Under this Project, \$15 million was available for investment credit and/or equity support to domestic and foreign investors to stimulate the establishment of new or the expansion of existing non-traditional export-oriented light industrial or drawback operations in El Salvador. This Project's credit line was reduced to approximately \$8.5 million due to initial poor utilization of funds. However, FIDEX has disbursed virtually all of this amount (\$6.236 million) as of December 31, 1990. Although the majority of the lending to date under the Project has been for clothing/textile assembly operations (63%), other loans have been for paper/paper products, (16%); wood products, (furniture), (15%); handicrafts, (5%); and metal/mechanics, (1%). FUSADES has not made any equity investments to date under the Project.

While it is true that utilization of the Project's resources has improved in the past two years, restructuring of the credit delivery mechanism is needed to better serve the non-traditional export sector. The financing needs of this sector are tremendous, and the to-be-privatized national banking system is ill equipped to respond in the near term. A recent projection of El Salvador's financing needs for the private sector as part of the National Export Strategy reveals a need for \$100 million in working capital and almost \$300 million for long-term credit over the four year period for non-traditional export oriented projects alone.

As presently structured, FIDEX is functioning as a financial intermediary, channeling A.I.D. funds through other financial institutions which act as disbursement agents. However, the changing environment in El Salvador led the Mission and FUSADES to conclude that it would be more appropriate to reorganize FIDEX as a private development finance institution, FIDEX, S.A. While it will be initially wholly owned by FUSADES, FUSADES will begin to reduce its equity participation in FIDEX, S.A. in 1991. The reasons for converting FIDEX to a private development finance institution include:

- It is expected that as a private development institution, FIDEX will be able to mobilize other resources, and therefore will have a greater impact over time. Other resources include private investors, other donors, long-term deposits, and access to existing or new local currency lines within the Central Bank.

- An arms length relationship between FUSADES and FIDEX would allow FIDEX to respond to a profit motive, to stimulate a broader participation by the private sector, and to help access new resources, while permitting FUSADES to concentrate on other development initiatives more in keeping with its charter.

- It is anticipated that as a development finance institution, FIDEX will achieve greater operational efficiency. By concentrating on the development banking activity, the institution should be able to make a greater contribution to the country's development.

FIDEX, S.A. will have the following features:

- FIDEX will apply for an operating license to operate as a private financial institution in 1991.
- The institution will have authorized capital estimated at 20 million colones.
- Initial capitalization (25% of total authorized) will be paid in by FUSADES from its own (non-A.I.D.) resources.
- In keeping with the agreement reached with the BCR, FUSADES will offer stock to international organizations in 1991, but wait to offer stock to the general public until 1992, so as to not interfere with the privatization of the state-owned banks.
- FUSADES will divest its shares over the life of the Project to a position no greater than any other largest single investor.
- FUSADES will maintain the Trust in Cititrust/Bahamas until the Salvadoran legal and financial framework make a transfer of the funds to El Salvador and FIDEX, S.A. possible. FIDEX, S.A. will, once established and functioning, become the Trust's agent in El Salvador; receiving and approving loan applications, disbursing and collecting repayments; and providing other financial services related to lending through the Trust mechanism.
- A.I.D. and FUSADES will annually review the feasibility of moving the Trust onshore, as the legal and financial framework permit.
- FUSADES will maintain the risk of lending on its own funds, FIDEX, S.A. for the services provided on lending activities.
- FUSADES will establish lending criteria for its portfolio, but FIDEX, S.A. will make lending decisions, subject to rejection by FUSADES for failure to follow guidelines established in the Cooperative Agreement.
- FIDEX, S.A. will manage its portfolio freely, accessing other sources of funding, including BCR lines and other donor financing.

- FIDEX will provide financial services and products in keeping with market demand. The BCR will, however, initially restrict FIDEX, S.A. to receiving deposits with a twelve month or greater maturity.

- FIDEX, S.A. will utilize generations from its own paid-in capital, deposits, and loans to engage in the broad range of financial services permitted by its charter; and will utilize the income from said activities to finance operations and to pay dividends to its shareholders.

At the time of the conversion of FIDEX to a private development finance institution in 1991, FUSADES is expected to have a total of \$35 million in the form of grant funds (\$15 million under this Project, \$10 million under the Water Management Project, and \$10 million under the Agribusiness Development Project) available for lending, most of which will have already been lent out. Of these funds, the \$25 million in dollar-denominated credit will be maintained, for a short period, in the offshore Trust Fund. Until the legal and financial framework is in place to permit the Trust Fund to be moved onshore, FIDEX, S.A. will act as the agent, responsible for lending and receiving repayments for the offshore trust, and will enter into a similar arrangement for the colón-denominated credit facility under the Water Management Project. In both cases, FUSADES will assume the risk and FIDEX, S.A. will receive fees commensurate with its administrative management services. The arrangement is consistent with the current Cooperative Agreements with minor modification, and does not require FIDEX, S.A. to begin with the enormous capitalization that a large "risky" loan portfolio would require. For its part, FUSADES, using its own resources, will capitalize FIDEX, S.A. at a level of 5,000,000 colones (approximately \$625,000). This paid-in capital will permit FIDEX, S.A. to initially lend resources of up to 60 million colones, assuming all risks inherent to such lending. The additional sale of stock to international institutions and to the public (15,000,000 colones) will further increase FIDEX, S.A. "risky" portfolio to a potential ceiling of 250 million colones. The IDB has already expressed interest in acquiring an equity interest in FIDEX, S.A., and FUSADES has written to the Bank inviting it to purchase 25% of the authorized capital. By virtue of the large loan portfolio that FUSADES will have managed by FIDEX, S.A., FUSADES will have considerable influence on the management of the institution, even when its participation is reduced to 25% or less. At the AID/W review of the Project in March 1991, concern was expressed as to whether the management fees would be adequate to ensure that FIDEX, S.A. carefully and profitably manages the FUSADES portfolio. The Mission agreed that if there were any indications that the proposed arrangement was inadequate in this regard, it would examine whether additional incentives were warranted.

As the financial projections for FIDEX clearly demonstrate (see Annex F), the institution is financially viable in its first year of operations with a loan portfolio of approximately \$26 million. This portfolio depends in large part on lending the \$6.5 million in credit contemplated in this PP Supplement.

Although initial credit utilization was slow, FIDEX has placed almost \$6 million in the past year from the industrial line. This demand is a reflection of growing investment in the non-traditional industrial export sector, and the shortage of lending for fixed and working capital from the existing financial system. The industrial credit fund is virtually fully utilized. FIDEX, S.A. will not be able to access rediscount facilities or foreign loans until operational at the end of 1991. Therefore, the \$6.5

million added herein is necessary to maintain FIDEX as a source of non-traditional investment financing until FIDEX, S.A. is operational. The amount also coincides with the reduction that was effected in the credit fund to cover program and administrative costs until this PP Supplement could be effected. Moreover, FUSADES' future income stream depends significantly upon the replenishment of these funds to the industrial credit fund.

It is expected that by the end of the Project in 1994, FIDEX, S.A., with the additional credit and 1991 operating costs financed by A.I.D., will be a self-sufficient financial institution serving, among others, the non-traditional export sector by lending reflows of principal, earnings from financial services, and capital contributed by the private sector and, perhaps, foreign institutional investors.

TABLE VII  
FIDEX BUDGET: 1991-1994  
 (U.S. \$000s)

<u>ACTIVITY</u>	<u>A.I.D.</u>	<u>FUSADES</u>	<u>BORROWERS</u>	<u>TOTAL</u>
- Technical Assistance	50	--	--	50
- Seminars and Conferences	1	--	--	1
- Communications, Dissem.	20	--	--	20
- Travel and Training	20	--	--	20
- Equipment and Supplies	35	--	--	35
- Personnel	185	--	--	185
- Contingencies	68	--	--	68
- Overhead	30	--	--	30
- FIDEX, S.A. Paid-in Capital	--	625	--	625
- Investment Fund Credit	6,500	--	4,125	10,625
- In-kind Counterpart	--	<u>145</u>	<u>--</u>	<u>145</u>
<b>TOTAL</b>	<b>6,909</b>	<b>770</b>	<b>4,125</b>	<b>11,804</b>

The following is the projected loan portfolio for FIDEX, S.A. for the 1991-1994 period:

**TABLE VIII**  
**F I D E X, S.A.**  
**LOAN PORTFOLIO PROJECTIONS**  
**(in U.S.\$)**

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
<b>I. FUSADES FUNDS:</b>					
- Local Currency (1)	9,536,125	10,762,588	12,156,613	12,910,438	13,056,650
- Foreign Currency (2)	15,898,100	16,726,900	17,108,000	16,785,400	16,802,600
<b>II. FIDEX, S.A. PORTFOLIO:</b>					
<b>A. FIDEX FUNDS:</b>					
- Local Currency (3)	375,000	1,000,000	1,728,688	2,096,588	2,338,063
<b>B. OTHER FUNDS:</b>					
- Local Currency (4)	375,000	1,625,000	2,862,213	4,007,100	5,038,350
- Foreign Currency(5)	0	0	4,000,000	8,583,300	12,395,800
<b><u>TOTAL FIDEX PORTFOLIO (6)</u></b>					
- Local Currency	750,000	2,625,000	4,590,900	6,103,688	7,376,413
- Foreign Currency	0	0	4,000,000	8,583,300	12,395,800
<b><u>TOTAL PORTFOLIO (I + II):</u></b>					
- Local Currency	10,286,125	13,387,588	16,747,514	19,014,126	20,433,063
- Foreign Currency	15,898,100	16,726,900	21,108,000	21,368,700	29,198,400

**NOTES:**

- (1): Includes loans from the Water Management Project No.519-0303, (up to \$7,937,000), and loans from the local currency component of the Agroindustrial Development Project, No.519-0327, (up to \$6,000,000).
- (2): Includes loans from the Industrial Stabilization and Recovery Project (up to \$15,000,000), and the foreign currency component of the Agroindustrial Development Project (up to \$4,000,000).
- (3): Represents loans made with FIDEX, S.A. own paid-in capital (up to \$2,500,000).
- (4): Represents rediscount operations of Banco Central de Reserva lines.
- (5): Represents rediscount operations of international agencies lines.
- (6): The limitation of credit operations, which amounts to 12.5 times the paid-in capital (12.5 x \$2,500,000) or \$31,250,000 for our purposes) applies only to FIDEX, S.A. own portfolio.

c. Department of Economic and Social Studies (DEES)  
(\$2,740,887 A.I.D., \$205,000 FUSADES, \$2,945,887 total)

Under this sub-component, A.I.D. funding will be provided to enable the DEES to continue its active program of economic and social research, policy analysis, and dissemination activities in support of FUSADES' free enterprise, private sector-led growth model. The DEES efforts are expected to contribute to alleviation of the attitudinal constraint on the part of Salvadorans. A.I.D. will finance the core program and operational costs of the DEES through the LOP. FUSADES counterpart under this component will consist of revenue from the sale of DEES products and services (\$60,000), and will be used to finance additional program activities under the Project. In addition, the estimated in-kind contribution of FUSADES, (volunteer time of the Commission and Board of Directors), is \$145,000. A brief summary of planned activities over the LOP follows.

Support for the National Export Strategy. In the National Export Strategy exercise, the DEES was tasked with providing conceptual and analytical support to CONAEXI. This includes the following, of which some are primary activities for the DEES and others are research/analysis in support of the efforts of other organizations: analysis of the impact of fiscal and regulatory policies and laws and possible options; analysis in support of efforts to promote open skies/seas policy; analysis of existing commercial agreements and treaties; analysis in support of Salvadoran participation with other Central American countries in multilateral negotiations; improve statistics and data collection on exports, especially "maquila"; and a study of possible revisions to port tariffs and possibilities for privatization.

Research and Analysis. The DEES employs the following criteria in determining its research agenda: (1) importance of the topic, either in the short-term where it would be timely, or in the medium-term, when the topic is important and is not being addressed by others; (2) the real possibilities for influencing policy makers, including determining the right moment for tackling issues; and (3) the interests and abilities of its staff. The DEES helps the private sector adjust to the new economic environment through the provision of current economic information. For that purpose, the DEES will increase its efforts to gather and process relevant information and to develop efficient systems to transmit it to economic agents. In the social area, the DEES looks at social issues that meet the above criteria from an economic point of view. The modernization of the social sectors (health, education, social security) and the implementation of a more efficient social strategy is also an important part of the work of the DEES.

1991 Program. Specific activities for 1991 include: updating and expanding the database on principal economic and social variables; preparing studies on financial regulation and the informal sector; preparing a study of alternatives to reduce El Salvador's external debt; undertaking periodic analyses of the industrial sector, including studies on agroindustry and sugar; analyzing transportation subsidies; preparing a study on industrial reconversion; analyzing higher education in El Salvador; assessing resources in the health sector; studying family income and expenses; and analyzing the social expenditures of the public sector.

Dissemination. Dissemination of its research and analysis will continue to be an important function of the DEES in order to influence policy makers and public opinion. The DEES will continue to present its work in publications, seminars, and public and private discussions. The DEES will also maintain and improve its library of more than 1,800 volumes and technical papers on diverse economic topics.

Publications. The DEES publishes frequently and regularly. Pamphlets are published on special topics relating to free market economic reforms or on the Salvadoran economy. The DEES will continue to publish:

<u>REPORT</u>	<u>APPROX. LOP TOTAL</u>
- Weekly Economic Report	200
- Weekly Economic Discussion	200
- Monthly Economic and Social Bulletin	50
- Quarterly Situation Report	16
- Quarterly Business Climate Report	16
- Annual State of the Economy Report	4

Cost Recovery. The DEES will continue its efforts to increase revenues from its services and products when doing so is not incompatible with its outreach/education/dissemination objectives. The DEES' basic product, the monthly Bulletin, will be widely disseminated. The Situation Report and the associated database service will be restricted to subscribers. The DEES will continue to develop linkages with international organizations and donors to sell its research/analysis services. A third source of income is the Department's seminars and conferences, which heretofore have been free. FUSADES will determine, on a case-by-case basis, what, if anything, should be charged on particular seminars or conferences, again depending on the objective and the target audience. The audience for the DEES publications is government, business, universities, the press, and other organizations.

Staff Development. Staff development will continue to be a key area for the DEES over the remainder of the Project. Given the paucity of economists with advanced degrees or research experience in El Salvador, the DEES has emphasized staff development and has done considerable long- and short-term training to improve the skills of its people. It is expected that, as the skills of the staff further improve, the current Chilean director will be replaced with a Salvadoran.

As mentioned elsewhere, the DEES has, for the past several years, been financed under the Private Sector Initiatives Project. The PACD for this Project was recently extended through December 31, 1991, for the DEES component only (the Project also financed FORTAS through December 31, 1990). Therefore, the 1991 expenses of the DEES will be financed with the \$950,000 in remaining funds (as of December 31, 1990) under the Private Sector Initiatives Project. Beginning in 1992, the DEES will be financed under the Industrial Stabilization and Recovery Project.

It is expected that by the end of the Project in 1994, the DEES will be a highly respected and influential "think tank" supported by FUSADES with the in-house technical capacity for monitoring economic events and performing rigorous micro, sectoral, and industry analysis.

**TABLE IX**  
**DEES BUDGET: 1992-1994**  
**(\$000s)**

<u>Activity</u>	<u>A.I.D.</u>	<u>FUSADES</u>	<u>Total</u>
- Technical Assistance	369	--	369
- Seminars and Conferences	64	10	74
- Communications, Dissemination	120	50	170
- Travel and Training	78	--	78
- Equipment and Supplies	220	--	220
- Personnel	1,522	--	1,522
- Contingencies	130	--	130
- Overhead	238	--	238
- In-kind Counterpart	--	145	145
<b>TOTAL</b>	<b>2,741</b>	<b>205</b>	<b>2,946</b>

**2. Public Sector Activities**  
**(\$1,250,000 GOES counterpart)**

In response to the identified institutional and policy/regulatory constraints, the GOES will finance the operating costs of the National Export and Investment Commission (CONAEXI), the coordinating entity for the National Export Strategy. Remaining A.I.D. funds (\$1,050,000 as of March 31, 1991), will be utilized to finance technical assistance and training for CONAEXI.

The original Project design called for support for public sector activities in three areas: Export and Investment Strategy Formulation and Policy Analysis, Strategy Support Mechanisms, and Free Zone Development. Under the new institutional framework, the first three activities (e.g., strategy formulation, policy studies, and support activities), will be the responsibility of CONAEXI. The free zone development activity, which has supported the expansion of industrial space and improvement of operations at the GOES San Bartolo Free Zone, will remain the responsibility of the Ministry of Economy. At this point, however, A.I.D. is only interested in providing further support to San Bartolo to privatize it, and this is being provided under a separate Project, the Free Zone Development Project. Therefore, no further support for San Bartolo will be furnished under this Project.

Experience indicates that the failure of export and investment promotion programs in developing countries can be mostly attributed to the lack of a viable relationship between trade promotion activities carried out by either or both the public and private sector, and to the lack of coordination between different actors -- in other words, the lack of an overall strategy.\* The proposed new approach for the public sector program of activities is consistent with the above analysis. The public sector component has been restructured around CONAEXI and the implementation of the National Export Strategy. No additional funding is being provided, as remaining funds

are adequate to cover the technical assistance needs of CONAEXI. The GOES will provide the colón equivalent of \$1,250,000 for operational support for CONAEXI from ESF local currency generations.

Although the organization of CONAEXI is still in its initial stages, it is envisioned that it will be an statutory body reporting directly to the President of El Salvador. It will be headed by a Board of Directors that will have representatives in equal number from the government and El Salvador's manufacturing and trade associations and chamber of commerce. The public sector representatives are expected to come from the Central Reserve Bank and the Ministries of Economy, Finance, Agriculture, and Planning. Private sector representatives are expected to come from the business organizations related to exports (Corporation of Exporters, Salvadoran Association of Industrialists, etc.). The chairman will be a prominent private sector individual selected by the President.

To carry out the activities in support of the National Export Strategy, CONAEXI will rely on a technical support unit consisting of an executive director, three senior professionals, a research assistant and a secretary. The Commission will: aggressively coordinate, monitor, and mobilize support committees for specific investment and export promotion activities; and advocate specific actions to improve the policy and regulatory framework, infrastructure (free zones, transportation), and others activities to allow for successful implementation of the National Export Strategy. CONAEXI's monitoring activities include: establishing a data base for tracking results vs. targets; preparing quarterly progress reports reviewing accomplishments and problems; carrying out periodic meetings with key private associations to obtain feedback, and conducting annual reviews to analyze the Strategy in light of results as well as new internal and external developments. CONAEXI's ombudsman and trouble-shooting role includes: meetings to discuss what to do about problems or institutions not collaborating with strategy implementation; informal discussions with relevant top level officials (of private or public entities) to seek resolution of problems or speed up implementation of tasks; mobilization of support from interest groups to exert stronger pressure when needed; and the organization of working committees or task forces to resolve difficult problems.

CONAEXI's communications role contemplates: dissemination of information regarding the export strategy and progress in implementation; enhancement of public awareness regarding the importance of the Strategy and its key elements; and facilitation of communications among key private and public sector players involved in strategy implementation.

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\* Donald B. Keesing and Andrew Singer, "What Goes Wrong in Official Promotion and Marketing Assistance for Manufactured Exports from Developing Countries" and "How to Provide Impact Assistance to Manufactured Exports from Developing Countries", October 1989.

It is expected that CONAEXI will require some outside short-term technical assistance in carrying out the above mentioned responsibilities. Technical assistance would permit CONAEXI to keep abreast of changes in other countries of the region to ensure El Salvador remains competitive. CONAEXI will also require technical assistance in the design of the organizational structure for and staffing of the technical support unit; the design and establishment of mechanisms to coordinate the National Export Strategy activities with other government, parastatal and private institutions; and the design and establishment of mechanisms to follow up on progress achieved on the targets of the National Export Strategy. Approximately \$895,000 of the remaining dollar funds under this component will be utilized for this purpose. The remaining A.I.D. funds will be used to train selected staff from different GOES export related agencies in the most up-to-date date practices in export and investment facilitation (\$150,000). The salaries and operational expenses of the unit will be financed with counterpart funds originating from ESF generated local currency.

Since the Commission has not been fully established yet, Condition Precedents to disbursement of the remaining A.I.D. resources under the Grant Agreement with the GOES will be included which states that:

- The GOES will present documentation, in form and substance satisfactory to A.I.D., which details the staffing, organizational structure, and functions of the new Commission; and
- The GOES will present an Action Plan for 1991 which contains the individuals, salaries, and list of equipment proposed for the technical unit, the activities from the National Export Strategy to be implemented in 1991, as well as a procurement and implementation schedule.

It is anticipated that, at the end of the Project in 1994, Project resources will have contributed to improvements in El Salvador's export and investment climate, and improved public/private sector coordination in support of exports.

TABLE X  
NATIONAL EXPORT AND INVESTMENT COMMISSION  
1991-1994 BUDGET

<u>ACTIVITY</u>	<u>A.I.D.*</u>	<u>GOES</u>	<u>TOTAL</u>
1. Technical Assistance	895,000	---	895,000
2. Training	150,000	---	150,000
3. Personnel	---	532,560	532,560
4. Operating Costs	---	283,110	283,110
5. NES Support for GOES entities	---	352,775	352,775
6. Contingencies	---	81,555	81,555
	<u>1,045,000</u>	<u>1,250,000</u>	<u>2,295,000</u>

\* Previously obligated funds. No additional A.I.D. funds are needed for this public sector component.

3. Other Project Costs  
(\$649,000 A.I.D.)

Other costs associated with Project implementation include A.I.D. Project management expenses, and evaluation and audit. A.I.D. Project Management expenses (\$309,000) include salary and benefits of the FSN Project Manager, FSN Assistant Project Manager; training and travel; and computer equipment. It is estimated that \$200,000 will be adequate for the mid-term and final project evaluation and \$140,000 for audit of the Project. It is contemplated that there would be an external audit of the Project, in addition to the annual audits paid for by FUSADES and the annual GOES internal audits. In sum, the total for other Project costs, then, is \$649,000.

TABLE XI  
OTHER PROJECT COSTS BUDGET: 1991-1994  
(U.S.\$000s)

1. <u>A.I.D. Project Management</u>	
- FSN Project Manager	125
- FSN Assistant Project Manager	65
- Project-related Travel and Training	80
- Computer Equipment	10
- Contingencies (15% of salaries)	29
2. <u>Evaluation and Audit</u>	
- Evaluation	200
- Audit	<u>140</u>
TOTAL	649

#### IV. SUMMARY COST ESTIMATES AND FINANCIAL PLAN

##### A. Project Budget

The total cost of the activities contemplated under this PP Supplement is \$29,465,000, of which A.I.D. will contribute \$21,000,000 (71%), and FUSADES and the GOES will contribute \$8,465,000 (29%) in in-kind and other counterpart. The added A.I.D. resources will be used to finance the following at FUSADES: technical assistance (\$3,284,400); seminars and conferences (\$350,300); communications/dissemination (\$1,014,200); invitational travel/training (\$838,400); equipment and supplies (\$1,177,900); personnel (\$3,424,500); promotion offices abroad (\$1,920,700); audit and evaluations (\$340,000); contingencies (\$667,707); overhead (\$1,172,893); A.I.D. Project management (\$309,000); and credit (\$6,500,000).

The counterpart contribution will consist of sub-borrower contributions, contributions received from beneficiaries of technical assistance and training activities, and in-kind counterpart volunteer time of the FUSADES Commissions and Board members. As of 9/30/90, the last Semi-Annual Report, the local currency equivalent of \$9,327,000 in in-kind and local currency counterpart had been contributed by the GOES, and \$1,000,000 in in-kind and beneficiary contributions had been made by FUSADES. In addition, the local currency equivalent of approximately \$2,500,000 has been contributed to date in the form of borrower contributions to projects financed by the FIDEX credit facility, which only finances up to 75% of investment projects. It is estimated that an additional \$100,000 will be provided by GOES and \$250,000 by FUSADES over the 10/1/90 - 3/31/91 period. This would bring the total counterpart contributions through the current PACD to \$10,677,000. During the extension through December 1994, an additional approximately \$8,465,000 in local currency cost sharing will be provided as follows: \$4,125,000 from FIDEX borrowers; \$1,970,000 in beneficiary contributions of PRIDEX technical assistance and training activities; \$60,000 from DEES beneficiaries (seminars and conference fees, sales of publications, etc.); \$625,000 for the capitalization of FIDEX, S.A.; \$435,000 in in-kind contributions from FUSADES (volunteer time of Board and Commission members); and \$1,250,000 in local currency generations for the public sector side. Total Project counterpart, then, is \$19,142,000 or 28% of the total Project cost of \$69,602,000.

A total of \$1.4 million has been budgeted for the overhead expenses of FUSADES associated with the implementation of this Project. This is based on a review of FUSADES' total overhead costs (including Central Management, Planning and Development, Communications, and Administration and Finance) proportionately assigned to each of the FUSADES program budgets (PRIDEX, DIVAGRO, FIDEX, DEES, FORTAS, and PROPEMI). Since the overhead rate is provisional, it will be reviewed in audits to establish the actual rate.

The following tables contain illustrative financial information. Table XII contains the summary cost estimate and financial plan, including a breakdown of the estimated foreign exchange (66%) and local currency (34%) requirements of the Project. Table XIII shows an estimate of project expenditures by year. Table XIV contains the payment verification matrix, which summarizes the proposed method of implementation and financing for each

major category of inputs. Budgets for the individual components are contained in Section III, the Detailed PP Supplement Description.

#### B. Recurrent Costs

On the FUSADES side, annual recurrent costs include in-country salaries, and operating expenses, and the expenses of the promotion offices abroad. The focus of the financial planning exercise undertaken by FUSADES as part of the preparation of this Project Paper Supplement was on achieving financial self-sufficiency by 1995. As shown in Annex H, FUSADES' income in 1995, which for the most part is a result of earnings on the Investment Fund, are estimated at \$5,000,000 p.a. This should be sufficient to maintain a basic core program, and to allow FUSADES to maintain basic services in DIVAGRO, PRIDEX, and the DEES, as well as core central overhead from 1995 on. FUSADES has also adopted an operational structure that will permit it to implement new programs or to continue to operate current programs at increased levels of funding should additional donor funds become available.

On the GOES side, recurrent costs include the salaries and operating expenses of the Commission, which will be covered by the GOES during the LOP. A.I.D. will not finance CONAEXI after the Project. However, if the GOES were to decide to continue the operations of the Commission beyond the PACD, it will be responsible for financing it. There are no recurrent costs for the USAID Mission after the Project other than the usual Project close-out activities, as the A.I.D. Project management responsibilities will cease with the Project.

#### C. Financial Monitoring, Accountability and Audit

Financial monitoring of the revenues and expenditures of the program shall continue to be done on a monthly basis through a series of reports developed by FUSADES and the Mission, and the Commission and the Mission, respectively, and will follow standard USG disbursement procedures.

On a yearly basis, a complete audit shall be conducted by the external auditors contracted by FUSADES. These external auditors shall be affiliated with U.S. CPA firms using GAO standards to include a review of overhead. These independent audits are currently carried out by Peat, Marwick, and Mitchell. In addition, once FIDEX becomes independent from FUSADES, it will provide FUSADES and A.I.D. full access to inspect, audit, or otherwise examine all of the accounts, books, documents, instruments, papers, and records related to the A.I.D.-financed portfolio, as deemed necessary.

It is important to note that while A.I.D. has been satisfied with FUSADES' accounting and financial reporting system, FUSADES is currently in the process of upgrading its existing accounting system in order to improve its project accounting capabilities. The changes in the accounting system respond to FUSADES' strategic decision to shift towards a system which will allow FUSADES to define and fund a core program, and seek donor financing in the future for new programs as opportunities and needs arise. This process will, at the same time, improve on the ability to monitor project costs which will assist FUSADES and USAID staff in implementing and monitoring their programs. This

new system includes the introduction of cost-center accounting and overhead rates. It should be noted that the other A.I.D. projects with FUSADES will be amended to include overhead, since virtually all core costs for all the Projects have been covered to date under the 0287 Project.

The Commission will be audited annually by the Corte de Cuentas (Court of Accounts), the GOES auditing entity.

At the end of the Project, a complete financial audit of both FUSADES and the GOES programs of activity shall be conducted of the results of the program. All audits shall be conducted with U.S. CPA and GAO standards.

On the FUSADES side, all A.I.D. appropriated credit funds for foreign exchange costs, other than the funds for FIDEX, will be managed directly by FUSADES. FUSADES will continue to work under a system of periodic advances and direct reimbursements, and will be responsible for sound cash management and fiscal control of all funds disbursed to it, including detailed accounting and reporting for cash receipts, cash outlays and expenditures by obligating documents. The Commission's operating expenses will be local currency-funded. As such, it will follow GOES and A.I.D. local currency procedures. Specific reporting formats and procedures will be those established by A.I.D. for the local currency and U.S. dollar financing.

Funding for FIDEX will continue to be managed through the existing Trust Agreement, which operates with a system of periodic advances with direct reimbursements. During the process of converting FIDEX to a private development institution, A.I.D. and FUSADES will renegotiate the existing Trust Agreement to accommodate the changes in FIDEX, eventually establishing a system of direct advances and reimbursements with FIDEX, S.A. rather than through a Trust Agreement.

**TABLE XII**  
**INDUSTRIAL STABILIZATION AND RECOVERY**  
**PROJECT NO. 519-0287**  
**PROJECT PAPER SUPPLEMENT**

SOURCE	PRIOR YEAR OBLIGATIONS			THIS PP-SUPPLEMENT			TOTAL LOP	TOTAL LOP	TOTAL LOP	GRAND TOTAL
	AID	FUSADES	GOES	AID	FUSADES	GOES	AID	FUSADES	GOES	
TECHNICAL ASSISTANCE	7,457,727			3,284,400			10,742,127	0	0	10,742,127
EXPORT & INVESTMENT STRATEGY	724,743						724,743	0	0	724,743
STRATEGY SUPPORT	1,080,048						1,080,048	0	0	1,080,048
POLICY STUDIES	15,464						15,464	0	0	15,464
FREE TRADE ZONE DEVELOPMENT	349,485						349,485	0	0	349,485
AID SPECIAL ACTIVITIES	334,846						334,846	0	0	334,846
SEMINARS AND CONFERENCES				350,300			350,300	0	0	350,300
COMMUNICATIONS / DISSEMINATION				1,014,200			1,014,200	0	0	1,014,200
TRAVEL/TRAINING	1,399,336			838,400			2,237,736	0	0	2,237,736
SUPPLIES AND EQUIPMENT	924,775			1,177,900			2,102,675	0	0	2,102,675
SALARIES AND RELATED COSTS	5,032,107			3,424,500			8,456,607	0	0	8,456,607
PROMOTION OFFICE ABROAD				1,920,700			1,920,700	0	0	1,920,700
ASSISTANCE TO ASSOCIATIONS	206,462						206,462	0	0	206,462
PROGRAM LOGISTIC SUPPORT	741,811						741,811	0	0	741,811
FUSADES BUILDING	800,000						800,000	0	0	800,000
CONTINGENCIES	251,254			667,707			918,961	0	0	918,961
AID PROJECT MANAGMENT				309,000			309,000	0	0	309,000
AUDITS AND EVALUATION				340,000			340,000	0	0	340,000
OVERHEAD	1,593,405			1,172,893			2,766,298	0	0	2,766,298
INVESTMENT FUND - CREDIT	8,548,537			6,500,000			15,048,537	0	0	15,048,537
COUNTERPART		1,250,000	9,427,000		7,215,000	1,250,000	0	8,465,000	10,677,000	19,142,000
<b>TOTAL</b>	<b>29,460,000</b>	<b>1,250,000</b>	<b>9,427,000</b>	<b>21,000,000</b>	<b>7,215,000</b>	<b>1,250,000</b>	<b>50,460,000</b>	<b>8,465,000</b>	<b>10,677,000</b>	<b>69,602,000</b>

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**TABLE XIII**

**INDUSTRIAL STABILIZATION AND RECOVERY  
PROJECT NO. 519-0287  
PROJECT PAPER SUPPLEMENT  
SUMMARY COST ESTIMATE AND FINANCIAL PLAN**

SOURCE COMPONENT	AID		FUSADES		GÔES	TOTAL	TOTAL	TOTAL
	FX	LC	FX	LC	LC	AID	FUSADES	GOES
TECHNICAL ASSISTANCE	2,374,400	910,000				3,284,400	0	
SEMINARS AND CONFERENCES	230,300	120,000				350,300	0	0
COMMUNICATION/DISEMINATION	610,000	404,200				1,014,200	0	0
TRAVEL/TRAINING	335,360	503,040				838,400	0	0
SUPPLIES AND EQUIPMENT	800,000	377,900				1,177,900	0	0
SALARIES AND RELATED COSTS		3,424,500				3,424,500	0	0
PROMOTIONAL OFFICES ABROAD	1,920,700					1,920,700	0	0
AID PROJECT MANAGEMENT	77,000	232,000				309,000	0	0
AUDIT AND EVALUATION	175,000	165,000				340,000	0	0
CONTINGENCIES		667,707				667,707	0	0
OVERHEAD		1,172,893				1,172,893	0	0
INVESTMENT FUND - CREDIT	6,500,000					6,500,000	0	0
COUNTERPART				7,215,000	1,250,000	0	7,215,000	1,250,000
<b>TOTAL</b>	<b>13,022,780</b>	<b>7,977,240</b>	<b>0</b>	<b>7,215,000</b>	<b>1,250,000</b>	<b>21,000,000</b>	<b>7,215,000</b>	<b>1,250,000</b>

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TABLE XIV  
INDUSTRIAL STABILIZATION AND RECOVERY  
PROJECT NO. 519-0287  
1991 PROJECT PAPER SUPPLEMENT  
PROJECTION OF EXPENDITURES BY YEAR  
US (\$)

TOTAL PROJECT	PP SUPPL AID FUNDS 1991	PRIOR YEAR FUNDS 1991	PP SUPPL AID FUNDS 1992	PRIOR YEAR FUNDS 1992	PP SUPPL AID FUNDS 1993	PRIOR YEAR FUNDS 1993	PP SUPPL AID FUNDS 1994	PRIOR YEAR FUNDS 1994	TOTAL PP SUPPL FUNDS	TOTAL PRIOR YEAR FUNDS
TECHNICAL ASSISTANCE	150,000	783,000	1,050,500	0	1,100,500	0	874,400	0	3,184,400	783,000
SEMINARS AND CONFERENCES	23,800	90,200	130,200	0	132,800	0	63,500	0	350,300	90,200
COMMUNICATIONS/DISSEMINATION	69,000	200,000	311,500	0	331,100	0	302,600	0	1,014,200	200,000
TRAVEL/TRAINING	69,000	200,000	259,500	0	265,700	0	244,200	0	818,400	200,000
SUPPLIES AND EQUIPMENT	61,000	290,700	334,600	0	415,400	0	366,900	0	1,177,900	290,700
SALARIES	279,000	349,600	882,800	76,156	1,095,900	0	1,166,800	0	3,424,500	427,156
PROMOTION OFFICES ABROAD	120,000	271,300	589,700	0	600,000	0	611,000	0	1,920,700	271,300
INVESTMENT FUND CREDIT	6,500,000								6,500,000	0
CONTINGENCIES	80,160	39,564	192,091	0	202,474	0	192,982	0	667,707	39,564
<b>SUBTOTAL</b>	<b>7,351,960</b>	<b>2,224,164</b>	<b>3,759,891</b>	<b>76,156</b>	<b>4,331,674</b>	<b>0</b>	<b>3,622,162</b>	<b>0</b>	<b>19,078,107</b>	<b>2,302,520</b>
OVERHEAD (7.896%) 1991 (Excl. credit)	67,271	175,636	0	0	0	0	0	0	67,271	175,636
OVERHEAD (8.757%) 1992	0	0	329,254	6,844	0	0	0	0	329,254	6,844
OVERHEAD (8.871%) 1993	0	0	0	0	367,603	0	0	0	367,603	0
OVERHEAD (10.695%) 1994	0	0	0	0	0	0	408,766	0	408,766	0
<b>SUBTOTAL OVERHEAD</b>	<b>67,271</b>	<b>175,636</b>	<b>329,254</b>	<b>6,844</b>	<b>367,603</b>	<b>0</b>	<b>408,766</b>	<b>0</b>	<b>1,172,893</b>	<b>182,480</b>
<b>SUBTOTAL AID</b>	<b>7,419,231</b>	<b>2,400,000</b>	<b>4,089,145</b>	<b>83,000</b>	<b>4,511,477</b>	<b>0</b>	<b>4,231,148</b>	<b>0</b>	<b>20,251,000</b>	<b>2,485,000</b>
AID PROJECT MANAGEMENT	99,000		69,000		69,000		72,000		309,000	0
AUDITS AND EVALUATIONS	25,000		170,000		100,000		145,000		440,000	0
<b>TOTAL AID</b>	<b>7,543,231</b>	<b>2,400,000</b>	<b>4,328,145</b>	<b>83,000</b>	<b>4,680,477</b>	<b>0</b>	<b>4,448,148</b>	<b>0</b>	<b>21,000,000</b>	<b>2,485,000</b>
DIRECTORS IN-KIND CONTRIBUTION	111,000	0	108,000	0	108,000	0	108,000	0	435,000	
SERVICE CONTRIBUTION BY BENEFICIARIES	431,000		546,000		561,000		432,000		1,970,000	
CONTRIBUTION OF FUSADES OWN FUNDS	640,000	0	15,000	0	15,000	0	15,000	0	685,000	
CONTRIBUTION OF MAQUILA CLIENTS	2,500,000		500,000		500,000		625,000		4,125,000	
<b>TOTAL FUSADES</b>	<b>3,682,000</b>	<b>0</b>	<b>1,189,000</b>	<b>0</b>	<b>1,184,000</b>	<b>0</b>	<b>1,180,000</b>	<b>0</b>	<b>7,215,000</b>	<b>0</b>

PRIOR YEAR FUNDS (GOES COMPONENT)	AID 1991	GOES 1991	AID 1992	GOES 1992	AID 1993	GOES 1993	AID 1994	GOES 1994	TOTAL PP AID FUNDS	TOTAL GOES FUNDS
TECHNICAL ASSISTANCE	200,000		200,000		200,000		200,000		800,000	0
TRAVEL/TRAINING	25,000		50,000		50,000		25,000		150,000	0
AUDITS AND EVALUATIONS			25,000		75,000				100,000	0
OPERATIONAL SUPPORT		200,000		300,000		500,000		250,000	0	1,250,000
<b>TOTAL FUNDS</b>	<b>225,000</b>	<b>200,000</b>	<b>275,000</b>	<b>300,000</b>	<b>425,000</b>	<b>500,000</b>	<b>225,000</b>	<b>250,000</b>	<b>1,075,000</b>	<b>1,250,000</b>

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TABLE XIV  
 INDUSTRIAL STABILIZATION AND RECOVERY  
 PROJECT NO 519-0287  
 1991 PROJECT PAPER SUPPLEMENT  
 PROJECTION OF EXPENDITURES BY YEAR  
 US (\$)

FIDEX	PP SUPPL	PRIOR	PP SUPPL	PRIOR	PP SUPPL	PRIOR	PP SUPPL	PRIOR	TOTAL PP	TOTAL
	AID	YEAR	AID	YEAR	AID	YEAR	AID	YEAR	SUPPL	PRIOR
	FUNDS	FUNDS	FUNDS	FUNDS	FUNDS	FUNDS	FUNDS	FUNDS	FUNDS	YEAR
	1991	1991	1992	1992	1993	1993	1994	1994		FUNDS
TECHNICAL ASSISTANCE	50,000	0	0	0	0	0	0	0	50,000	0
SEMINARS AND CONFERENCES	1,000	0	0	0	0	0	0	0	1,000	0
COMMUNICATIONS/DISSEMINATION	20,000	0	0	0	0	0	0	0	20,000	0
TRAVEL/TRAINING	20,000	0	0	0	0	0	0	0	20,000	0
SUPPLIES AND EQUIPMENT	35,000	0	0	0	0	0	0	0	35,000	0
SALARIES	185,000	0	0	0	0	0	0	0	185,000	0
CONTINGENCIES	67,981	0	0	0	0	0	0	0	67,981	0
INVESTMENT FUND - CREDIT	6,500,000	0	0	0	0	0	0	0	6,500,000	0
SUBTOTAL	6,878,981	0	0	0	0	0	0	0	6,878,981	0
OVERHEAD (7.898%) 1991 (Excl. credit)	29,924	0	0	0	0	0	0	0	29,924	0
OVERHEAD (8.757%) 1992			0	0					0	0
OVERHEAD (8.871%) 1993					0	0			0	0
OVERHEAD (10.697%) 1994							0	0	0	0
SUBTOTAL OVERHEAD	29,924	0	0	0	0	0	0	0	29,924	0
TOTAL AID	6,908,905	0	0	0	0	0	0	0	6,908,905	0
DIRECTORS IN-KIND CONTRIBUTION	37,000		36,000		36,000		36,000		145,000	
CONTRIBUTION OF FUSADES OWN FUNDS	625,000		0		0		0		625,000	
CONTRIBUTION OF MAQUILA CLIENTS	2,500,000		500,000		500,000		625,000		4,125,000	
TOTAL FIDEX	2,537,000		536,000	0	536,000	0	661,000	0	4,895,000	0

TABLE XIV  
 INDUSTRIAL STABILIZATION AND RECOVERY  
 PROJECT NO. 519-0287  
 1991 PROJECT PAPER SUPPLEMENT  
 PROJECTION OF EXPENDITURES BY YEAR  
 US (\$)

PRIDEX	PP SUPPL AID FUNDS 1991	PRIOR YEAR FUNDS 1991	PP SUPPL AID FUNDS 1992	PRIOR YEAR FUNDS 1992	PP SUPPL AID FUNDS 1993	PRIOR YEAR FUNDS 1993	PP SUPPL AID FUNDS 1994	PRIOR YEAR FUNDS 1994	TOTAL PP SUPPL FUNDS	TOTAL PRIOR YEAR FUNDS
TECHNICAL ASSISTANCE	100,000	783,000	909,300	0	966,000	0	769,400	0	2,764,900	783,000
SEMINARS AND CONFERENCES	22,800	90,200	110,100	0	111,900	0	40,700	0	385,500	90,200
COMMUNICATIONS/DISSEMINATION	49,000	200,000	275,200	0	291,200	0	258,800	0	874,300	200,000
TRAVEL/TRAINING	49,000	200,000	235,900	0	239,700	0	215,600	0	740,300	200,000
SUPPLIES AND EQUIPMENT	26,000	290,700	260,200	0	335,600	0	301,400	0	923,200	290,700
SALARIES	94,000	349,600	482,800	0	561,700	0	579,200	0	1,717,700	349,600
PROMOTION OFFICES ABROAD	120,000	271,300	589,700	0	600,000	0	611,000	0	1,910,700	271,300
CONTINGENCIES	12,179	39,544	147,031	0	160,760	0	149,434	0	469,404	39,544
SUBTOTAL	472,979	2,224,164	3,010,311	0	3,266,840	0	2,925,514	0	9,695,804	2,224,364
OVERHEAD (7.896%) 1991	37,346	175,636							37,346	175,636
OVERHEAD (8.757%) 1992			263,623	0					263,623	0
OVERHEAD (8.871%) 1993					291,577	0			291,577	0
OVERHEAD (10.694%) 1994							312,857	0	312,857	0
SUBTOTAL OVERHEAD	37,346	175,636	263,623	0	291,577	0	312,857	0	905,404	175,636
TOTAL AID	510,325	2,400,000	3,274,054	0	3,578,417	0	3,238,391	0	10,601,208	2,400,000
DIRECTORS IN-KIND CONTRIBUTION	37,000		36,000		36,000		36,000		145,000	0
SERVICE CONTRIBUTION BY BENEFICIARIES	411,000		536,000		561,000		472,000		1,970,000	0
TOTAL PRIDEX		0		0		0		0		0

TABLE XIV  
 INDUSTRIAL STABILIZATION AND RECOVERY  
 PROJECT NO. 519-0287  
 1991 PROJECT PAPER SUPPLEMENT  
 PROJECTION OF EXPENDITURES BY YEAR  
 US (\$)

DEES	PP SUPPL AID FUNDS 1991	PRIOR YEAR FUNDS 1991	PP SUPPL AID FUNDS 1992	PRIOR YEAR FUNDS 1992	PP SUPPL AID FUNDS 1993	PRIOR YEAR FUNDS 1993	PP SUPPL AID FUNDS 1994	PRIOR YEAR FUNDS 1994	TOTAL PP SUPPL FUNDS	TOTAL PRIOR YEAR FUNDS
TECHNICAL ASSISTANCE	0	0	130,000	0	114,300	0	103,000	0	369,500	0
SEMINARS AND CONFERENCES	0	0	20,100	0	20,900	0	22,800	0	63,800	0
COMMUNICATIONS/DISSEMINATION	0	0	36,300	0	39,900	0	43,800	0	119,900	0
TRAVEL/TRAINING	0	0	23,600	0	26,000	0	28,600	0	78,200	0
SUPPLIES AND EQUIPMENT	0	0	74,400	0	79,800	0	65,500	0	219,700	0
SALARIES	0	0	400,000	78,156	534,200	0	587,600	0	1,521,800	78,156
CONTINGENCIES	0	0	45,060	0	1,714	0	41,548	0	710,322	0
SUBTOTAL	0	0	749,460	78,156	857,014	0	846,848	0	2,501,322	78,156
OVERHEAD (7.69%) 1991	0	0	0	0	0	0	0	0	0	0
OVERHEAD (8.75%) 1992	0	0	65,630	6,844	0	0	0	0	65,630	6,844
OVERHEAD (8.87%) 1993	0	0	0	0	76,026	0	0	0	76,026	0
OVERHEAD (10.69%) 1994	0	0	0	0	0	0	95,902	0	95,902	0
SUBTOTAL OVERHEAD	0	0	65,630	6,844	76,026	0	95,902	0	237,565	6,844
TOTAL AID	0	0	815,090	85,000	933,040	0	942,750	0	2,740,887	85,000
DIRECTORS IN-KIND CONTRIBUTION	37,000	0	36,000	0	36,000	0	36,000	0	145,000	0
CONTRIBUTION WITH FUSAD'S OWN FUNDS	15,000	0	15,000	0	15,000	0	15,000	0	60,000	0
TOTAL DEES	52,000	0	51,000	0	51,000	0	51,000	0	205,000	0

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TABLE XV

INDUSTRIAL STABILIZATION AND RECOVERY  
 PROJECT NO.519-0287  
 1991 PROJECT PAPER SUPPLEMENT  
 PAYMENT VERIFICATION MATRIX

METHOD OF IMPLEMENTATION	METHOD OF FINANCING	APPROXIMATE AID AMOUNT
TECHNICAL ASSISTANCE	DIRECT REIMBURSEMENT	3,184,400
SEMINARS AND CONFERENCES	DIRECT REIMBURSEMENT	350,300
COMMUNICATIONS / DISSEMINATION	DIRECT REIMBURSEMENT	1,014,200
TRAVEL / TRAINING	DIRECT REIMBURSEMENT	838,400
SUPPLIES AND EQUIPMENT	DIRECT REIMBURSEMENT	1,177,900
SALARIES	DIRECT REIMBURSEMENT	3,424,500
PROMOTION OFFICES ABROAD	DIRECT REIMBURSEMENT	1,920,700
INVESTMENT FUND - CREDIT	DIRECT REIMBURSEMENT	6,500,000
OVERHEAD	DIRECT REIMBURSEMENT	1,172,893
AID PROJECT MANAGMENT	DIRECT PAYMENT	309,000
AUDIT / EVALUATIONS	DIRECT PAYMENT	440,000
CONTINGENCIES	TO BE DETERMINED	667,707
<b>TOTAL</b>		<b>21,000,000</b>

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## V. PROJECT SUPPLEMENT IMPLEMENTATION ARRANGEMENTS

### A. Obligating Instrument

No additional funds are needed under the public sector component of the Project. Funds added under the PP Supplement will be obligated by means of Amendments, as A.I.D. funds become available, to the Cooperative Agreement with FUSADES. The planned initial obligation of FY 1991 funds is \$9.0 million (\$5.5 million ESF, \$2.5 million PSEE).

### B. Project Management and Coordination

#### 1. USAID responsibilities

In USAID, principal Project oversight and management will be exercised by the Mission's Private Sector Office (PRE). Project implementation will be managed by the existing full-time FSN Project Manager and Program Assistant. The Project Manager and Program Assistant will: (a) attend meetings with FUSADES, FIDEX, S.A., and CONAEXI and provide guidance on A.I.D. regulations and policies, as appropriate; (b) take action as needed on Project correspondence; (c) review and give administrative approval to disbursement requests; (d) make visits to Project activity; (e) monitor the A.I.D.-contracted technical assistance for CONAEXI; (f) prepare semi-annual progress reports on the Project; (g) review the annual action plans of FUSADES, FIDEX, S.A., and CONAEXI, and initiate action for Mission approval thereof; (h) arrange for and supervise Project evaluations; (i) review reports prepared by Project-financed consultants; (j) review the annual audits of the Project; (k) monitor Project activity to ensure compliance with the Grant Agreements, taking action as necessary; and (l) track procurements and conduct periodic end-use checks of Project-financed goods and services.

Via the Project Implementation Committee, other USAID offices will assist in Project implementation and oversight as follows: (a) the Projects Office will monitor implementation and compliance with the terms and conditions of the Grant Agreements; (b) the Contracting Office will assist in procurement actions related technical assistance and training for CONAEXI, audit, and evaluation; (c) the Executive Office will contract A.I.D. Project management, using personal services contracts with cooperating country nationals; (d) the Controller's Office will effect disbursement and reimbursement actions in conformity with A.I.D. regulations, and certify that adequate financial controls are in place; and (e) the Program Office will assist in budgeting funding increments, as well as in evaluation activity.

#### 2. FUSADES responsibilities

FUSADES, as the implementing entity for the private sector program of activities under the Project, will: (a) provide office space and adequate staff and support for the Project; (b) Prepare the required financial and programmatic reports, draft scopes of work for the annual audits (to be approved by A.I.D.), and forward requests for disbursement and supporting documentation to A.I.D; and (c) track Project procurement, preparing waiver requests as appropriate, and monitor and spot-check Project activity.

### 3. FIDEX responsibilities

FIDEX will: (a) prepare the timetable organizational chart and proposed charters for FIDEX, S. A.; (b) negotiate the charter of FIDEX, S.A. with the Central Reserve Bank; and (c) establish FIDEX, S. A. as a legally registered Sociedad Anonima once the charter is approved. FIDEX, S. A. will be responsible for promoting, receiving and reviewing loan applications, managing loans and paying interest to FUSADES on the FUSADES credit portfolio.

### 4. GOES responsibilities

CONAEXI will do the following as the implementing entity for the public sector program of activities under the Project: (a) designate counterparts for Project activities, i.e., the Commission Director and key staff; (b) through SETEFE, certify the adequacy of CONAEXI's financial systems to allow for disbursements of GOES counterpart; (c) work with SETEFE on Annual Action Plans for counterpart; (d) Prepare the required financial and programmatic reports to be done under the Project, and forward requests for disbursement and supporting documentation to A.I.D; (e) track procurement under the Project, preparing waiver requests as appropriate, and monitor and spot-check Project activity; and (f) in general terms, coordinate public and private sector export and investment promotion efforts. This will involve working closely with FUSADES to maximize Project results.

#### C. Procurement Plan

A.I.D. assistance under the Project consists of technical assistance, training, credit, and some commodities. The majority of the procurement actions, including short- and long-term U.S. technical assistance, personnel, and commodities will be contracted by FUSADES. FUSADES' operations, including procurement systems, have been reviewed in various evaluations, as discussed in Section VII herein. Based on past performance, the Mission is confident that FUSADES can adequately manage Project procurement. Project evaluations and audits and A.I.D. Project management will be contracted by the Mission. The Mission will also contract for the U.S. technical assistance needs of CONAEXI. A PIO/T will be prepared requesting the Mission's Contracts Office to use full and open competitive procedures to award a contract for technical assistance and training for CONAEXI as discussed in Section III, to be requested as specific needs are identified over the remaining life of the Project. Contractor selection will be based on technical qualifications of proposed personnel and organizational capability to provide and support technical assistance on short notice. A level of effort will be established for this contract based on current estimates of required technical assistance and available funding. CONAEXI will be responsible for procurement actions related to its local currency counterpart, such as training expenses, operational support, promoters, etc. Project procurements will have as their source, origin, and nationality the United States, unless A.I.D. otherwise agrees in writing. Annex J hereto contains a source, origin, and nationality waiver for local source and CACM procurement which has been determined to be essential to the achievement of Project objectives. Any deviation from the Project's authorized procurement source, origin, or nationality will require a waiver approved by the Mission Director, on a case by case basis.

#### D. Schedule of Major Events

- Project Paper Supplement approved in AID/W.....	March 1991
- Agreement Amendments with FUSADES and GOES signed.....	March 1991
- Commission named.....	April 1991
- Final Action Plan for 1991 received from FUSADES.....	May 1991
- CPs to Disbursement for CONAEXI met.....	June 1991
- CPs to Disbursement for FIDEX Met.....	June 1991
- Technical Assistance for CONAEXI contracted.....	July 1991
- Final Action Plan for 1991 received from CONAEXI.....	July 1991
- FIDEX, S.A. legally established and fully functioning.	December 1991
- Final Action Plan for 1992 received from FUSADES.....	January 1992
- Final Action Plan for 1992 received from CONAEXI.....	January 1992
- Mid-Term Evaluation contracted.....	December 1992
- Mid-Term Evaluation completed.....	March 1993
- Final Action Plan for 1993 received from FUSADES.....	January 1993
- Final Action Plan for 1993 received from CONAEXI.....	January 1993
- Final Action Plan for 1994 received from FUSADES.....	January 1994
- Final Action Plan for 1994 received from CONAEXI.....	January 1994
- Project evaluation contracted.....	August 1994
- PACD.....	September 1994
- Project evaluation completed.....	September 1994
- RIG-supervised audit completed.....	December 1994

#### E. Environmental Impact

As provided in Handbook 3, Appendix 2D, under 22 CFR Part 16, entitled Environmental Procedures, the Project qualifies for a negative determination subject to the condition being placed in appropriate documents that any funds, including local currency, associated with the Project are not used to finance: (1) the purchase, use, or importation of pesticides, or (2) any activity that would result in any significant loss of tropical forests, or involve industrial timber extraction in primary tropical forest areas. Annex E hereto provides the Environmental Threshold Decision.

#### F. Application of the Lautenberg Amendment

The Lautenberg Amendment, originally included in the FY 1987 Continuing Resolution, prohibits A.I.D. from directly procuring feasibility studies, prefeasability studies, or project profiles of potential investments for the manufacture of "import sensitive articles" for export to the U.S. or to third countries in direct competition with U.S. exports, or from directly assisting in establishing facilities for the export of such items. Import sensitive items are defined as textiles and apparel articles, footwear, handbags, luggage, flat goods, work gloves, and leather wearing apparel. Completely hand-made cottage industry textiles and drawback (Section 807) operations in CBI countries are exempted. Only activities which result in direct competition with U.S. exports or to the U.S. are prohibited. It is expected that, as in the past, a large portion of Project-assisted export activities will be drawback, i.e., exempted from the Lautenberg restrictions. Nevertheless, a provision will be included in the Agreement Amendments which stipulates that A.I.D. funds will not be used to finance activities prohibited by the Lautenberg Amendment.

## VI. SUMMARIES OF PROJECT SUPPLEMENT ANALYSES

### A. Technical Analysis of FUSADES

Section III, the Project Description, discusses the activities of FUSADES under the Project through September 1994. The Institutional Analysis Annex contains an overview of both FUSADES and CONAEXI. The Technical Analysis Annex provides greater detail on the individual programs financed under this Amendment. This section, then, focuses on FUSADES beyond the life of the Project. Because of A.I.D.'s special interest in the self-sustainability of FUSADES beyond this Project, and the impact of Project activities on the viability of the institution, the results of FUSADES' 1990-1991 Strategic Planning Exercise are provided herein.

Both the Mission and FUSADES recognized the need for FUSADES to address the question of what the institution will look like and be engaged in beyond the life of this Project. Accordingly, in September 1990, FUSADES entered into a process of self-examination with the assistance of Project-financed outside technical assistance. This effort began with the premise that beyond 1994, FUSADES would receive no additional funds from A.I.D. Although it is assumed that FUSADES will seek other donor financing in the future, it was not included in the base analysis, since no such funding is assured. These assumptions resulted in a recognition by FUSADES that it would have to make immediate and fundamental adjustments to prepare for the cessation of A.I.D. funding in 1994.

The first task, then, was to examine and redefine the mission of FUSADES and to determine which programs were essential to it. This exercise resulted in an assessment that the DEES, the Economic and Social Research Program, should maintain a fundamental role in FUSADES. Secondly, FUSADES determined that, for the foreseeable future, the Foundation could best contribute to the social and economic development of El Salvador by concentrating its efforts on the development of investment in and export of non-traditional products. This function is and would be performed primarily by PRIDEX, the Export and Investment Promotion Program, and DIVAGRO, the Agricultural Diversification Program. Therefore, the priority areas of interest for FUSADES were determined to be: the DEES, PRIDEX and DIVAGRO. It was then necessary to decide how to deal with the other departments of FUSADES, namely PROPEMI, the Small and Microenterprise Program, FORTAS, the Association Strengthening Program, and FIDEX, the credit facility. It was clear that, given the realities of funding, that FUSADES could not continue to finance either the priority programs or the secondary ones at the levels that they had been supported to date.

Heretofore, A.I.D. had been funding virtually all of the costs of the individual programs as well as the administration of the organization. FUSADES examined the funding available through existing projects and the anticipated funding available through this Project until the end of 1994. At the same time, it analyzed other sources of income, both from the credit programs and from services sold by the various departments. It then studied the administrative costs of maintaining six departments and their support structures. Three significant decisions resulted from this exercise. First,

it was determined that at the end of 1990, FORTAS would be reduced to a skeleton staff, with all future program activities determined by the availability of external (i.e., non-A.I.D.) financing. Second, PROPEMI, already virtually self-sufficient, would sustain its costs and its future credit program from the resources presently in place, but would seek other donor funding to expand its program. Third, FIDEX would be converted into a diversified financial institution engaged in development lending and divested from FUSADES. These decisions were fundamental in that they proposed the almost immediate reduction of FUSADES cost centers from six to three, namely DEES, PRIDEX and DIVAGRO. (Although PROPEMI and FORTAS would remain as departments of FUSADES, the former would be financially self-sufficient, and the latter reduced to a maintenance level.)

Given the unlikelihood that future donors would be willing to fund FUSADES administrative costs, it was decided that FUSADES should immediately convert to a system wherein FUSADES was responsible for administrative costs, with the core programs being charged overhead. (PROPEMI and FORTAS, although smaller cost centers, would also be charged overhead.) This change will begin preparing FUSADES for a future that, while not dependent upon donor funding, puts it in a better position to seek donor funding. It was therefore agreed that A.I.D. would cease funding FUSADES administrative costs, and that FUSADES would charge overhead to the projects funded by A.I.D. and other donors.

FUSADES' major source of income, beyond 1994, was determined to be the interest income generated by the credit programs of FIDEX. If FIDEX was to be divested, it was critical that the divestiture be accomplished in a manner that would assure this continued stream of income while maximizing the opportunity for the divested FIDEX to become a viable and self-sufficient financial entity in a better position to address the needs of the NTE sector. Through a process of negotiation among A.I.D., FUSADES and the BCR, the divestiture plan discussed in the Technical Analysis was designed. Under that plan, FIDEX S.A. becomes an independent financial institution with its own loan portfolio, but will manage the FUSADES portfolio of credits on a fee basis. This enables FUSADES to shed the costs and management burden of FIDEX, while providing an estimated income of \$5 million per year, as seen in Annex H.

The next step was to design and cost out the DEES and PRIDEX programs to be funded under this Project (DIVAGRO already being funded by A.I.D. under the Agribusiness Development Project). This design took into account the previous directions and accomplishments of the two programs and the changing environment in El Salvador. The programs and funding levels for the DEES and PRIDEX programs for the 1991-1994 period are discussed in detail in the Project Description and pertinent Technical Analyses.

Having reached consensus on the projected structure of FUSADES and the funding levels and sources for all programs through 1994, it remained for FUSADES to address what the organization would consist of beyond 1994. This part of the exercise began with an assessment of what internally generated resources FUSADES could depend upon. Each program was analyzed to determine what income the programs themselves could realistically be expected to generate through the sale of products or services. Next, the FUSADES portfolio of loans and potential loans, to be managed by FIDEX S.A., was

analyzed to produce realistic projections of the interest income. As above mentioned, it was determined that FUSADES could reasonably project interest earnings on the A.I.D.-funded credit programs of approximately \$5 million per annum in 1994 and beyond. (This includes earnings on two A.I.D.-financed credit facilities in addition to the industrial credit line under the subject Project: the Water Management credit line, and the Agribusiness Development credit fund.) Using this level of income as a base, FUSADES then projected a structure for its core programs for 1995 along with detailed budgets (see Annex H). The programs are summarized below.

**PRIDEX:** The PRIDEX budget in 1995 will be reduced by 36% over 1994 to a level of approximately \$2.0 million. This amount includes approximately \$400,000 in program income from the private sector for external technical assistance, which PRIDEX will contract on behalf of the companies requesting the technical assistance. PRIDEX will provide external technical assistance but charge clients fully for it. It will still share the cost of technical assistance provided by its own staff. Staffing will be reduced by 20-25%, or four to six professionals, with some of their functions being absorbed by Administration. The support unit for free zone development will be eliminated, but PRIDEX will continue to promote free zones through its communications budget and its overseas promotion offices. At this time, it is planned that the overseas promotion offices will be reduced from three to two, leaving the Miami office and one other whose location will be determined by a cost/benefit analysis. The PRIDEX staff will therefore consist of the director, three division chiefs, eight professionals, two overseas promoters, and secretarial support.

Technical assistance in 1995 will be either contracted or provided directly by PRIDEX staff to approximately 90 exporters and potential exporters for export market studies, feasibility studies, development of business plans, management training, increased efficiency, technology transfer, and increased productivity. This activity will be focused in the six priority sectors (garment drawback, textiles, footwear, metal-mechanics, electronic drawback, furniture) on which PRIDEX currently focuses; although thought is already being given to the possibility of greater attention to high value-added industries (appliance assembly, medical equipment, etc.), should conditions permit. Foreign technical assistance to specific companies will be primarily in the areas of product design, marketing, quality control, market search and market entry matchmaking. (Gross income from this service is expected to total approximately \$400,000.) PRIDEX will also continue to assist foreign investors by handling their itineraries for visits to El Salvador, providing information, identifying local joint-venture prospects and expediting start-up. Investor visits, the product of the overseas promotion offices, are expected to total 70-80 in 1995, with 10-12 major investments.

PRIDEX will also contract foreign technical assistance for itself (\$150,000) to improve its capabilities in investment promotion and export development. It will continue to participate with booths in at least two international fairs annually, and will send staff members on a total of 18 trips to events such as 807 seminars, transportation seminars, CBI conferences and specialized training courses in 1995. A significant budget (\$105,000) will be maintained for the publication of investment brochures and

informational materials, direct mailing, and the sponsoring of at least two seminars on export related topics.

In addition to the above, PRIDEX is assigned a major role in the implementation of the National Export Strategy. In addition to its role in local export facilitation, foreign investment promotion and free zone development, it will be responsible for continuing to assist in addressing institutional constraints to exports such as customs operations; and infrastructure constraints such as port services, airport handling, and industrial space availability. It is expected that this role will continue beyond 1994, even if the need for CONAEXI per se has ended.

In summary, the major reductions in the PRIDEX budget in 1995 and beyond come from increased cost-sharing on the part of clients for foreign technical assistance. It is difficult at this point to determine the level of services that clients will require and for which they will be willing to pay. But it is anticipated that it will be significantly less than the levels projected for the life of the Project. Other budget reductions are at the margin, and PRIDEX will be able to continue to provide a level of service commensurate with present levels.

DEES: As indicated in the 1995 budget, FUSADES plans to maintain the DEES at the same nominal levels that are anticipated for the life of this Project. This level of funding is based upon the projection that the need for a quality economic think tank will not be diminished. The activities of the DEES will encompass the three areas of Applied Research, Dissemination, and Information.

Applied Research encompasses four areas: macroeconomic studies; microeconomic studies; social studies; and studies of the institutional and legal framework. Macroeconomic studies will be primarily in the area of short term economic performance. Microeconomic studies will consist of analyses of problems and constraints in the agrarian and industrial sectors. Social studies will be aimed at the identification of constraints to social development and improved administration of GOES social programs. Applied research, which will be carried out by the DEES staff, represents approximately 60% of the total budget.

Dissemination refers to both the dissemination of ideas and information. The DEES will continue to publish the Weekly Economic Report, Weekly Economic Discussion, monthly Economic and Social Bulletin, Quarterly Situation Report, quarterly Business Climate Report, and the the annual State of the Economy. The DEES will continue to give courses to interest groups or free market economic principles and will conduct seminars and workshops on specialized topics. The library, which contains 1,800 volumes will be expanded, and the DEES intends to more aggressively promote its use. Approximately 30% of the technical assistance budget will be used to fund speakers for seminars and workshops. At the same time, seminars and subscriptions to publications are expected to earn the major portion of the DEES' projected \$65,000 in program income.

Information refers to the gathering of data and its sale in a specific format to public and private sector institutions. Examples include wage data, employment analyses, export and import statistics, performance tracking for specific sectors such as drawback and non-traditional agriculture, and analyses of comparative advantages and constraints in competing countries. Although most of these tasks will be undertaken by the DEES staff, a small portion will require foreign technical assistance.

The DEES will continue to send staff to seminars and conferences and to bring technicians to El Salvador for training of staff. The budgets for travel and seminars will enable the DEES to send 8-10 staff members to international seminars and conferences.

It should be noted that approximately 70% of the DEES budget in 1995 is dedicated to salaries and related costs. This reflects the efforts that the DEES has made to develop an in-house capability to perform almost all of the tasks that it has set for itself. Throughout the LOP and beyond 1994, its need for technical assistance remains constant, and primarily for specific tasks such as conducting seminars on specialized topics. The DEES contemplates that its staff level will fluctuate little. It will maintain its intern program, which develops professionals to replace those that are lost through natural attrition.

DIVAGRO: The strategic objectives of DIVAGRO run parallel to those of PRIDEX. Dedicated to promoting non-traditional agricultural exports (NTAE), it will intensify training for its staff during the next four years, slowly reducing the budgets for costly foreign technical assistance. Two of the four experimental stations will be closed, and contracts for DIVAGRO's five long-term US technical advisors will terminate. However, other activities such as in-house technical assistance, quality assurance programs, and seminars will continue past the PACD at current levels. This is reflected in the 1995 core budget of \$2.1 million (see Annex H).

The range of NTAE items promoted by DIVAGRO will not change. It is projected that winter melons, warm season processing of vegetables, sesame, farm-raised shrimp, ornamentals, and fresh horticultural specialties will continue to demonstrate good export potential, although DIVAGRO staff will assess crop priorities during annual strategic planning reviews. Existing export marketing services and foreign trade and investment promotion will continue. An investment promotion officer and other facilities will be maintained in the Miami office, and four professionals will make up to 20 trips to/from Miami and to trade shows in 1995 and beyond. Production research for NTAE crops, by four agronomists, will include variety and cost trials on the two remaining experimental stations. These stations are expected to produce annual sales of by-product from test plots of \$80,000. The Quality Assurance Laboratory will provide analyses and outreach on pesticide issues to public sector agencies. Staffed by 11 professionals, the \$500,000 annual cost of the lab will be partially offset by income generations of \$250,000 in fees.

DIVAGRO will maintain a staff of eight professionals to administer core services and specific consulting contracts with NTAE clients. DIVAGRO

expects to maintain at least 40 technical assistance contracts with local agribusiness clients in 1995, who will pay all direct costs, such as fees for visits by foreign specialists. Gross proceeds from these contracts are projected to total \$450,000 per annum.

Other items contained in the budget include a technical library which serves the DIVAGRO staff and the public, and also earns modest fees. DIVAGRO will conduct 15 seminars, update and sell a dozen field guides, and continue to engage in other NTAE extension efforts, again earning fees. Although DIVAGRO's staff capabilities will be greatly enhanced, technical assistance to DIVAGRO by short-term foreign consultants and studies to enhance staff capabilities is also budgeted.

Compared to its current operating budget, DIVAGRO will be operating in 1995 at 55% of the 1991 levels with 75% of its 1991 staff. This four year evolution reflects: (1) the expected shift from crop R&D to immediate commercial sub-project development as the program matures; and (2) the need to focus on services that clients are willing to pay for. Although the program will be restructured and made more cost effective, it will still continue to provide comparable levels of service once A.I.D. funding ends.

FUSADES is presently completing its most recent strategic planning exercise. In general, the Foundation plans to increase efforts to reduce costs and to identify opportunities to recover costs over the LOP and beyond. At the same time, it is creating a project office to identify opportunities for other donor financing of specific activities. In 1991, FUSADES plans to implement a program to reduce administrative costs by revising internal systems and consolidating areas of administration that are now decentralized and more costly. Finally, in its annual strategic planning reviews, it plans to investigate the feasibility of combining the DIVAGRO and PRIDEX programs into a single department with the resultant economies of scale that may accrue.

#### B. Financial Analysis

A detailed financial analysis was carried out on the private sector component of the Project implemented by FUSADES, and this is presented in Annex J. As part of that analysis, detailed annual budgets for the PRIDEX, FIDEX, the DEES, and FUSADES administration were developed. Since the National Export and Investment Commission is not expected to be a permanent fixture, it was not included in this analysis.

The major focus of the financial analysis was on assessing the financial viability of FUSADES after Project funding terminates in 1994. As a result, considerable effort was devoted to estimating FUSADES' income from other sources in 1995, and on developing initial budget projections for that year. As demonstrated in the Annex H, FUSADES will be able to maintain its core program activities, albeit at reduced levels, thus ensuring that the benefits of the Project will continue beyond the Project Assistance Completion Date of September 30, 1994.

A financial analysis was also carried out on FIDEX, S.A. for the period 1992 (the first year of operations as a development finance institution) to

1996. This analysis, which is contained in Annex J, the Financial Analysis, clearly demonstrates the profitability and financial viability of FIDEX, S.A. during this period and beyond.

### C. Economic Analysis

The purpose of the Economic Analysis is to determine if the proposed investment in Project activities is economically viable. To accomplish this, the overall economic impact, a sector overview, and the rate of return likely to accrue to investments in the non-traditional industrial export sector were examined. First, it was determined that the overall economic impact of the additional resources provided under this PP Supplement was to generate 23,500 jobs, \$110.4 million in investment and \$131.6 million in export sales. Second, an overview of the industrial sector revealed that, due to recent reforms in the economic policy regime, private profitability in manufactured exports has increased, allowing El Salvador to realize its comparative advantage in this sector. Lastly, the microeconomic analysis in which the social rate of return to investments in manufactured exports was calculated in the context of sample firm budgets. This analysis estimated the economic benefits of the Project, utilizing two different cost scenarios to measure the economic internal rate of return (EIRR). In developing the cost scenarios, alternative assumptions for the exchange rate were used since it is known that in investment and export projects, the EIRR is very sensitive to this variable. The analysis shows that the EIRR for the Project is 41%. When the shadow price of unskilled labor was assumed to increase by 50%, the EIRR dropped to a still very acceptable 25%. When it was assumed that the exchange rate was overvalued by 20%, the EIRR dropped to 24%.

### D. Social Soundness Analysis

The Project is designed to take advantage of two of El Salvador's best resources: (1) a skilled, well-educated and aggressive entrepreneurial class; and (2) a plentiful pool of low-cost, productive labor. In putting these two resources to greater use, the Project will address the serious problems of underemployment and low incomes. Both for the entrepreneur and for the worker, the higher incomes will be generated by this Project.

Direct beneficiaries are those gaining employment and income as a result of increased investment in productive sectors. Industrial operations, which pay at least the minimum wage, employ large numbers of females, and provide training to upgrade skills. There will also be indirect job creation, as backward linkages are developed. To the extent that A.I.D.'s and FUSADES' investment in FIDEX, S.A. is leveraged as the institution gains access to other funding sources to permit greater lending, investment, and job creation, the spillover benefits could be significant. The nation as a whole will benefit from the generation of foreign and local investment, increased employment and wages, and increased foreign exchange earnings. The impact of the Project is positive and should extend well beyond the life of the Project.

In order to more fully identify Project beneficiaries, FUSADES will prepare an analysis of Project benefits on the poor and historically disadvantaged. This study, planned for 1991, will include gender disaggregated data identifying Project beneficiaries. This study will serve as a baseline for further analysis of the Project's impact over the LOP.

## VII. SPECIAL PROVISIONS

It is contemplated that the following provisions will be included in the respective Agreement Amendments:

### A. Conditions Precedent to Disbursement for Special Activities

#### 1. FUSADES

a. Prior to disbursement of additional A.I.D. resources for the industrial credit activity, FUSADES will present, in form and substance satisfactory to A.I.D., the timetable, organizational chart, and charter for FIDEX, S.A., unless A.I.D. otherwise agrees in writing.

b. Prior to disbursement of additional A.I.D. resources for the industrial credit activity in excess of \$3.5 million, FUSADES will present documentation, in form and substance satisfactory to A.I.D., which demonstrates that FIDEX, S.A. has been legally established, and that FUSADES has contributed five million colones from its resources for its capitalization, unless A.I.D. otherwise agrees in writing.

c. Prior to disbursement of A.I.D. resources to be channeled through FIDEX, S.A., FUSADES will present, in form and substance satisfactory to A.I.D., for A.I.D.'s review, the funds management agreement(s) for A.I.D. funds to be managed by FIDEX, S.A., unless A.I.D. otherwise agrees in writing.

#### 2. GOES

a. Prior to disbursement of A.I.D. resources for the National Export and Investment Commission (CONAEXI), the GOES will present documentation in form and substance satisfactory to A.I.D., which details the staffing, organizational structure, and functions of CONAEXI.

b. Prior to disbursement of A.I.D. resources for CONAEXI, the GOES will present an Action Plan for 1991 which contains the individuals, salaries, and list of equipment proposed for the technical unit, the activities from the National Export Strategy to be implemented in 1991, and a procurement and implementation schedule.

c. Prior to disbursement of A.I.D. resources for CONAEXI, the GOES will provide A.I.D. with the names and signatures of those individuals empowered to act for the GOES on behalf of the Projects.

### B. Covenants

#### 1. FUSADES

a. FUSADES and A.I.D. will annually review the feasibility of moving the offshore trust onshore.

b. FUSADES covenants that it will reduce its participation in FIDEX, S.A. to 25%, or the maximum allowable under Salvadoran banking law, over the life of this Project.

### VIII. EVALUATION AND MONITORING ARRANGEMENTS

Since its authorization in 1984, the Industrial Stabilization and Recovery Project and its components have been evaluated on numerous occasions.\* Of particular relevance to this Project Paper Supplement were the Assessment of FUSADES Performance Under the Industrial Stabilization and Recovery Project, July, 1990; and the Evaluation of the Export Investment Fund (FIDEX), 1990. The former assessment was done as part of the preparation of this PP Supplement. The recommendations of the latter, specifically that FIDEX become a licensed Salvadoran financial institution and that its relationship vis-a-vis FUSADES be restructured were incorporated into this PP Supplement.

The Mission will conduct annual reviews with the Project's implementing entities (CONAEXI, FUSADES and FIDEX) to assess progress in achieving objectives, to develop methods to improve performance, and to consider possible modifications to project implementation and design as appropriate. The reviews, which may or may not include outside assistance, will be held annually. Each review will thus serve as the basis for the subsequent year's implementation plan and budget. The reviews will be held independently with the respective implementing entities, with a specific focus on the development and needs of each organization. For example, reviews with FIDEX will address the issue of financial viability and sustainability, as well as the need to maintain the dollar trust offshore.

In addition to the annual reviews, it is expected that the Mission will undertake, with Project resources, two formal, in-depth evaluations utilizing outside expertise and objectivity. The Project budget includes \$200,000 in A.I.D. resources for Project evaluations. The first evaluation will occur at the mid-point of this extension period, in 1993. The purpose of this evaluation is to determine if the project design is still valid as structured, or if revisions are needed to facilitate accomplishment of the Project goal and purpose. It is envisioned that specific attention will be given to CONAEXI, on progress in implementing the National Export Strategy, on FUSADES' progress towards self-sufficiency, on the effectiveness of PRIDEX' new strategy, and on FIDEX, S.A.'s development. Modifications to this evaluation plan may be warranted by Project implementation.

Because of the importance of this Project to the Mission's and the GOES' efforts to re-orient the economy and promote development, an end of Project evaluation will be performed to assess the Project's impact on the country's export sector -- not only in terms of production and investment, but also in terms of attitudinal changes. The Project is an integral part of efforts to bring about a national consensus on exports. Both purpose and goal achievement will be assessed. Key indicators include: foreign exchange

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\* Assessment of FUSADES, Aaron Williams and Daniel Chaij, September 1988; Final Report - Evaluation of FUSADES, Development Associates, Inc., June 1988; Computer Needs Assessment for the Ministry of Foreign Trade (MICE), Deloitte, Haskins, and Sells, December 1988; Interim Report - Assessment of FUSADES Performance under the Industrial Stabilization and Recovery Project, CARANA Corporation, July 1990; Fondo de Inversion para Exportaciones, Thomas Mooney and Robert Laport, June 1990.

earnings from non-traditional industrial or assembly export operations, jobs created in the sector, new direct foreign and domestic investment in the sector, status of the National Export Strategy, and status of San Bartolo Free Zone development. The Mission will work with the DEES to develop and track indicators over the LOP for use in the final evaluation. In view of declining A.I.D. resources and the capabilities of the Salvadoran private sector, the final evaluation will provide recommendations for remaining actions on the part of the GOES, FUSADES or other donors to stimulate export and investment.

The Mission will do the contracting for the evaluations, collaborating with FUSADES, FIDEX, and the GOES on the terms of reference for the evaluations of their respective programs of activities.

As mentioned in Section IV, there will be annual audits of the Project, contracted by the implementing entities, using a Scope of Work provided by the Regional Inspector General. The Project budget includes \$140,000 for audits to be performed by local affiliates of U.S. CPA firms that have been prequalified by the RIG using GAO standards; audits will be supervised by A.I.D.

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**INDUSTRIAL STABILIZATION AND RECOVERY**

**PROJECT NO. 519-0287**

**PROJECT PAPER SUPPLEMENT NO. 2**

**ANNEXES**

- A. Logical Framework**
- B. Statutory Checklist**
- C. Grantees' Request for Additional Assistance**
- D. Environmental Threshold Decision**
- E. 611 (e) Certification**
- F. Technical Analysis**
  - 1. FIDEX**
  - 2. PRIDEX**
  - 3. DEES**
- G. Economic Analysis**
- H Financial Analysis**
- I. Institutional Analysis**
- J. Procurement Waiver**

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Industrial Stabilization and Recovery  
Project No. 519-0287  
1991 PP Supplement

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p><u>Goal</u></p> <p>To accelerate economic growth and diversify the economy to attain higher levels of economic well being.</p>	<p>1. Increased contributions to real GDP growth by non-traditional sectors.</p>	<p>1. Macroeconomic data and statistics.</p>	<p>1. The GOES is committed to maintaining an appropriate policy environment for export development.</p> <p>2. The political, economic and social situation of El Salvador will not deteriorate further in the near term, and will improve over the long-term.</p>
<p><u>Purpose</u></p> <p>To stimulate growth in the non-traditional export sectors of El Salvador, resulting in increased levels of employment, income, investment, and foreign exchange earnings.</p>	<p><u>EOPS</u></p> <p>1. Increased non-traditional exports to non-CACM markets.</p> <p>2. Increased employment in export-oriented, non-traditional sectors.</p>	<p>1. FUSADES, GOES and Department of Commerce data.</p> <p>2. FUSADES and GOES data.</p>	<p>1. a. Domestic investment, complemented by foreign investment, will play a key role in the development and expansion of labor intensive export enterprises.</p> <p>1. b. CBI and other incentives are attractive for stimulating growth in labor intensive, light industrial and drawback production.</p>

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NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<u>Outputs</u>	<p>3. FUSADES will be self-sufficient fulfilling a major objective of the Project, enabling FUSADES to continue to contribute significantly to the economic development process in El Salvador without additional financial support by A.I.D. FUSADES will be able to support core programs in non-traditional agricultural diversification and development; export and investment development and promotion; economic studies and policy dialogue; small and microenterprise assistance and credit; and related activities without additional donor support.</p>	<p>3. FUSADES and A.I.D. records.</p>	
	<p>1. An additional estimated 23,500 jobs (LOP total of 40,000) will be generated for skilled and unskilled workers of export enterprises assisted by the Project.</p>	<p>1. PRIDEX and FIDEX records, Project reports, evaluations.</p>	

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
	2. An additional estimated \$110 million (LOP total of \$155 million) of new direct investment will be generated in export enterprises assisted by the Project's PRIDEX and Investment Fund activities.	2. Project records, reports and evaluations.	
	3. An estimated \$94 million (LOP total of \$139 million) in net foreign exchange earnings will be generated by export enterprises assisted by the Project's PRIDEX and Investment Fund activities.	3. Project records, reports and evaluations.	

INPUTS (\$)

1. A.I.D. Grant (This PP SUPPL)

-Technical Assistance	3,284,400
-Seminars and Conferences	350,300
-Communications/Dissemination	1,014,200
-Travel/Training	838,400
-Supplies and Equipment	1,177,900
-Personnel	3,424,500
-Promotion Offices Abroad	1,920,700
-Investment Fund - Credit	6,500,000
-Overhead	1,172,693
-A.I.D. Project Management	309,000
-Audits and Evaluations	340,000
-Contingencies	<u>667,707</u>
-Total Additional AID Obligation	21,000,000

1. A.I.D. records, Fund reports, and annual independent audited Statements.

1. A.I.D. records.

1. Incremental A.I.D. funds will be available in FYs 91, 92, and 93.

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATORS	MEANS OF VERIFICATION	IMPORTANT ASSUMPTIONS
<p><b>2. FUSADES Counterpart</b>            -FIDEX borrower contributions 4,125,000            -PRIDEX beneficiary contributions 1,970,000            -DEES beneficiary contributions 60,000            -FUSADES capitalization of FIDEX, S.A. 625,000            -In-kind (volunteer time of Commission and Board) 435,000  <u>TOTAL ADDITIONAL FUSADES COUNTERPART</u> 7,215,000</p>		<p>2. FUSADES records, audited annual statements.</p>	<p>2. FUSADES will continue to mobilize cost sharing from beneficiaries of its programs.</p>
<p><b>3. GOES Counterpart</b>            - HCLOC 1,250,000</p>		<p>3. GOES and A.I.D. records.</p>	<p>3. Host country owned local currency will be available in FY 91, 92 and 93.</p>
<p><b>TOTAL FOR THIS PP SUPPL</b> 29,465,000</p>			

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5C(2) - PROJECT CHECKLIST

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

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

A. GENERAL CRITERIA FOR PROJECT

- 1. FY 1990 Appropriations Act Sec. 523; FAA Sec. 634A. If money is to be obligated for an activity not previously justified to Congress, or for an amount in excess of amount previously justified to Congress, has Congress been properly notified? YES.
- 2. FAA Sec. 611(a). Prior to an obligation in excess of \$500,000, will there be: (a) engineering, financial or other plans necessary to carry out the assistance; and (b) a reasonably firm estimate of the cost to the U.S. of the assistance? NO.
- 3. FAA Sec. 611(a)(2). If legislative action is required within recipient country with respect to an obligation in excess of \$500,000, what is the basis for a reasonable expectation that such action will be completed in time to permit orderly accomplishment of the purpose of the assistance? N/A

4. FAA Sec. 611(b); FY 1990 Appropriations Act Sec. 501. If project is for water or water-related land resource construction, have benefits and costs been computed to the extent practicable in accordance with the principles, standards, and procedures established pursuant to the Water Resources Planning Act (42 U.S.C. 1962, et seq.)? (See A.I.D. Handbook 3 for guidelines.) N/A
  
5. FAA Sec. 611(e). If project is capital assistance (e.g., construction), and total U.S. assistance for it will exceed \$1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability to maintain and utilize the project effectively? N/A
  
6. FAA Sec. 209. Is project susceptible to execution as part of regional or multilateral project? If so, why is project not so executed? Information and conclusion whether assistance will encourage regional development programs. N/A
  
7. FAA Sec. 601(a). Information and conclusions on whether projects will encourage efforts of the country to:  
(a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions. The Project is designed to:  
(a) increase exports;  
(b) foment private sector growth; and (c) improve the efficiency of the industrial export sector.
  
8. FAA Sec. 601(b). Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise). One objective of the project is to promote non-traditional exports and investment through policy support, technical assistance, technology transfer and provision of training services for private sector entities. Trade and investment promotion services will be provided to the private sector via linkages with U.S. private enterprise.

9. FAA Secs. 612(b), 636(h). Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized in lieu of dollars. The Project will primarily fund foreign exchange cost Requirements for local currency will be met through host country counterpart.
10. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release? NO.
11. FY 1990 Appropriations Act Sec. 521. If assistance is for the production of any commodity for export, is the commodity likely to be in surplus on world markets at the time the resulting productive capacity becomes operative, and is such assistance likely to cause substantial injury to U.S. producers of the same, similar or competing commodity? NO.
12. FY 1990 Appropriations Act Sec. 547. Will the assistance (except for programs in Caribbean Basin Initiative countries under U.S. Tariff Schedule "Section 807," which allows reduced tariffs on articles assembled abroad from U.S.-made components) be used directly to procure feasibility studies, prefeasibility studies, or project profiles of potential investment in, or to assist the establishment of facilities specifically designed for, the manufacture for export to the United States or to third country markets in direct competition with U.S. exports, of textiles, apparel, footwear, handbags, flat goods (such as wallets or coin purses worn on the person), work gloves or leather wearing apparel?
13. FAA Sec. 119(g)(4)-(6) & (10). Will the assistance: (a) support training and education efforts which improve the capacity of recipient countries to prevent loss of biological diversity; (b) be provided under a long-term agreement in which the recipient country agrees to protect ecosystems or other N/A

wildlife habitats; (c) support efforts to identify and survey ecosystems in recipient countries worthy of protection; or (d) by any direct or indirect means significantly degrade national parks or similar protected areas or introduce exotic plants or animals into such areas?

14. FAA Sec. 121(d). If a Sahel project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (either dollars or local currency generated therefrom)? N/A
15. FY 1990 Appropriations Act, Title II, under heading "Agency for International Development." If assistance is to be made to a United States PVO (other than a cooperative development organization), does it obtain at least 20 percent of its total annual funding for international activities from sources other than the United States Government? N/A
16. FY 1990 Appropriations Act Sec. 537. If assistance is being made available to a PVO, has that organization provided upon timely request any document, file, or record necessary to the auditing requirements of A.I.D., and is the PVO registered with A.I.D.? YES.
17. FY 1990 Appropriations Act Sec. 514. If funds are being obligated under an appropriation account to which they were not appropriated, has the President consulted with and provided a written justification to the House and Senate Appropriations Committees and has such obligation been subject to regular notification procedures? N/A

18. State Authorization Sec. 139 (as interpreted by conference report). Has confirmation of the date of signing of the project agreement, including the amount involved, been cabled to State L/T and A.I.D. LEG within 60 days of the agreement's entry into force with respect to the United States, and has the full text of the agreement been pouched to those same offices? (See Handbook 3, Appendix 6G for agreements covered by this provision). N/A
19. Trade Act Sec. 5164 (as interpreted by conference report), amending Metric Conversion Act of 1975 Sec. 2. Does the project use the metric system of measurement in its procurements, grants, and other business-related activities, except to the extent that such use is impractical or is likely to cause significant inefficiencies or loss of markets to United States firms? Are bulk purchases usually to be made in metric, and are components, subassemblies, and semi-fabricated materials to be specified in metric units when economically available and technically adequate? NO.
20. FY 1990 Appropriations Act, Title II, under heading "Women in Development." Will assistance be designed so that the percentage of women participants will be demonstrably increased? Yes, and the increased participation of women in Project activities and as direct Project beneficiaries will be documented in Project status reports.
21. FY 1990 Appropriations Act Sec. 592(a). If assistance is furnished to a foreign government under arrangements which result in the generation of local currencies, has A.I.D. (a) required that local currencies be deposited in a separate account established by the recipient government, (b) entered into an agreement with that government providing the amount of local currencies to be generated and the terms and conditions under which the currencies so deposited may be utilized, and (c) established by agreement the responsibilities of A.I.D. and that government to monitor and account for deposits into and disbursements from the separate account? N/A

Will such local currencies, or an equivalent amount of local currencies, be used only to carry out the purposes of the DA or ESF chapters of the FAA (depending on which chapter is the source of the assistance) or for the administrative requirements of the United States Government?

N/A

Has A.I.D. taken all appropriate steps to ensure that the equivalent of local currencies disbursed from the separate account are used for the agreed purposes?

N/A

If assistance is terminated to a country, will any unencumbered balances of funds remaining in a separate account be disposed of for purposes agreed to by the recipient government and the United States Government?

N/A

**B. FUNDING CRITERIA FOR PROJECT**

**1. Development Assistance Project Criteria**

a. FY 1990 Appropriations Act Sec. 546 (as interpreted by conference report for original enactment). If assistance is for agricultural development activities (specifically, any testing or breeding feasibility study, variety improvement or introduction, consultancy, publication, conference, or training), are such activities: (1) specifically and principally designed to increase agricultural exports by the host country to a country other than the United States, where the export would lead to direct competition in that third country with exports of a similar commodity grown or produced in the United States, and can the activities reasonably be expected to cause substantial injury to U.S. exporters of a similar agricultural commodity; or (2) in support of research that is intended primarily to benefit U.S. producers?

N/A

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

YES.

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

The Project takes into account the special needs and attributes of El Salvador and relies on Salvadorans for its implementation.

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d. FAA Sec. 101(a). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

Yes. This is the goal of the Project.

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

Over the remaining IOP, the Project is expected to generate approximately 23,000 new jobs. Many of the jobs created by Project activities will be occupied by women in drawback industries. The jobs will require training for semi-skilled and skilled labor resulting in a better trained and subsequently higher paid labor force earning salaries which will provide for a better quality of life for the workers.

f. FAA Secs. 103, 103A, 104, 105, 106, 120-21; FY 1990 Appropriations Act, Title II, under heading "Sub-Saharan Africa, DA." Does the project fit the criteria for the source of funds (functional account) being used?

N/A

g. FY 1990 Appropriations Act, Title II, under heading "Sub-Saharan Africa, DA." Have local currencies generated by the sale of imports or foreign exchange by the government of a country in Sub-Saharan Africa from funds appropriated under Sub-Saharan Africa, DA been deposited in a special account established by that government, and are these local currencies available only for

N/A

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use, in accordance with an agreement with the United States, for development activities which are consistent with the policy directions of Section 102 of the FAA and for necessary administrative requirements of the U. S. Government?

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

Yes, to the extent possible the Project will increase capacity of the industrial sector to export non-traditional products. The Project supports small scale export firms, especially in artisa and agriculture activities.

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

YES.

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

Yes, the highest percentage of beneficiaries are those lower income workers who will gain from better, higher paying jobs. The institutional capabilities of the private implementing organization will be improv to continue to provide trai ing and other services need

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

The Project takes into account the special needs and attributes of El Salvador and relies on Salvadoran implementation.

l. FY 1990 Appropriations Act, under heading "Population, DA," and Sec. 535. Are any of the funds to be used for the performance of abortions as a method of family planning or to motivate or coerce any person to practice abortions?

NO.

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- Are any of the funds to be used to pay for the performance of involuntary sterilization as a method of family planning or to coerce or provide any financial incentive to any person to undergo sterilizations? NO.
- Are any of the funds to be made available to any organization or program which, as determined by the President, supports or participates in the management of a program of coercive abortion or involuntary sterilization? NO.
- Will funds be made available only to voluntary family planning projects which offer, either directly or through referral to, or information about access to, a broad range of family planning methods and services? NO.
- In awarding grants for natural family planning, will any applicant be discriminated against because of such applicant's religious or conscientious commitment to offer only natural family planning? N/A
- Are any of the funds to be used to pay for any biomedical research which relates, in whole or in part, to methods of, or the performance of, abortions or involuntary sterilization as a means of family planning? NO.
- m. FAA Sec. 601(e). Will the project utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? YES.
- n. FY 1990 Appropriations Act Sec. 579. What portion of the funds will be available only for activities of economically and socially disadvantaged enterprises, historically black colleges and universities, colleges and universities having a student body in which more than 40 percent of the students are Hispanic Americans, and

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private and voluntary organizations which are controlled by individuals who are black Americans, Hispanic Americans, or Native Americans, or who are economically or socially disadvantaged (including women)?

o. FAA Sec. 118(c). Does the assistance comply with the environmental procedures set forth in A.I.D. Regulation 16? Does the assistance place a high priority on conservation and sustainable management of tropical forests? Specifically, does the assistance, to the fullest extent feasible: (1) stress the importance of conserving and sustainably managing forest resources; (2) support activities which offer employment and income alternatives to those who otherwise would cause destruction and loss of forests, and help countries identify and implement alternatives to colonizing forested areas; (3) support training programs, educational efforts, and the establishment or strengthening of institutions to improve forest management; (4) help end destructive slash-and-burn agriculture by supporting stable and productive farming practices; (5) help conserve forests which have not yet been degraded by helping to increase production on lands already cleared or degraded; (6) conserve forested watersheds and rehabilitate those which have been deforested; (7) support training, research, and other actions which lead to sustainable and more environmentally sound practices for timber harvesting, removal, and processing; (8) support research to expand knowledge of tropical forests and identify alternatives which will prevent forest destruction, loss, or degradation; (9) conserve biological diversity in forest areas by supporting efforts to identify, establish, and maintain a representative network of protected tropical forest ecosystems on a worldwide basis, by making the establishment of protected areas a

yes.

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condition of support for activities involving forest clearance or degradation, and by helping to identify tropical forest ecosystems and species in need of protection and establish and maintain appropriate protected areas; (10) seek to increase the awareness of U.S. Government agencies and other donors of the immediate and long-term value of tropical forests; and (11) utilize the resources and abilities of all relevant U.S. government agencies?

p. FAA Sec. 118(c)(13). If the assistance will support a program or project significantly affecting tropical forests (including projects involving the planting of exotic plant species), will the program or project: (1) be based upon careful analysis of the alternatives available to achieve the best sustainable use of the land, and (2) take full account of the environmental impacts of the proposed activities on biological diversity?

N/A

q. FAA Sec. 118(c)(14). Will assistance be used for: (1) the procurement or use of logging equipment, unless an environmental assessment indicates that all timber harvesting operations involved will be conducted in an environmentally sound manner and that the proposed activity will produce positive economic benefits and sustainable forest management systems; or (2) actions which will significantly degrade national parks or similar protected areas which contain tropical forests, or introduce exotic plants or animals into such areas?

NO.

r. FAA Sec. 118(c)(15). Will assistance be used for: (1) activities which would result in the conversion of forest lands to the rearing of livestock; (2) the construction, upgrading, or maintenance of roads (including temporary haul roads for logging or other extractive industries) which pass through relatively undergraded forest lands; (3) the

NO

colonization of forest lands; or (4) the construction of dams or other water control structures which flood relatively undergraded forest lands, unless with respect to each such activity an environmental assessment indicates that the activity will contribute significantly and directly to improving the livelihood of the rural poor and will be conducted in an environmentally sound manner which supports sustainable development?

s. FY 1990 Appropriations Act Sec. 534(a). If assistance relates to tropical forests, will project assist countries in developing a systematic analysis of the appropriate use of their total tropical forest resources, with the goal of developing a national program for sustainable forestry?

N/A

t. FY 1990 Appropriations Act Sec. 534(b). If assistance relates to energy, will such assistance focus on improved energy efficiency, increased use of renewable energy resources, and national energy plans (such as least-cost energy plans) which include investment in end-use efficiency and renewable energy resources?

N/A

Describe and give conclusions as to how such assistance will: (1) increase the energy expertise of A.I.D. staff, (2) help to develop analyses of energy-sector actions to minimize emissions of greenhouse gases at least cost, (3) develop energy-sector plans that employ end-use analysis and other techniques to identify cost-effective actions to minimize reliance on fossil fuels, (4) help to analyze fully environmental impacts (including impact on global warming), (5) improve efficiency in production, transmission, distribution, and use of energy, (6) assist in exploiting nonconventional renewable energy resources, including wind, solar, small-hydro, geo-thermal, and advanced

N/A

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biomass systems, (7) expand efforts to meet the energy needs of the rural poor, (8) encourage host countries to sponsor meetings with United States energy efficiency experts to discuss the use of least-cost planning techniques, (9) help to develop a cadre of United States experts capable of providing technical assistance to developing countries on energy issues, and (10) strengthen cooperation on energy issues with the Department of Energy, EPA, World Bank, and Development Assistance Committee of the OECD.

u. FY 1990 Appropriations Act, Title II, under heading "Sub-Saharan Africa, DA" (as interpreted by conference report upon original enactment). If assistance will come from the Sub-Saharan Africa DA account, is it: (1) to be used to help the poor majority in Sub-Saharan Africa through a process of long-term development and economic growth that is equitable, participatory, environmentally sustainable, and self-reliant; (2) being provided in accordance with the policies contained in section 102 of the FAA; (3) being provided, when consistent with the objectives of such assistance, through African, United States and other PVOs that have demonstrated effectiveness in the promotion of local grassroots activities on behalf of long-term development in Sub-Saharan Africa; (4) being used to help overcome shorter-term constraints to long-term development, to promote reform of sectoral economic policies, to support the critical sector priorities of agricultural production and natural resources, health, voluntary family planning services, education, and income generating opportunities, to bring about appropriate sectoral restructuring of the Sub-Saharan African economies, to support reform in public administration and finances and to establish a favorable environment for individual enterprise and self-sustaining development, and to take

N/A

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into account, in assisted policy reforms, the need to protect vulnerable groups; (5) being used to increase agricultural production in ways that protect and restore the natural resource base, especially food production, to maintain and improve basic transportation and communication networks, to maintain and restore the renewable natural resource base in ways that increase agricultural production, to improve health conditions with special emphasis on meeting the health needs of mothers and children, including the establishment of self-sustaining primary health care systems that give priority to preventive care, to provide increased access to voluntary family planning services, to improve basic literacy and mathematics especially to those outside the formal educational system and to improve primary education, and to develop income-generating opportunities for the unemployed and underemployed in urban and rural areas?

v. International Development Act Sec.

711. FAA Sec. 463. If project will finance a debt-for-nature exchange, describe how the exchange will support protection of: (1) the world's oceans and atmosphere, (2) animal and plant species, and (3) parks and reserves; or describe how the exchange will promote: (4) natural resource management, (5) local conservation programs, (6) conservation training programs, (7) public commitment to conservation, (8) land and ecosystem management, and (9) regenerative approaches in farming, forestry, fishing, and watershed management.

N/A

w. FY 1990 Appropriations Act Sec. 515.

If deob/reob authority is sought to be exercised in the provision of DA assistance, are the funds being obligated for the same general purpose, and for countries within the same region as originally obligated, and have the House and Senate Appropriations Committees been properly notified?

N/A

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2. Development Assistance Project Criteria  
(Loans Only)

N/A

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

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

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

3. Economic Support Fund Project Criteria

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

Yes, The purpose of the Project is to reinforce and build on the economic and political gains of the latter part of the decade of the 80's.

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

NO.

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

N/A

5C(3) - STANDARD ITEM CHECKLIST

Listed below are the statutory items which normally will be covered routinely in those provisions of an assistance agreement dealing with its implementation, or covered in the agreement by imposing limits on certain uses of funds.

These items are arranged under the general headings of (A) Procurement, (B) Construction, and (C) Other Restrictions.

A. PROCUREMENT

1. FAA Sec. 602(a). Are there arrangements to permit U.S. small business to participate equitably in the furnishing of commodities and services financed? YES.
2. FAA Sec. 604(a). Will all procurement be from the U.S. except as otherwise determined by the President or determined under delegation from him? YES
3. FAA Sec. 604(d). If the cooperating country discriminates against marine insurance companies authorized to do business in the U.S., will commodities be insured in the United States against marine risk with such a company? N/A
4. FAA Sec. 604(e). If non-U.S. procurement of agricultural commodity or product thereof is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity? (Exception where commodity financed could not reasonably be procured in U.S.) N/A

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5. FAA Sec. 604(g). Will construction or engineering services be procured from firms of advanced developing countries which are otherwise eligible under Code 941 and which have attained a competitive capability in international markets in one of these areas? (Exception for those countries which receive direct economic assistance under the FAA and permit United States firms to compete for construction or engineering services financed from assistance programs of these countries.) N/A
6. FAA Sec. 603. Is the shipping excluded from compliance with the requirement in section 901(b) of the Merchant Marine Act of 1936, as amended, that at least 50 percent of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed shall be transported on privately owned U.S. flag commercial vessels to the extent such vessels are available at fair and reasonable rates? NO. No Commodity purchases are contemplated under the Project.
7. FAA Sec. 621(a). If technical assistance is financed, will such assistance be furnished by private enterprise on a contract basis to the fullest extent practicable? Will the facilities and resources of other Federal agencies be utilized, when they are particularly suitable, not competitive with private enterprise, and made available without undue interference with domestic programs? Yes, all technical assistance under the Project is expected to be through the private sector.
8. International Air Transportation Fair Competitive Practices Act, 1974. If air transportation of persons or property is financed on grant basis, will U.S. carriers be used to the extent such service is available? YES.
9. FY 1990 Appropriations Act Sec. 504. If the U.S. Government is a party to a contract for procurement, does the contract contain a provision authorizing termination of such contract for the convenience of the United States? YES.

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10. FY 1990 Appropriations Act Sec. 524. If assistance is for consulting service through procurement contract pursuant to 5 U.S.C. 3109, are contract expenditures a matter of public record and available for public inspection (unless otherwise provided by law or Executive order)? N/A
11. Trade Act Sec. 5164 (as interpreted by conference report), amending Metric Conversion Act of 1975 Sec. 2. Does the project use the metric system of measurement in its procurements, grants, and other business-related activities, except to the extent that such use is impractical or is likely to cause significant inefficiencies or loss of markets to United States firms? Are bulk purchases usually to be made in metric, and are components, subassemblies, and semi-fabricated materials to be specified in metric units when economically available and technically adequate? NO.
12. FAA Secs. 612(b), 636(h); FY 1990 Appropriations Act Secs. 507, 509. Describe steps taken to assure that, to the maximum extent possible, foreign currencies owned by the U.S. are utilized in lieu of dollars to meet the cost of contractual and other services. No foreign currencies of the host government are owned by the United States.
13. FAA Sec. 612(d). Does the U.S. own excess foreign currency of the country and, if so, what arrangements have been made for its release? NO.
14. FAA Sec. 601(e). Will the assistance utilize competitive selection procedures for the awarding of contracts, except where applicable procurement rules allow otherwise? YES

B. CONSTRUCTION

1. FAA Sec. 601(d). If capital (e.g., construction) project, will U.S. engineering and professional services be used? N/A
2. FAA Sec. 611(c). If contracts for construction are to be financed, will they be let on a competitive basis to maximum extent practicable? N/A
3. FAA Sec. 620(k). If for construction of productive enterprise, will aggregate value of assistance to be furnished by the U.S. not exceed \$100 million (except for productive enterprises in Egypt that were described in the CP), or does assistance have the express approval of Congress? N/A

C. OTHER RESTRICTIONS

1. FAA Sec. 122(b). If development loan repayable in dollars, is interest rate at least 2 percent per annum during a grace period which is not to exceed ten years, and at least 3 percent per annum thereafter? N/A
2. FAA Sec. 301(d). If fund is established solely by U.S. contributions and administered by an international organization, does Comptroller General have audit rights? N/A
3. FAA Sec. 620(h). Do arrangements exist to insure that United States foreign aid is not used in a manner which, contrary to the best interests of the United States, promotes or assists the foreign aid projects or activities of the Communist-bloc countries? YES.

4. Will arrangements preclude use of financing:

- a. FAA Sec. 104(f); FY 1990 Appropriations Act under heading "Population, DA." and Secs. 525, 535. YES.  
(1) To pay for performance of abortions as a method of family planning or to motivate or coerce persons to practice abortions; (2) to pay for performance of involuntary sterilization as method of family planning, or to coerce or provide financial incentive to any person to undergo sterilization; (3) to pay for any biomedical research which relates, in whole or part, to methods or the performance of abortions or involuntary sterilizations as a means of family planning; or (4) to lobby for abortion?
- b. FAA Sec. 483. To make reimbursements, in the form of cash payments, to persons whose illicit drug crops are eradicated? YES.
- c. FAA Sec. 620(g). To compensate owners for expropriated or nationalized property, except to compensate foreign nationals in accordance with a land reform program certified by the President? YES.
- d. FAA Sec. 660. To provide training, advice, or any financial support for police, prisons, or other law enforcement forces, except for narcotics programs? YES.
- e. FAA Sec. 662. For CIA activities? YES.
- f. FAA Sec. 636(i). For purchase, sale, long-term lease, exchange or guaranty of the sale of motor vehicles manufactured outside U.S., unless a waiver is obtained? YES.
- g. FY 1990 Appropriations Act Sec. 503. To pay pensions, annuities, retirement pay, or adjusted service compensation for prior or current military personnel? YES.
- h. FY 1990 Appropriations Act Sec. 505. To pay U.N. assessments, arrearages or dues? YES.

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- i. FY 1990 Appropriations Act Sec. 506. YES.  
To carry out provisions of FAA section 209(d) (transfer of FAA funds to multilateral organizations for lending)?
- j. FY 1990 Appropriations Act Sec. 510. YES.  
To finance the export of nuclear equipment, fuel, or technology?
- k. FY 1990 Appropriations Act Sec. 511. YES.  
For the purpose of aiding the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights?
- l. FY 1990 Appropriations Act Sec. 516; State Authorization Sec. 109. YES.  
To be used for publicity or propaganda purposes designed to support or defeat legislation pending before Congress, to influence in any way the outcome of a political election in the United States, or for any publicity or propaganda purposes not authorized by Congress?
5. FY 1990 Appropriations Act Sec. 574. YES.  
Will any A.I.D. contract and solicitation, and subcontract entered into under such contract, include a clause requiring that U.S. marine insurance companies have a fair opportunity to bid for marine insurance when such insurance is necessary or appropriate?
6. FY 1990 Appropriations Act Sec. 582. NO.  
Will any assistance be provided to any foreign government (including any instrumentality or agency thereof), foreign person, or United States person in exchange for that foreign government or person undertaking any action which is, if carried out by the United States Government, a United States official or employee, expressly prohibited by a provision of United States law?

FUSAL

EDUARDO NÚÑEZ I.  
DIRECTOR EJECUTIVO

San Salvador,  
7 de febrero de 1991.-

Señor  
Henry H. Bassford  
Director  
USAID / El Salvador  
Presente.-

REF.: DPD-017/RM-LB/91

Estimado Señor Bassford:

Como es de su conocimiento, desde hace ya algunos meses hemos venido trabajando con representantes de esa Agencia para preparar una ampliación y extensión al Convenio No. 519-0287, que incluye a nuestros Programas PRIDEX, FIDEX, DEES, Legislación y Administración, y el cual está proyectado para concluir el 31 de marzo próximo.

Consideramos que la labor realizada durante los últimos seis años ha sido de mucho beneficio para nuestro país. A pesar de haber contado hasta 1989 con un clima de negocios totalmente adverso y muchos otros factores negativos, FUSADES, a través del Convenio 519-0287, ha logrado generar más de 16,200 nuevos empleos permanentes, más de \$72,000,000 en nuevas exportaciones no-tradicionales, y casi \$24,000,000 en inversiones. Asimismo, hemos influido positivamente en la adopción de políticas y medidas gubernamentales, conducentes al desarrollo económico y social de nuestro país.

Sin embargo, todavía queda mucho por hacer. Empezamos a ver indicios de un despegue en el desarrollo de las exportaciones no-tradicionales, así como un verdadero interés de parte de los inversionistas extranjeros que ahora ven en El Salvador una alternativa atractiva para sus proyectos. Por lo anterior, consideramos de vital importancia el poder impulsar más agresivamente nuestra labor de promoción y apoyo, y de esa manera capitalizar los mayores beneficios posibles para El Salvador.

Después de revisar minuciosamente el desarrollo del Proyecto, y tomando en cuenta las recomendaciones de consultores expertos en los diferentes campos, hemos logrado redefinir las estrategias, actividades y alcance de los diferentes componentes que se incluyen en dicho Convenio, habiendo preparado planes provisionales de trabajo para los próximos años.

DFD-017/RM-LB/91  
Sr. Henry H. Bassford  
Página No. 2

En base al trabajo realizado, queremos por este medio solicitarle, de la manera más atenta, que se extienda el período del Convenio hasta el 31 de diciembre de 1994, y que se aumenten los fondos asignados al mismo por la cantidad de \$21,000,000 los cuales serán utilizados por los diferentes Departamentos de nuestra Fundación, de acuerdo al detalle que se anexa.

Vale la pena mencionar que, del total de fondos solicitados, \$14,500,000 serán destinados a cubrir los gastos de operación de los diferentes Programas y los \$6,500,000 restantes serán asignados al Fondo de Inversión para ser utilizados en créditos en el área de Maquila. Esta asignación corresponde prácticamente a una devolución de los recursos del Fondo de Inversión que fueron reprogramados en años anteriores para cubrir gastos de operación de los diferentes Programas financiados por el Convenio, y que ahora, debido al incremento considerable en la demanda de créditos de inversión, son considerados vitales para el éxito de nuestro programa en general.

Estamos seguros que contaremos con su respaldo para continuar y aumentar la importante labor que, en beneficio de nuestro país, estamos desarrollando a través de los diferentes componentes de este Convenio, y aprovechamos para recordarle que estamos a su disposición para cualquier información adicional o aclaración que ustedes puedan necesitar.

Muy cordialmente,



Eduardo Núñez I.  
Director Ejecutivo

ENI/lb\*

Anexos.

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CONVENIO #519-0287

SOLICITUD DE FONDOS ADICIONALES PARA EL PERIODO 1/4/91 - 31/12/94

(Cifras en Dólares)

	<u>TOTAL</u>
■ Asistencia Técnica	4,340,000
■ Seminarios y Conferencias	365,000
■ Gastos de Viajes	900,000
■ Publicidad-Publicaciones-Promoción	570,000
■ Adquisición Mobiliario y Equipo	245,000
■ Sueldos y Prestaciones	4,425,000
■ Servicios-Alquileres-Suministros	1,805,000
■ Fondo de Crédito Rotativo	6,500,000
■ Oficinas Exterior	1,850,000
<b>T O T A L</b>	<hr/> 21,000,000

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MINISTERIO DE PLANIFICACION  
Y COORDINACION DEL DESARROLLO  
ECONOMICO Y SOCIAL

S.E. No. 12/91.

San Salvador, 10. de Febrero de 1991.

ASUNTO: Convenio de Donación Proyecto  
No. 519-0287 "Estabilización  
y Recuperación Industrial"

Señor  
Henry H. Bassford  
Director Agencia para  
el Desarrollo Internacional  
AID  
Presente

Estimado señor Bassford:

Nos referimos al Convenio de Donación y sus enmiendas suscritas entre el Gobierno de El Salvador (GOES) y esa Agencia, el 24 de septiembre de 1984, para el Proyecto No. 519-0287, cuya fecha de vencimiento es el 31 de marzo de 1991.

Al respecto, como representante oficial del GOES ante esa Agencia, me permito solicitar una extensión de dicha fecha de vencimiento por un período de tres años y medio, hasta el 30 de septiembre de 1994, a fin de continuar utilizando la asistencia financiera que esa Misión ha brindado al Gobierno de El Salvador a través del Proyecto en referencia en apoyo de nuestros esfuerzos para promover el crecimiento económico del país a través del aumento y diversificación de las exportaciones.

Esta solicitud está basada en el éxito obtenido recientemente en la formulación de una Estrategia Nacional para el Desarrollo de las Exportaciones con la participación activa de representantes tanto del sector privado como del sector público, así como en el apoyo expresado por el Presidente de la República al proceso seguido y a los acuerdos alcanzados durante el mismo.

Así la extensión de la fecha de vencimiento del proyecto tendrá como propósito específico el llevar a ejecución los acuerdos alcanzados entre el sector privado y el sector público durante la formulación de la Estrategia Nacional para el Desarrollo de las Exportaciones, en lo referente a las metas, las actividades específicas y el mecanismo para el seguimiento de la Estrategia: Comisión Nacional para las Exportaciones (CONAEXI).

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MINISTERIO DE PLANIFICACION  
Y COORDINACION DEL DESARROLLO  
ECONOMICO Y SOCIAL

S.E. No. 12/91.

Con la confianza de obtener una respuesta positiva a nuestra solicitud dado el decidido apoyo que esa Agencia nos ha brindado en el pasado, me suscribo de usted muy atentamente.



  
MIRNA LIEVANO DE MARQUEZ  
MINISTRO

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## ANNEX D: ENVIRONMENTAL THRESHOLD DECISION

<u>Project Location</u>	:	El Salvador
<u>Project Title</u>	:	Industrial Stabilization and Recovery Project: Project Paper Supplement No. 2
<u>Project Number</u>	:	519-0287
<u>Funding</u>	:	\$50,450,000
<u>Life of Project</u>	:	10 years
<u>IEE Prepared by</u>	:	Maureen S. Dugan, PRJ USAID/El Salvador
<u>Recommended Threshold Decision</u>	:	Categorical Exclusion
<u>Bureau Threshold Decision</u>	:	Negative Determination
Comments	:	Negative Determination subject to condition being placed in appropriate documents that any funds, including local currency, associated with this project are not used to finance: (1) the purchase, use, or importation of pesticides; or (2) any activity that would result in any significant loss of tropical forests, or involve industrial timber extraction in primary tropical forest areas.
Copy to	:	Henry H. Bassford, Director USAID/El Salvador
Copy to	:	Deborah K. Kennedy, PRJ USAID/El Salvador
Copy to	:	Thomas McKee, DPP USAID/El Salvador
Copy to	:	Kenneth Ellis, RDO USAID/El Salvador

Copy to : Mark Silverman  
LAC/DR/CEN

Copy to : IEE File

James S. Hester Date FEB - 7 1991

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

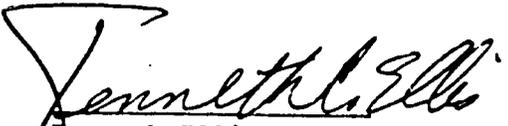
INDUSTRIAL STABILIZATION AND RECOVERY  
PROJECT NO. 519-0287  
PROJECT PAPER SUPPLEMENT NO. 2

CATEGORICAL EXCLUSION OF INITIAL ENVIRONMENTAL EXAMINATION

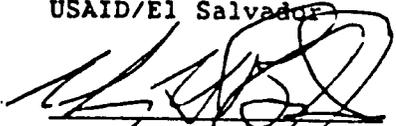
This Project Paper Supplement provides an additional \$21.0 million in A.I.D. funds and a PACD extension of approximately four years, bringing the ten year Project to a total of \$50.46 million in A.I.D. funds.

The goal of the Project is to accelerate economic growth and to diversify the economy to attain higher levels of economic well being. The Project purpose is to stimulate growth in the non-traditional export sectors of El Salvador, resulting in increased levels of income, investment, and foreign exchange earnings. The project finances technical assistance, training, research, institutional support, and credit to support achievement of the goal and purpose. The principal input in terms of financing is credit.

As provided in Handbook 3, Appendix 2D, under 22 CFR Part 16, entitled Environmental Procedures, the Project qualifies for a negative determination subject to condition being placed in appropriate documents that any funds, including local currency, associated with this project are not used to finance: (1) the purchase, use, or importation of pesticides; or (2) any activity that would result in any significant loss of tropical forests, or involve industrial timber extraction in primary tropical forest areas.



Kenneth Ellis  
Rural Development Officer  
USAID/El Salvador



Henry H. Bassford  
Director  
USAID/El Salvador

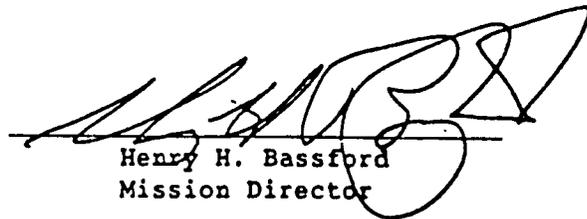


ANNEX B

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

Certification

I, Henry H. Bassford, Principal Officer of the Agency for International Development in El Salvador, having taken into account, among other things, the maintenance and utilization of projects in El Salvador previously financed or assisted by the United States, do hereby certify pursuant to Section 611(e) of the Foreign Assistance Act of 1961, as amended, that in my judgment the implementing entities have the financial capability and the human resources capability to effectively implement, utilize and maintain the Industrial Stabilization and Recovery Project No. 519-0287 Grant.



Henry H. Bassford  
Mission Director

Date 03/22/91

TECHNICAL ANALYSIS  
ANNEX F.1: FIDEX

I. Introduction

The primary conclusion of the technical analysis carried out by the consultants who reviewed FIDEX' operations was that FIDEX should be restructured as a private development finance institution, with FUSADES retaining a minority equity position after an initial transition period. This alternative requires that FIDEX formally apply for a license to operate as a private financial institution under Salvadoran law, and at the same time requires that FIDEX begin working on a transition plan in order to make a successful transformation to a private development finance institution.

Analysis of Salvadoran law and discussions with monetary authorities (the President of the Central Reserve Bank and Secretary of the Monetary Board) led to the development of the proposed structure for FIDEX, S.A.

Essentially all financial institutions involved in lending activities on a continual basis are subject to supervision and regulation by the monetary authorities (Central Reserve Bank, and the Superintendencia del Sistema Financiero) as provided in the "Ley de Instituciones de Credito y Organizaciones Auxiliares" (LICOA) and other banking law.

The current law, LICOA, while structured to regulate the nationalized banking system, does in theory permit private institutions. The LICOA is currently being revised to accommodate the privatization of the existing state banks. Consequently, there is some uncertainty about how the new law may impact upon FIDEX, S. A. operations in the future. (This uncertainty is one of the principal reasons for waiting to bring the Trust onshore.) Nevertheless, the BCR President has assured FIDEX and A.I.D. that the new law will not be restrictive, but rather will provide FIDEX, S.A. with even greater flexibility than the current LICOA. In the meantime, the existing law will permit the operation of a diversified development finance institution.

With respect to the distribution of shares, the BCR does not want FUSADES to offer shares to the general public until 1992, or one year after the start-up of the institution. This is because it does not want FIDEX, S.A. to initially compete for finite resources with the privatization of the nationalized banks scheduled to take place in 1991-1992. This time frame for divestiture is acceptable, although it does lengthen the capitalization period and delays broader participation.

With respect to financial products and services, the only restriction that the Central Bank may place on FIDEX, S.A. may be to limit the institution to receiving deposits with a maturity of over one year. The institution will be able to manage its lending portfolio freely and to access other sources of funding, including BCR rediscount credit lines, private sector resources in the form of term deposits or other financial instruments, and funding from other donors. A.I.D. and FUSADES continue to press the Central Reserve Bank

to, in the revisions to LICOA, permit the new institution to issue certificates of deposit with a maturity of less than one year. However, such deposits are not contemplated under the category in which the current law permits institutions such as FIDEX, S.A. to be chartered. Under the present law, the sale of certificates of deposit of less than one year maturity would require charter as a commercial banking institution, which the Central Reserve Bank is not prepared to do for FIDEX, S.A. at the present time.

Projections of demand over anything other than the immediate term are always tricky. Nevertheless, the demand for credit by export oriented firms was estimated as part of the National Export Strategy process. From 1990-1994, working capital requirements were expected to reach \$400 million above current levels, and the demand for long term financing for fixed assets was estimated at over \$500 million. It is important to note that this is \$500 million above and beyond what is estimated to be available from the banking system, which provides very little term lending. After excluding coffee and projects oriented towards the CACM, working capital demand is estimated to be over \$100 million, while long-term credit demand is estimated at some \$280 million. FIDEX S.A. will begin operations with a total portfolio of approximately \$35 million, of which more than \$21 million has already been disbursed. Capitalization of 20 million colones (\$2.5 million) will enable the institution to lend up to an additional 250 million colones (\$31 million). At the present time, there is no credit being provided by other sources, although the IDB does have a \$60 million loan for productive credit in the works. This loan, though, would be available for onlending for productive investment in agriculture and industry, including traditional and non-traditional activities. The GOES projects only modest increases in the supply of credit for the private sector over the LOP. Even with a privatized banking system, credit supply will fall far short of demand -- at least during the LOP of this Project. Since colón loans are scarce, there is considerable demand for long-term credit from FIDEX .

### III. Capitalization of the Bank and Initial Funding

FUSADES plans to capitalize FIDEX, S.A. with 5 million colones in paid-in capital of an authorized 20 million colones. An additional 5 million colones will be offered to international institutions, with the remaining 10 million colones to be offered to FUSADES employees and members, and the general public, with limitations on the amount of participation. FIDEX, S.A. will be authorized to lend up to twelve and one-half times its paid-in capital, the source of funding being locally mobilized savings, rediscount facilities of the Central Reserve Bank, and loans from offshore. FIDEX S.A. will bear the risk on these funds and earn appropriate interest spreads.

At the time of conversion to a private development institution in 1991, FUSADES is expected to have a total of \$35 million available for lending in the form of A.I.D. grant funds, of which approximately two-thirds will already be lent out to private sector entities. All of this amount will be managed by FIDEX S.A. under the terms and conditions of the existing A.I.D. Project Agreements with FUSADES. FUSADES will bear the risk of repayment. FIDEX S.A. will be paid fees commensurate with its services in promotion, loan analysis and approval, lending, collection, accounting and other financial services. The offshore Trust will be maintained temporarily until A.I.D. and FUSADES,

based upon annual reviews, determine that conditions exist in El Salvador to warrant moving the funds onshore. In that event, FIDEX S.A. would likely, but not necessarily, become the Trustee.

For FIDEX, S.A., this means that the institution begins operations with a conservative debt to equity ratio and a loan management portfolio which generates a sufficient interest income to cover its administrative and operating expenses. Few banks are able to begin operations in this enviable position, which makes it profitable from the first day of operation. This should make the offering of stock to the public very attractive. The arrangement is attractive for FUSADES as well, because it leverages its equity in both developmental and financial terms.

#### IV. Investor Interest in FIDEX

The various institutional alternatives for the restructuring of FIDEX summarized in Section VI were discussed with representatives of the public and private sectors. Opinions regarding the potential for private investment in a FIDEX development bank were consistently positive. In interviews with prominent Salvadoran businessmen the issue of private investment was discussed specifically. The following points characterize the interviewees' responses:

- o The Salvadoran business community can be expected to show strong interest in investing in FIDEX, S.A. as long as strong potential for profitability can be demonstrated.
- o It is not necessary for FIDEX, S.A. to be profitable in the short-term. Investors would primarily be family groups investing for the long-term. They are also comfortable with higher risk investments as long as the gains are commensurate with the risk.
- o If limits are placed on individual shareholding (e.g. 7.5% of the total), it is likely that private investment will tend to be small. Investors would prefer to limit their participation to 3% if no possibility exists for a controlling interest. It is likely, therefore, that FIDEX, S.A. would be owned by as many as 35 investors (rather than by 14 which would be implied by an average purchase of 7.5% of stock).
- o Access to financing beyond that which is currently provided by A.I.D. would enhance the potential for private investment. Such additional financing is recognized by potential investors as crucial to FIDEX long-term profitability. Particular interest was expressed in "more flexible resources" if they were available for financing a broader range of productive activities.

#### V. FIDEX, S.A./FUSADES Relationship

Close coordination between FUSADES and FIDEX, S.A. will be essential to the efficient operations of both organizations. FIDEX' investment and export promotion efforts will be well served by efficient and responsive FIDEX S.A. financing. FIDEX, S.A. can expect FIDEX to be an important resource for project identification and technical assistance for potential borrowers.

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DIVAGRO (FUSADES' Agricultural Diversification program) should continue to be the primary mechanism for developing and assisting agroindustrial projects. As with the current situation, FIDEX, S.A. should continue to utilize the DIVAGRO and PRIDEX programs to identify potential borrowers, perform feasibility analyses, and provide technical assistance to clients in support of FIDEX S.A. portfolio management. It is envisioned that these services would be provided on a fee basis. A fee structure and related contractual arrangements should be negotiated, through which FIDEX S.A. and/or its clients would pay both DIVAGRO and PRIDEX for services as appropriate.

Ongoing financial relationships between FUSADES and FIDEX, S.A. will exist as a function of the loan management agreement(s) between the two organizations and FUSADES' equity holdings in FIDEX, S.A.

#### VI. FIDEX Services and Operational Scope

FIDEX, S.A. will function primarily as a development lender in full compliance with A.I.D. Project Agreements. The improvements which have been demonstrated to date in FIDEX development lending can be expected to continue, since the initial staffing of FIDEX will transfer to the new institution. It is also anticipated that the private ownership of FIDEX, S.A. will result in improved clarity of institutional mission and corresponding improvements in service delivery efficiency.

Following an initial period of consolidation it can be expected that the owners and managers of FIDEX, S.A. will consider expanding its scope of services beyond development lending. Several advantages could result from such an expansion, including greater financial health and balance as risk is reduced with diversification. Initial activity scope and related financial projections are limited to development lending.

As described in the following financial projections, FIDEX, S.A. is expected to develop loan portfolios totaling approximately \$50 million in dollar and local currency lending during its first five years. In addition to the A.I.D.-provided initial resources of \$35 million, FIDEX, S.A. is expected to mobilize savings, utilize BCR credit lines, and draw resources from other international organizations. All of the lending activity with these resources is assumed to be development oriented, in compliance with the conditions associated with the funding sources.

Maximum flexibility should be permitted regarding the terms of lending for non A.I.D. resources. Interviews with current and potential borrowers indicate that loan packages including both long and short-term lending are most effective in meeting financing requirements. (This Project only permits working capital loans in conjunction with capital investment.) In addition to better addressing the needs of borrowers, thereby enhancing their viability, such flexibility with non-A.I.D. resources will allow FIDEX S.A. to balance its loan portfolio without compromising development impact. Flexibility should also be encouraged regarding currency mix. Many of the FIDEX, S.A. borrowers will be well served by access to both local currency and dollar financing, as appropriate.

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Many current FIDEX borrowers have indicated that A.I.D.'s conditions include insufficient grace periods. FIDEX, S.A. may need to be more flexible with non-A.I.D. resources to maximize the viability of its client projects.

FIDEX' collateral policies, which are not regulated by A.I.D., are often characterized as excessive. Review of the current loan portfolio indicates that FIDEX policy with regard to guarantees has become somewhat more liberal, depending more on cash flow considerations that will ensure that repayment obligations are met. This liberalization is a result of more experience on the part of FIDEX management. In sum, flexibility with the non-A.I.D. resources that FIDEX, S.A. succeeds in attracting will complement the A.I.D. Project funds and help make FIDEX, S.A. a dynamic, responsive institution. Ultimately, the viability of FIDEX S.A. as a private development finance institution, from the marketability of FIDEX S.A. stock to its ongoing profitability, will depend upon its ability to be creative, responsive, and balanced with respect to operational caution and development objectives.

#### VII. Organizational Structure

In the transition stage, FIDEX, S.A.'s staff will have to be increased to take over the accounting and documentation functions now being performed by the Banco Hipotecario under the Water Management Project, No. 519-0303 and the Agribusiness Development Project, No. 519-0327. The Banco Hipotecario's monitoring function will also have to be absorbed by FIDEX S.A. As the FIDEX, S.A. loan portfolio expands in the future, there could be a need for additional account officers and support staff. The attached organizational chart shows the FIDEX, S.A. organization as it will appear through the first few years of operations.

#### VIII. Transition Plan

If FIDEX is to be transformed, a detailed plan will be necessary to ensure an efficient transition to a development bank. The following plan is presented for illustrative purposes. The time frame reflects the Mission's desire to aid FIDEX to become a development finance institution within the shortest time frame that the legal framework and GOES policy will permit:

##### Phase One (first quarter 1991)

- Technical Assistance for and Initiation of measures related to the transition
- Application to the Central Reserve Bank for a license to operate
- Legal analysis
- Establish coordination FIDEX/FUSADES

##### Phase Two (second/third quarters 1991)

- FIDEX S.A. legally approved
- FUSADES invests 25 million, 25% of FIDEX, S.A.'s authorized capital.
- Contractual relationship established between FIDEX, S.A. and FUSADES (DIVAGRO & PRIDEX)
- FUSADES/FIDEX, S.A. fund management and control agreements signed
- Offer 25.0 million in stock to international institutions

Phase Four (upon the successful completion of Phase Three)

- Public offer of remaining stock, limiting the shares available to any one investor group to avoid a concentration in ownership
- FUSADES may reduce its equity position in FIDEX by selling its stock to the public

IX. Financial Analysis

As can be seen in the Profit and Loss Statement and Year End Balance Sheet, FIDEX, S.A. shows a modest profit in 1991, as it initiates operations with a substantial loan management portfolio in place. The loan portfolio is expected to grow conservatively from \$26 million to approximately \$50 million by 1996. The financial statements demonstrate that even under modest growth and conservative income and expense assumptions, FIDEX, S.A. is financially viable. Estimated to have a debt to equity ratio of 7.5 to 1 and a return on equity of about 24% in 1996, FIDEX, S.A. should be able to attract investors to complete the initial capitalization by FUSADES, and FUSADES should be able to sell its shares at a reasonable profit should it choose to do so.

F I D E X, S.A.  
LOAN PORTFOLIO PROJECTIONS  
(in U.S.\$)

	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Year 4</u>	<u>Year 5</u>
<b>I. <u>FUSADES FUNDS:</u></b>					
- Local Currency (1)	9,536,125	10,762,588	12,156,613	12,910,438	13,056,650
- Foreign Currency (2)	15,898,100	16,726,900	17,108,000	16,785,400	16,802,600
<b>II. <u>FIDEX, S.A. PORTFOLIO:</u></b>					
<b>A. <u>FIDEX FUNDS:</u></b>					
- Local Currency (3)	375,000	1,000,000	1,728,688	2,096,588	2,338,063
<b>B. <u>OTHER FUNDS:</u></b>					
- Local Currency (4)	375,000	1,625,000	2,862,213	4,007,100	5,038,350
- Foreign Currency (5)	0	0	4,000,000	8,583,300	12,395,800
<b><u>TOTAL FIDEX PORTFOLIO (6)</u></b>					
- Local Currency	750,000	2,625,000	4,590,900	6,103,688	7,376,413
- Foreign Currency	0	0	4,000,000	8,583,300	12,395,800
<b><u>TOTAL PORTFOLIO (I + II):</u></b>					
- Local Currency	10,286,125	13,387,588	16,747,514	19,014,126	20,433,063
- Foreign Currency	15,898,100	16,726,900	21,108,000	21,358,700	29,198,400

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Notes:

- a) FUSADES resources are assumed to total \$19,000,000 for foreign currency loans (\$15,000,000 from the industrial line and \$4,000,000 from the Agribusiness line), and £111,500,000 for local currency loans (£63,500,000 from the Water Management line, and £48,000,000 from the Agribusiness line).
- b) FIDEX, S.A. resources include £20,000,000 as paid in capital, available for local currency loans beginning in Year 1. Initially, FUSADES will participate with 25% equity position (£5,000,000).
- c) The average term for foreign currency loans will be seven years with a one year grace period (only interest payments over the grace period). For local currency loans, the average term will be a 13 years, with a two year grace period.

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## F I D E X S.A.

## PROFIT AND LOSS STATEMENT

	<u>YEAR 1</u>	<u>YEAR 2</u>	<u>YEAR 3</u>	<u>YEAR 4</u>	<u>YEAR 5</u>	<u>YEAR 6</u>
<b>INCOME</b>						
a) Loan Interest:						
- FUSADES Local Currency	1,804,263	2,031,350	2,294,750	2,510,125	2,599,913	3,530,000
- FUSADES Foreign Currency	1,672,100	1,800,700	1,867,400	1,871,300	1,854,900	1,860,000
- FIDEX Local Currency	41,250	151,250	300,738	421,763	488,988	52,000
- Other Local Currency	20,625	220,000	494,413	757,575	996,950	1,210,000
- Other Foreign Currency	0	0	240,000	761,300	1,266,600	1,670,000
Subtotal	<u>3,538,238</u>	<u>4,203,300</u>	<u>5,197,300</u>	<u>6,322,063</u>	<u>7,207,350</u>	<u>7,880,000</u>
b) Commissions:						
- Foreign Currency Loans	32,000	32,000	75,000	86,000	98,000	100,000
- Local Currency Loans	20,000	33,750	38,125	30,625	26,250	20,000
Subtotal	<u>52,000</u>	<u>65,750</u>	<u>113,125</u>	<u>116,625</u>	<u>124,250</u>	<u>120,000</u>
c) Other Investments	338,838	360,213	291,150	253,913	254,400	210,000
<b>GROSS INCOME</b>	<b>3,929,075</b>	<b>4,629,263</b>	<b>5,601,575</b>	<b>6,692,600</b>	<b>7,586,000</b>	<b>8,210,000</b>
<b>EXPENSE:</b>						
a) Interest Paid:						
- FUSADES Local Currency	1,673,238	1,877,250	2,122,513	2,339,225	2,446,525	2,450,000
- FUSADES Foreign Currency	1,575,100	1,696,100	1,769,400	1,777,300	1,766,400	1,770,000
- Other Local Currency	15,938	170,000	382,050	585,400	770,375	93,000
- Other Foreign Currency	0	0	180,000	570,900	949,900	1,250,000
Subtotal	<u>3,264,275</u>	<u>3,743,350</u>	<u>4,453,963</u>	<u>5,272,825</u>	<u>5,933,200</u>	<u>6,420,000</u>
b) Loan Reserve	7,500	26,250	85,913	146,838	197,763	230,000
c) Administration:						
- Staff	0	235,000	260,000	287,500	310,000	340,000
- Rent and Service	0	55,000	60,000	65,000	75,000	80,000
- Furniture and Equipment	0	30,000	30,000	30,000	30,000	30,000
- Other	50,000	20,000	25,000	30,000	35,000	40,000
Subtotal	<u>50,000</u>	<u>340,000</u>	<u>375,000</u>	<u>412,500</u>	<u>450,000</u>	<u>500,000</u>
<b>TOTAL EXPENSE</b>	<b>3,321,775</b>	<b>4,109,600</b>	<b>4,914,875</b>	<b>5,832,163</b>	<b>6,580,963</b>	<b>7,150,000</b>
<b>NET INCOME BEFORE TAX</b>	<b>607,300</b>	<b>519,663</b>	<b>686,700</b>	<b>860,438</b>	<b>1,005,038</b>	<b>1,060,000</b>
<b>TAX (30%)</b>	<b>182,190</b>	<b>155,899</b>	<b>206,010</b>	<b>258,131</b>	<b>301,511</b>	<b>318,000</b>
<b>NET INCOME BEFORE LEGAL RESERVE</b>	<b>425,110</b>	<b>363,764</b>	<b>480,690</b>	<b>602,306</b>	<b>703,526</b>	<b>742,000</b>
<b>LEGAL RESERVE (10%)</b>	<b>42,511</b>	<b>36,376</b>	<b>48,069</b>	<b>60,231</b>	<b>70,353</b>	<b>74,200</b>
<b>NET INCOME</b>	<b>382,599</b>	<b>327,387</b>	<b>432,621</b>	<b>542,076</b>	<b>633,174</b>	<b>668,000</b>

Notes on Profit and Loss Projections:

- a) Year No. 1 refers to calendar year 1992.
- b) All figures in the loan portfolio projections represent year end balances. Interest paid and earned by FIDEX is calculated on averages outstanding during the year.
- c) Throughout this analysis, the exchange rate used is 28.00/ US\$1.00.

INCOME ASSUMPTIONS:

- Project Loans funded from FUSADES resources reflect local currency interest rates of 20% and foreign currency rates of 11%. Since the risk of these loans remains with FUSADES, FIDEX, S.A. receives a spread of only 2% in local currency loans, and 1% for foreign currency loans.
- Project loans from FIDEX, S.A. resources reflect colon rates of 22%.
- Other colon loans refer to BCR lines which currently allow a 5% spread. Lending rates for loans funded by the BCR is projected at 22%.
- Other foreign currency loans assume that international donor agencies will provide loan funds at a rate of 9% to be relent at 12% (3% spread).
- Other investments refer to the placement of FIDEX, S.A. paid-in capital and FUSADES funds (from principal reflows) in fixed deposits at 18% for local currency, and 8% for foreign currency.
- Commission reflects a one time charge to project clients of 1%.

EXPENSE ASSUMPTIONS:

- Interest Paid:
  - To FUSADES: local currency loans at 18%, dollar loans at 10%.
  - To Other Lenders:
    - \* BCR lines are assumed to be available to FIDEX beginning in 1991. Interest paid for these funds is at 17% (5% spread for FIDEX, S.A.).
    - \* Beginning in year three, additional US dollar funds are assumed to be available from international donor agencies. Interest paid on these funds is calculated at 9% (with 3% spread for FIDEX, S.A.).
- Loss Reserve:
  - Calculated and expensed incrementally to a total of 1% of loan portfolio (does not include loans with FUSADES resources, which are only administered by FIDEX S.A.).
- Administration Expenses:
  - \* It is assumed that A.I.D. will cover the administrative expenses of FIDEX for the first of operation.
  - \* Staff expense as well as Rent and Services expenses increase approximately 10% annually.
  - \* Furniture and equipment for new premises is projected at a total cost of \$180,000.
  - \* Other expenses include advertising, security, travel, seminars, etc.

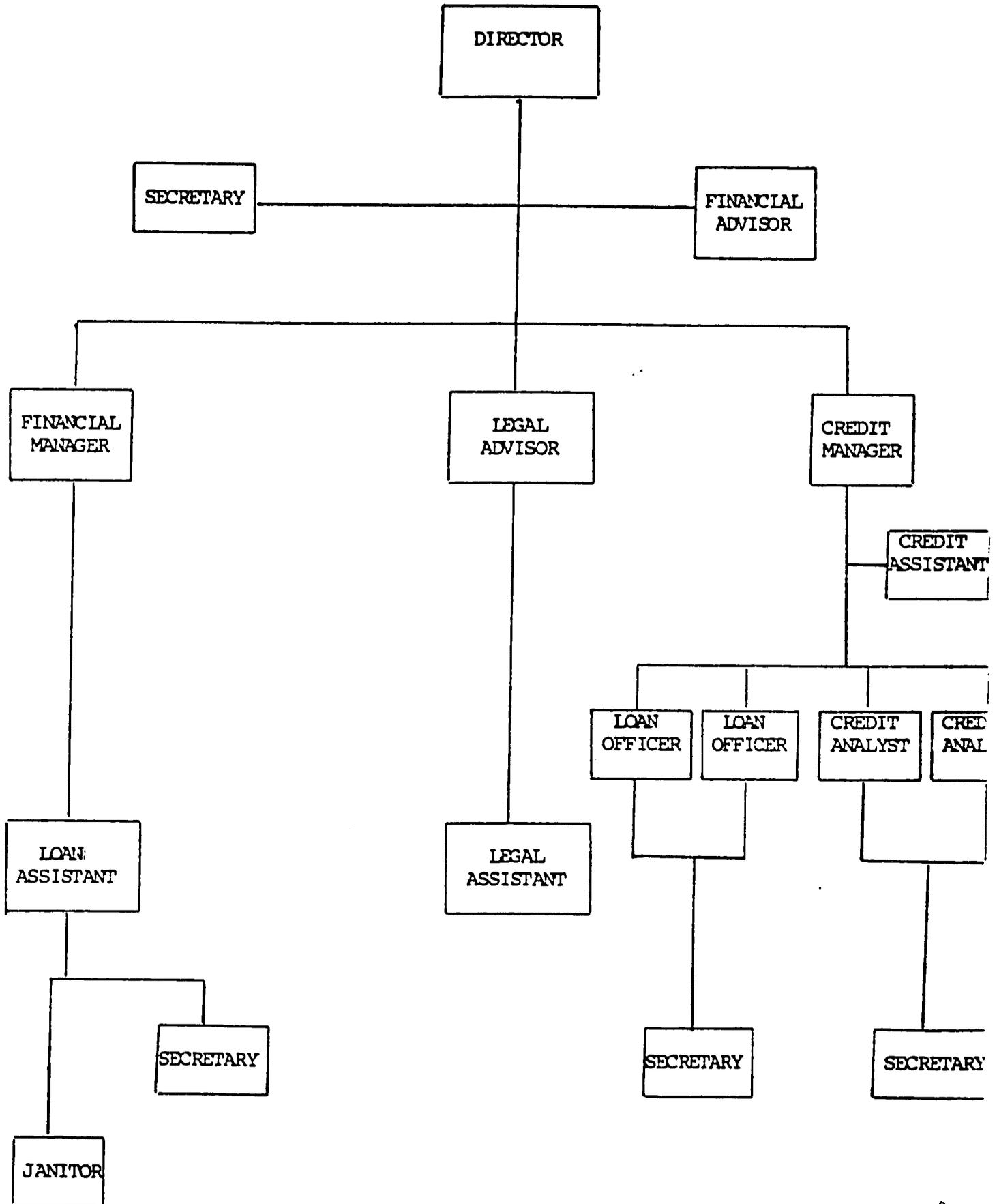
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**F I D E X S.A.**  
**YEAR END BALANCE SHEET**  
**(in US\$)**

	<u>YEAR 1</u>	<u>YEAR 2</u>	<u>YEAR 3</u>	<u>YEAR 4</u>	<u>YEAR 5</u>	<u>YEAR</u>
<b>ASSETS:</b>						
<b>Current Assets:</b>						
Cash and Banks	2,167,511	1,599,187	918,557	610,899	439,764	45
<b>Investments:</b>						
Local Currency Loans	750,000	2,625,000	4,590,913	6,103,698	7,376,425	8,36
Foreign Currency Loans	0	0	4,000	8,583,300	12,395,800	15,37
<b>TOTAL ASSETS</b>	<b>2,917,511</b>	<b>4,224,187</b>	<b>9,509,469</b>	<b>15,297,887</b>	<b>20,211,989</b>	<b>24,18</b>
<b>LIABILITIES</b>						
<b>Long Term Debt:</b>						
BCR	375,000	1,625,000	2,862,213	4,007,100	5,038,350	5,95
Other	0	0	4,000,000	8,583,300	12,395,800	15,37
<b>TOTAL LIABILITIES</b>	<b>375,000</b>	<b>1,625,000</b>	<b>6,862,213</b>	<b>12,590,400</b>	<b>17,434,150</b>	<b>21,33</b>
<b>STOCKHOLDERS EQUITY</b>						
Paid-in Capital	2,500,000	2,500,000	2,500,000	2,500,000	2,500,000	2,50
Legal Reserve	42,511	99,187	147,256	207,487	277,839	35
Retained Earnings	0	0	0	0	0	0
<b>TOTAL EQUITY</b>	<b>2,542,511</b>	<b>2,599,187</b>	<b>2,647,256</b>	<b>2,707,487</b>	<b>2,777,839</b>	<b>2,85</b>
<b>TOTAL LIABILITIES &amp; EQUITY</b>	<b>2,917,511</b>	<b>4,224,187</b>	<b>9,509,469</b>	<b>15,297,887</b>	<b>20,211,989</b>	<b>24,18</b>

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FIDEX, S. A.  
ORGANIZATIONAL CHART



**TECHNICAL ANALYSIS  
ANNEX F.2: PRIDEX**

**I. EVOLUTION AND PERFORMANCE OF PRIDEX**

**A. Background**

The Project Paper for the Industrial Stabilization and Recovery Project prepared in September, 1984, specified the creation of a trade and promotion services (TIPS), within FUSADES, to provide "technical assistance at the enterprise level to specific export projects..." TIPS was designed to "link Salvadoran firms interested in exports to necessary information, technical assistance and possible foreign partners," and to emphasize licensing, production sharing, subcontracting and technical assistance relationships. It was expected that TIPS would generate a 5% annual increase in non-traditional exports (about \$1.5 million in net foreign exchange earnings), \$2.8 million in investment and about 500 direct jobs.

The 1986 Project Paper Amendment indicated the need to accelerate the promotion of light manufacturing and assembly industry. This was to be accomplished with an extension and expansion of the trade and promotion service, now known as PRIDEX, and the creation of an investment fund. PRIDEX was expected to focus its efforts on apparel/textiles, electronics, medical supplies and light manufacturing/industrial handicrafts. Through its linkage with the Investment Fund, PRIDEX was expected to create 14,000 jobs, \$45 million in foreign exchange and \$25 million in investment from 1984-1989.

By learning from experience and adjusting to changing circumstances in El Salvador, PRIDEX has evolved through two phases and is now entering a third.

The first phase (known as the Trade and Promotion Service- TIPS) was based on the initial project design, and lasted until August 1987. The primary thrust in this phase involved the promotion of direct U.S. investment, with heavy reliance on an outside contractor to carry out studies of opportunities and promote follow-up. The contractor was also responsible for institutional development in El Salvador and the operation of a U.S. office. Support for export development by local firms was given secondary priority.

However, the political situation (including both government policies and the war) was too negative for the promotion of direct foreign investment. Results (jobs, investment and foreign exchange) were perceived to be disappointing, especially when contrasted with the costs.

The second phase can be characterized by a primary focus on promoting exports from existing companies, with much less emphasis on promoting direct foreign investment. Furthermore, the second phase was designed to stress institutional development and upgrading of the PRIDEX staff to reduce dependence on outside contractors. This phase, which is still largely in place, has involved the following elements:

- o Sector studies to analyze export market potential, the country's overall competitiveness, and the export prospects/limitations of specific firms. These studies have been used to select twelve

"priority" sectors (initially there were more) and identify firms with export potential. Firms are placed into four categories: 1) idea stage; 2) has product; 3) has export capacity; and 4) exports and seeks to expand.

- o Orientation, education and information services, especially for firms in categories 1 and 2. These have involved seminars, partial subsidization of travel to trade fairs, visits by PRIDEX staff and assistance in preparing export business plans (to help companies reach category 3).
- o Intensive planning, marketing and production services for companies in category 3. This assistance primarily involves technical assistance (provided by outside contractors) and marketing assistance and travel (involving outside contractors and subsidized travel). Clients pay for 35% of the technical assistance and 50% of the travel.
- o Facilitation of export expansion for companies already exporting (category 4). This usually involves subsidized travel (50%) to assist in exploring new markets and marketing assistance (65% covered by PRIDEX).
- o An office in Miami with one promoter, aimed at promoting U.S. company interest in contract production, direct investment or joint ventures in El Salvador.
- o Promotion of private free zones, as one of the implementing institutions for the Free Zone Project, No. 519-0323. This mainly involved financing feasibility studies and seminars.
- o A different approach to the use of outside contractors. While one firm had the full responsibility for the PRIDEX program during the first phase, a Salvadoran Director has since been responsible for overall management and institutional development. A range of different, and specialized contractors have been utilized for various tasks as required by PRIDEX management. In 1989, these contractors absorbed about 53% of the \$3.2 million budget.

B. Results

As specified in the Project Paper, results have been measured in terms of jobs, foreign exchange and investment. The results to date, as reported by PRIDEX, are summarized below:

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>Total</u>
Jobs	1,281	587	1,466	3,221	4,200	5,478	16,233
Foreign Exchange (\$000)	2,241	3,354	5,024	12,734	19,355	29,185	72,056
Investment (\$000)	401	560	937	3,834	7,930	9,971	23,633

PRIDEX' results, however, must be viewed in light of the following observations:

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- o The results are tabulated on the basis of a questionnaire sent out to client companies. Companies are asked to indicate their export related performance for the period, and to specify the percentage of these results they would attribute to PRIDEX. Thus, if PRIDEX helps pay for some marketing travel, the company would determine what percentage of the resulting sales could be attributed to this assistance. Although this methodology is not very reliable, it is particularly difficult to measure results in situations where PRIDEX is only partially responsible for exports and investment.
- o Of the 85 companies listed as clients in 1989, 18 accounted for about 80% of the the results. In terms of jobs, 8 companies accounted for 80% of the results. There does not seem to be any comparable data to indicate the cost and level of effort associated with the assistance given to these successful companies.
- o Almost all the results are derived from assistance to existing companies (including foreign firms), with very little attributable to direct foreign investment. (However, some sizeable U.S. companies such as Perry Manufacturing, Val D'Or, and S&C Apparel have decided to invest in 1990).
- o It takes several years of assistance for a firm to show any significant results (and some are never successful). This helps explain the concentration of results in a few firms. However, these firms continue to report results even after the PRIDEX assistance is no longer critical. The question is how long results should be reported for PRIDEX to "recoup" its "investment."
- o Two sectors, apparel and handicrafts, represent 71% of the jobs and 40% of the foreign exchange generated over the five years. Since one of the intentions in the project design was to focus on priority sectors, this raises the question of why so many sectors were tackled.
- o The investment per job of \$1,270 (only \$312 in 1985) is extraordinarily low. Assuming the numbers are accurate, they indicate that firms have been generally utilizing excess capacity. Over time, the investment requirements per job have increased and will continue to do so.

Despite these concerns, from the perspective of the initial project design, PRIDEX has generally met the established targets. The caveats listed above were not contemplated in either the project design, but are apparent in hindsight. Their relevance is primarily as factors to consider in further adjusting PRIDEX' strategy and targets, as discussed below.

## II THE EMERGING PRIDEX STRATEGY AND ITS ORGANIZATIONAL IMPLICATIONS

### A. Rationale for a Modified Strategy

A review of PRIDEX' strategy conducted in late 1989 recommended a greater emphasis on investment promotion, both foreign and local. The rationale includes the following factors:

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- o The magnitude of the number of new jobs (about 40,000 entrants into the labor force annually) and the increased level of exports required per the National Export Strategy (a \$1 billion increase over 5 years) indicates the need for significant levels of new investment in export oriented production.
- o As indicated above, the previous PRIDEX strategy emphasized exports from existing productive capacity. Since existing excess capacity is limited, the results (and the targets established in the Project design) were modest in relation to the overall macroeconomic needs.
- o The political environment has changed considerably since the initial design of the Project. Government policies and attitudes are much more supportive of local and foreign investment, and of exports. The local business community appears ready to invest, and recent developments suggest a greater interest by U.S. companies than had previously been assumed.
- o In helping existing companies export, the critical constraint has been the need for extensive technical and marketing assistance in El Salvador just to get their management and products ready to export. However, in promoting new investment, the critical constraint is convincing foreign firms to consider direct investment, contract production arrangements or joint ventures. The latter two provide access to markets for local entrepreneurs, thus making it possible for them to invest.

The implication is that until now, meeting the needs of PRIDEX' clients has meant committing the bulk of its budget and resources to activities in El Salvador. With a heavier emphasis on investment promotion, a greater share must be devoted to the external promotion capability.

#### B. The PRIDEX Strategy for 1990-1994

PRIDEX' main objective is to maximize its impact on jobs and foreign exchange earnings by promoting local and foreign investment in export firms. This will involve the following strategic thrusts, in order of priority:

1. Aggressive external promotion, primarily in the U.S., to generate direct investment, production contracts and joint ventures. The external promotion capability must largely be developed.
2. Developments of local export capacity by providing technical and marketing assistance, and with a particular emphasis on those industries and firms that can become attractive contractors and joint venture partners for the foreign firms identified by the external promoters. This strategic thrust involves a refinement of current PRIDEX initiatives.
3. Initiatives to address major barriers to new investment and exports, such as the lack of industrial space, by sponsoring studies, advocating appropriate measures, coordinating with other institutions, etc. This involves a refinement of current initiatives.

1. External Promotion

PRIDEX will strengthen its external promotion capability with the objective of actively targeting foreign companies most likely to be interested in El Salvador. The initial focus will be on companies likely to engage in assembly (maquila) operations, either through direct investments (including joint ventures) or contract production. The industry focus will largely be apparel, but could also include electronic/electrical assembly and other labor intensive assembly activities. This emphasis on assembly industries, and particularly apparel, is consistent with an assessment of El Salvador's strengths and weaknesses in the context of key location criteria used by foreign investors. The following considerations support this conclusion:

- o An abundant supply of relatively low cost, productive labor is the most important resource that the country offers, making assembly industries a likely focus.
- o The perception of political risk created by the war implies that foreign companies will not want to make large investments in fixed assets. Contract production implies almost no risk of this type, while even direct investment in most assembly industries involves only limited exposure (especially when industrial space is rented).
- o Not only are there few natural resources to develop, but the political risks associated with agriculture suggest that most interest will be in industry.
- o El Salvador has established a relatively good image in textiles and apparel (where the country has long been known as a reliable supplier in the trade), and in electronics (due to the positive experiences of AVX and Texas Instruments).
- o El Salvador's current contract producers have a good image abroad for reliability (the top consideration among buyers) and value (the second most important consideration). This reputation, including the ability to meet delivery schedules during a time of war, will help attract further contracts and direct investment.
- o The National Export Strategy defined "maquila" as the top priority for development, primarily because it would generate by far the most jobs (as well as the greatest increase in foreign exchange). Furthermore, PRIDEX has been assigned the task (by the GOES and the private sector) of external investment promotion.
- o Although PRIDEX has not recently emphasized investment promotion, the results of the Miami office's efforts confirm that apparel and some related assembly industry is by far the most promising area. Almost all U.S. firms showing a recent interest in direct investments in El Salvador have been in the apparel area.

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In terms of geographic focus, the external promotion will be concentrated in the U.S., at least over the remaining LOP of this Project. A combination of factors make the U.S. the logical choice, including: the 807 (now 9802) and 807a programs, the greater tendency of U.S. firms to contract out assembly activities, and geographic location. Within the U.S., the regions with the greatest concentration of relevant firms are likely to be the Northeast and Southeast.

The methodology presently being introduced to PRIDEX is based on the successful Costa Rican model (more recently also successfully implemented by Honduras). The key features of this approach include:

- o A proactive, direct and systematic sales effort involving direct contact with targeted U.S. firms to convince them to explore opportunities in El Salvador. This aggressive marketing and sales effort is to be carried out by promoters located in U.S. offices.
- o Strong local support to assist the overseas promoters and coordinate investor site visits. The first function involves providing the overseas promoters with the timely information required to convince target companies to schedule a site visit to El Salvador. These site visits must be carefully scheduled and managed, with the local promoter attending to the investor from the moment they arrive until they leave, to ensure the most positive impression possible.
- o Active and well coordinated follow-up by overseas and local promoters. The overseas promoter must clear up remaining doubts or concerns (with information provided by the local promoter) and schedule further visits if required (which is usually the case). Each overseas promoter generally teams up with one local promoter.
- o A disciplined, results-oriented approach in which everyone in the organization is clearly focused on activities that produce the largest returns in terms of jobs and exports. This discipline is enforced with the setting of targets for each promotion team, as well as for the organization as a whole. These targets are closely monitored with a management information system that tracks progress by "lead", promoter and industry, and also provides summary management reports. Performance rewards are also important.
- o Periodic adjustments of strategy and tactics, based on results as indicated by the management information system. For example, if it becomes apparent that a target industry or one of the promoters is not generating the expected results, the reasons should be immediately analyzed and remedial action taken as needed.
- o A data base with fact sheets that provide the information most likely to be required by foreign investors. These must be periodically updated and expanded.

PRIDEX is presently introducing this strategy and methodology. A manual providing a detailed description and guide for implementation has been

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developed. Some of the local promoters, together with the database, are also in place. External promoters are being recruited. The selling skills of these individuals will be critical to the success of the overall strategy. Training support for the promoters is being arranged.

## 2. Export Development

The principal objective of the export development thrust will be to assist in the restructuring of Salvadoran firms with high potential to enable them to market successfully their production capability. The principal changes from the current PRIDEX approach to export development are:

- o The current approach implicitly emphasizes helping companies market their products in the U.S. Thus, the services emphasize marketing assistance (largely provided through a U.S. contractor), subsidized travel to facilitate market exposure, etc. The refinement of this strategy involves helping companies re-orient their production and management capabilities to allow them to obtain successfully production contracts or interest U.S. firms in joint ventures.
- o The modified approach involves more careful screening of clients, emphasizing those willing to make structural changes (including setting up separate production lines, reducing overhead, improving productivity and quality standards, improving financial controls, etc.) introduce improved technologies, and expand to meet foreign buyer volume requirements.
- o PRIDEX has reduced the number of priority sectors from 12 to 6. The selected sectors are complementary with the focus of the external promotion thrust, so that they are mutually reinforcing.
- o Since the cost per firm of providing technical and management assistance can be high, the number of clients that PRIDEX can work with will have to be reduced. Furthermore, the increased budget requirements of the external promotion thrust will leave less for the export development program.
- o PRIDEX will work with each client to prepare a business plan that defines the steps required to re-orient the company. The plan will define the assistance to be provided by PRIDEX, the cost sharing arrangement and the point at which PRIDEX would no longer provide assistance. This planning process will lead to some self-screening by firms not willing to make the necessary changes and investments, and make it easier for PRIDEX to turn down clients without an adequate return in terms of jobs and exports on the PRIDEX investment.
- o The modified approach places greater emphasis on the institutional development of PRIDEX. Presently, most of the substantive work is carried out by outside contractors, while little is being done to develop in-house capabilities. While outside contractors will always be required for highly specialized technical or marketing assistance, greater attention will be devoted to identifying tasks which can be more cost-effectively performed in-house.

- o Greater creativity will be used in the structuring relationships with marketing oriented contractors. For example, in the apparel area, brokers can be retained for a very modest fee, with commissions paid on the value of contracts obtained (probably by the beneficiary firm). Performance incentives can be built into other contracts to give the contractor an incentive not to waste time on client firms with limited potential.
- o Greater emphasis will be given to increasing the percentage of program costs covered by client contributions. The export development program must begin to think of itself more as a consulting firm, selling services (albeit subsidized) for which clients are willing to pay. These services must be packaged and priced to include a value for the time of PRIDEX staff and overhead. Over time, PRIDEX will endeavor to reduce the subsidy component.
- o PRIDEX has operated on the implicit assumption that it must provide all services needed by client firms. However, with the increasing strength of business associations (often as a result of FUSADES/FORTAS assistance), some of these services can be left to others. For example, the apparel producers association (ASIC) is particularly active and could conduct member surveys and provide basic market information and advisory services (especially to members that do not qualify for more intensive PRIDEX assistance).
- o PRIDEX will improve monitoring and evaluation of the effectiveness of its assistance as well as its contractors. This information is critical for making difficult decisions regarding priorities.

These adjustments in focus and approach are expected to result in a more cost-effective export development program, as measured in terms of jobs and exports relative to the cost of PRIDEX assistance. The changes will also contribute to a higher level of credibility for the results reported by PRIDEX. Furthermore, PRIDEX will be "graduating" companies which no longer require assistance (unless they pay for 100% of the costs).

### 3. Institutional Support for Investment and Exports

PRIDEX has identified a number of constraints that must be addressed in order for the external promotion and export development thrusts to be successful. The objective of the third thrust is for PRIDEX to collaborate with other institutions in alleviating these constraints.

PRIDEX is presently targeting industrial space (free zones) and transportation as the top two constraints. These constraints may change over time as dictated by feedback from potential local and foreign investors. The important consideration is to maintain a budget and small staff for studies and follow-up activities to address these issues. It is equally important for PRIDEX to coordinate closely with other relevant entities, such as industry associations, other FUSADES divisions, FEPADE (a private vocational-technical training institute), etc.

The institutional support component must also provide internal support for the design and maintenance of PRIDEX' information system, including internal data bases, management information systems, linkages with external data bases, etc.

### C. Organizational Implications

The modified strategy has organizational implications. The new PRIDEX Director, who took charge in July 1990, has a mandate to develop the external promotion function and strengthen the effectiveness of the export development and institutional support functions. Two new divisions to undertake the External Promotion program have been established: an external marketing division with two foreign offices to be opened in 1991; and a local promotion division to provide support to the external promoters and provide local facilitation services for foreign investors. Later on, it is envisioned that PRIDEX would open a third office on the West coast of the United States.

While the local promoters will continue, PRIDEX is in the process of hiring two foreign promoters, a manager of the local promotion division and support staff. The selection of the foreign promoters is particularly critical. The profile which has been recommended to PRIDEX suggests Salvadoran nationals who are bicultural, bilingual, aggressive and self starters. The promoters will undergo specialized training in targeting companies, telephone "cold calling" skills, presentation and selling skills.

The three "offices" will have secretaries to provide backstop while the promoter is out (much of the time). These offices can be spartan since the promoters will visit prospective investors. Depending on the results of the first two offices, PRIDEX may consider opening additional offices in the future. By closely monitoring results, PRIDEX will have a precise estimate of the costs of each office as well as the jobs and benefits they generate. This will make it possible for PRIDEX, FUSADES and the donor agencies to decide whether funding new offices is a good investment compared to other projects.

The structure of the Export Development Division is being reexamined. Client executives are assigned to specific sectors (some manage several sectors) and act as liaisons between client firms and outside contractors providing technical and marketing assistance. The new director and head of the Export Development Program are reexamining this structure in light of the strategic considerations discussed above. Some possibilities which should be considered include: (1) reducing the number of sector specialist to about 4, to reflect a greater focus on fewer priority sectors; (2) hiring some functional specialists, such as business planning (for exports), cost accounting and financial controls, quality control, etc.; and (3) hiring 1-2 market research/marketing facilitators to be based in the U.S. Although these changes could result in an increase in the size of the staff, a decrease in the spending on contractors can be expected.

The staffing requirements for the Institutional Support Division are also being reviewed. The organization chart assumes two individuals: one to promote new industrial space and the other to work on transportation problems. The former is presently justified by the need to promote the AID

project for private free zones. However, it is not clear what a transport specialist will accomplish working out of PRIDEX. Furthermore, while the structure is defined on the basis of two specific constraints of current concern, these could change over time. Thus, it may be more appropriate to think in terms of a special studies and projects department that identified, analyzes and follows up constraints to investment and exports in close coordination with other relevant institutions.

#### IV. BUDGET

The principal assumptions used in deriving the PRIDEX budget found in the Summary Cost Estimates and Financial Plan, of this PP Supplement are:

##### Overhead

- o Salaries include the Director, Administrator, information systems person and support staff. A 2% real increase in annual salaries (over inflation) is assumed for all payroll line items.
- o Rent, utilities and services is based on PRIDEX projections. Only 10% has been assigned to overhead with 40% each to export development and external promotion, and 10% to institutional support.
- o Studies, consultants and MIS includes outside contractors for strategic planning and assessments for PRIDEX, assistance with MIS, and other consulting expertise not directly related to other programs.

##### Export Development

- o Payroll assumes in 1991, 6 clients executives, a program manager and support staff. In 1992, there would be a program manager, 4 client executives, 2 business or technical specialists, a market researcher (located abroad) and support staff. In 1993, 1 more business/technical specialist and one market researcher would be added.
- o Studies and strategic planning includes: initial and periodic strategic reviews of the program; updates of sectoral studies; and industry market studies to be carried out on behalf of several clients (multi-client studies at least partially paid for by companies). By having firms or industry associations contribute to these latter studies, it is believed that they will prove more useful than the large number of sector studies financed by PRIDEX to date.
- o Technical assistance for business plans includes all costs, except PRIDEX staff time, associated with helping firms determine the viability of an export orientation and define the required steps. This could include some structured marketing trips, market research, technical and management diagnostics, and preparation of a business plan or proposal for additional assistance. It is assumed that IESC and similar cost-effective mechanisms will be used when possible.
- o Technical assistance in marketing involves follow-up assistance defined in business plans. This can include additional market

research, assistance with test marketing of new product/designs or new geographic markets, etc., and covers contractors, travel, participation in specialized trade shows, etc. About 15 firms a year will be assisted at an average cost of \$25,000 per company.

- o Conferences and seminars will disseminate results of non-proprietary studies and offer generic technical assistance to a range of potential clients. Two seminars p.a. will be held in 1991 and 1994.

#### External Promotion

- o Two offices would be opened in 1991. Experience in other countries suggests that these offices, including promoter salaries, support staff, rent and operating costs, amount to about \$200,000 per office.
- o The local promotion division is expected to have a manager, two promoters and support staff.
- o Promotion materials are expected to be modest and geared to the information requirements of investors.
- o Training and consulting involves staff training and outside consultants to assist in program implementation.

#### Institutional Support

- o Most of the budget for the first three years in A.I.D. financing for technical assistance and promotion is for private free zones, under Project 519-0323. It is assumed that about \$3.5 million is available for this purpose, subject to the availability of funds.
- o Payroll assumes 1 professional and support staff in 1991-1992 and an additional professional in 1993.
- o Studies and projects will be defined on an ongoing basis to reflect key constraints and issues related to investment and export promotion. The definition and financing of these tasks will be undertaken jointly with other private and public sector organizations.
- o Seminars and promotion refers to activities to disseminate the results of studies, and to promote the required changes and measures.

The budget reflects the total cost of PRIDEX. One of the objectives in the coming years will be to reduce the reliance on A.I.D. An initial estimate of the sources of funds is indicated below. The principal sources are expected to be: A.I.D. Project 519-0287, A.I.D. Project 519-0323, corporate client contributions, and other sources expected to include other donors and additional financing/income raised by FUSADES. Project 519-0287 is expected to finance about \$9.2 million over the remaining LOP, or 55% of the total PRIDEX budget. The share of Project 519-0287 in the overall financing is expected to decline from about 59% in 1991 to about 56% in 1994.

The export development program offers the greatest opportunities for income generation. Some specific assumptions include the following:

- o In 1991-1992, clients are expected to pay \$5,000 for business plans (33% of the total), \$10,000 for production assistance (20%), and \$10,000 for marketing assistance (40%).
- o In 1993-1994, clients pay \$10,000 for business plans (66%), \$15,000 for production assistance (30%) and \$15,000 for marketing assistance (60%). It is assumed that PRIDEX will have developed services of sufficient quality and value that clients will pay an increasing share. Production assistance receives the highest subsidy because of longer payback periods for clients.
- o Companies and associations are expected to contribute an average of \$5,000 for multi-client studies.

The external promotion program, however, is not expected to generate any income, since it is unrealistic to expect foreign investors to pay for being "promoted." The charging of commissions to local firms for finding buyers in the U.S. is not recommended. It is important for the external promoters to perceive the foreign investor as their client. The external promotion program, however, could be presented to other donors for financing. Another source of funding could be private free zones which would channel part of their marketing budgets through PRIDEX' external promotion budget.

#### V. PERFORMANCE TARGETS

PRIDEX has established the following targets for the 1991-1994 period:

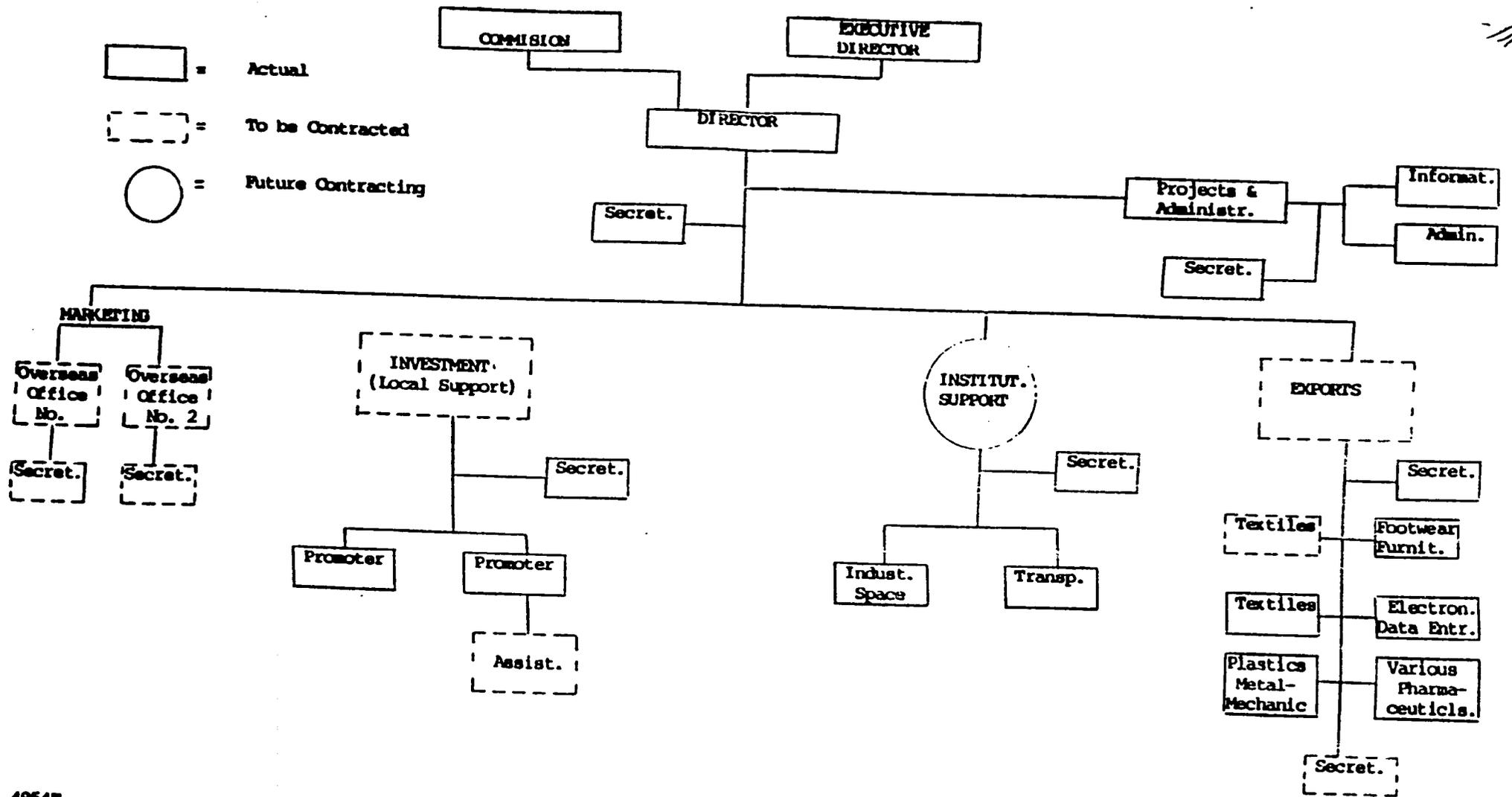
	<u>EXT. PROMOTION</u>	<u>EXPORT DEVT</u>	<u>TOTAL</u>
<u>1991</u>			
- Jobs	2,500	2,500	5,000
- Foreign Exchange (Net \$000)	8,000	12,000	20,000
- Investment (\$000)	9,000	8,500	17,500
<u>1992</u>			
- Jobs	3,000	2,500	5,500
- Foreign Exchange (Net \$000)	9,000	13,000	22,000
- Investment (\$000)	13,500	11,500	25,000
<u>1993</u>			
- Jobs	3,500	2,500	6,000
- Foreign Exchange (Net \$000)	10,500	13,500	24,000
- Investment (\$000)	17,500	13,500	31,000
<u>1994</u>			
- Jobs	4,000	3,000	7,000
- Foreign Exchange (Net \$000)	12,000	16,000	28,000
- Investment (\$000)	<u>20,500</u>	<u>16,000</u>	<u>36,500</u>
<u>1991-1994 TOTAL</u>			
- Jobs	13,000	10,500	23,500
- Foreign Exchange (Net \$000)	39,500	54,500	94,000
- Investment (\$000)	<u>60,500</u>	<u>49,500</u>	<u>110,000</u>

Notes:

1. For the external promotion program, the following guidelines were used:
  - o Experience elsewhere suggests that for every ten sales calls made by a promoter, one investor makes a site visit.
  - o For every ten site visits, one firm is makes a direct investment.
  - o Until the war ends, these guidelines for direct foreign investment might be somewhat optimistic for El Salvador.
  - o However, the potential for large buyers for contract producers should result in significant new local investments. Since contract production is easier to promote, this potential should more than offset the short term difficulties in promoting direct investment.
  - o As more firms have successful experience with contract production, more direct investment will become easier to promote.
  - o With two promoters in 1991-1992, each making about 200 sales calls per year, about 40 site visits would be made to El Salvador, resulting in about 4 direct investments per year. The size of the investments are likely to increase over time.
  - o In 1993-1994, an additional promoter would generate another 2 direct investments per year.
  - o In addition, the promoters will generate about 20-30 important contracts per year, helping 10 local firms set up or expand assembly operations annually.
2. For the export development program, the following was factored in:
  - o The current PRIDEX targets, excluding new investments, have been utilized for the first two years, albeit at a prorated lower level of funding than anticipated in the PRIDEX projections.
  - o It is assumed that with the new approach, PRIDEX will be working with only 20-25 firms, albeit more intensively.
  - o The export development process is likely to take about two years before generating any significant results.
  - o Although the results shown for 1993-1994 are somewhat lower, these can be more reliably linked to the PRIDEX assistance given the more intense and integrated restructuring of the program.

No separate targets have been defined for the institutional support component. It is assumed that the technical assistance for private free zones, and other projects designed to alleviate constraints to investment and exports, will primarily facilitate the realization of the targets established above. While additional investment and exports will probably be stimulated, these will be difficult to quantify.

- = Actual
- = To be Contracted
- = Future Contracting



**Annex F.3**  
**The Department of Economic and Social Studies**

**A. Introduction**

Originally, in 1983, FUSADES consisted only of the Department of Social and Economic Studies (DEES), a "think tank" created by a group of progressive businessmen to promote the economic and social development of El Salvador, advocating free market approaches to development, and publicizing private sector views on national issues. While FUSADES has grown considerably and includes a number of programs, the DEES continues to "define and promote the implementation of a strategy for economic and social development within the system of a market economy that is based on export promotion and on guarantees of political, economic and individual liberties, where private enterprise is the driving force for development."

**B. Program Objectives, Goals and Specific Targets**

The stated objectives of the DEES are:

- a) "to influence the economic and social policies of the government through analysis and recommendations of policies that promote economic and social development within the free market concepts;"
- b) "to create a consciousness about and to promote public opinion favorable to the principles of market economy, and to create a general consensus with respect to the strategy for economic and social development proposed by FUSADES;"
- c) "to create a consciousness in the private sector about the economic and social situation and proposals for solutions to problems; to provide information about the economic and social situation within stated objectives that support private sector decisions; and
- d) "to assist other programs in FUSADES, new foundations promoted by FUSADES, and other institutions of the private sector."

The DEES pursues these objectives through the following:

- a) economic and social analysis to demonstrate the need for policy reforms;
- b) promotion of free market concepts for solving the country's problems;
- c) collaboration with government ministries to help design and implement free market policies; and
- d) analysis of economic and social trends and monitoring of the progress and results of government policies.

### C. Principal Activities of the DEES

The main activities of the DEES are (1) to report on economic and social trends in El Salvador and (2) to analyze economic policies and advocate reforms consistent with free market concepts. The DEES presents its analysis and ideas in publications, seminars, and public and private discussions. The primary focus has been on economic policy, attempting to influence the government to reform El Salvador's policy framework along free market concepts. Secondly, the DEES has started to analyze social policy issues (e.g., education, housing, health care) and develop proposals for attacking these problems more effectively.

The professional economists in the DEES analyze all sectors of Salvadoran economy and the social situation in the country. They evaluate government economic and social policies and develop recommendations for change and reform. A macroeconomic database is being maintained and used by analysts within the DEES for work on specific sectors. In the social area, the DEES has decided initially to emphasize the educational sector, which is viewed as key to increasing productivity, employment and political participation.

The DEES conducts an active program of seminars on economic and business issues. The DEES holds seminars open to the general public on broad economic and social issues as well as workshops on specific topics, such as social security, tailored to individuals with a special interest in the topic. The main objective of these workshops is to mobilize action on a specific issue, in part through the participation of high level government officials. Regular briefings are also held for members of FUSADES about Salvadoran economic trends and current government policy issues.

The DEES maintains a library of more than 1,800 volumes and technical papers on diverse economic topics. Access to this library is available, free of charge, to businessmen, government officials, students, and other groups. The DEES publishes frequently and regularly. Pamphlets are published on special economic topics relating to free market economic reforms or on the Salvadoran economy. Included usually is an emphasis on free market theory, presented in clear, simple terms.

The DEES published the following regular publications:

- Informe Económico Semanal (Weekly Economic Report)
- Polémica Económica Semanal (Weekly Economic Polemic)
- Boletín Económico y Social (Economic and Social Bulletin) monthly
- Informe Trimestral de Coyuntura (Quarterly Situation Report)
- Informe sobre Clima de Negocios (Business Climate Report) quarterly
- Cómo está Nuestra Economía (State of the Economy) annual

These are among the best economic publications produced in El Salvador. The distribution of these publications is offered free of charge to government, business, universities, the press, and other organizations. An initial marketing effort has been started to sell subscriptions to these publications. Initial results have been positive.

#### D. Organization and Resources

The present organization consists of six sub-sections reporting to the manager and program director:

- a) Social Studies
- b) Microeconomics
- c) Macroeconomic Studies
- d) Information System
- e) Administrative
- f) Dissemination

The staff of the DEES is composed of the Technical Director, six sub-section managers, nine analysts, three junior economists, five secretaries and three other support personnel, totalling 27 employees. The junior economists are being trained to eventually assume positions within the sub-sections.

The DEES has a highly professional and competent staff. The current Technical Director has a PhD in economics from the Boston University and has done post graduate work in economics at Stanford University. The Technical Director delegates work responsibilities to the sub-section managers, and generally maintains a low key, mature management style. The macro- and microeconomics sub-section managers, both of whom have studied in the U.S., hold M.A. equivalent degrees in economics, and the manager of the social section has an advanced degree in sociology. None of these individuals appears to have published under their own names, but are authoring the regular publications of the DEES.

The DEES employs the following criteria in determining its research agenda: (1) importance of the topic, either in the short-term where it would be timely, or in the medium-term, when the topic is important and is not being addressed by others; (2) the real possibilities for influencing policy makers, including determining the right moment for tackling issues; and (3) the interests and abilities of the DEES staff. Within this framework and the philosophy of FUSADES, the DEES undertakes economic and social research and analysis. The DEES helps the private sector adjust to the new economic environment through the provision of current economic information. For that purpose, the DEES will increase its efforts to gather and process relevant information and to develop efficient systems to transmit it to economic agents. In the social area, the DEES looks at social issues that meet the above criteria from an economic point of view. The modernization of the social sectors (health, education, social security), and the implementation of a more efficient social strategy are also important to the DEES.

#### E. Analysis of DEES

The DEES is a high quality think tank, analyzing and publishing studies on important economic and social studies. It has made significant progress in gaining acceptance for free market concepts in El Salvador. The DEES has been effective in moving the Salvadoran government to adopt reforms toward a free market economy. Former DEES personnel have been appointed to the highest

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policy-making positions in the present administration. Government ministers attend meetings on economic policy issues organized by the DEES, and DEES staff maintains frequent direct communication with government officials.

The DEES has significantly improved the availability and analysis of economic statistics of El Salvador. The DEES is in the process of attaining similar achievements in social statistics, which will provide better support for recommendations of reform in social areas.

DEES publications and seminars have proven successful in publicizing free market concepts and the need for reforms, and in providing data on the economy. The DEES has become the foremost center for reliable statistics and analysis on the Salvadoran economy, overshadowing the output of government departments and gaining the respect of international organizations, such as the IDB and the World Bank, which seek data and informational meetings with DEES personnel. Local newspapers increasingly publish the results of DEES reports and conferences.

The DEES is proud of its accomplishments and wants to consolidate further its activities and successes already achieved. Its top priorities are to become a still better "think tank", to continue to advocate free market economic policies for El Salvador, to continue influencing government economic and social policies, to attempt to diversify and expand revenues from the DEES activities, and to cooperate more with similar think tanks abroad.

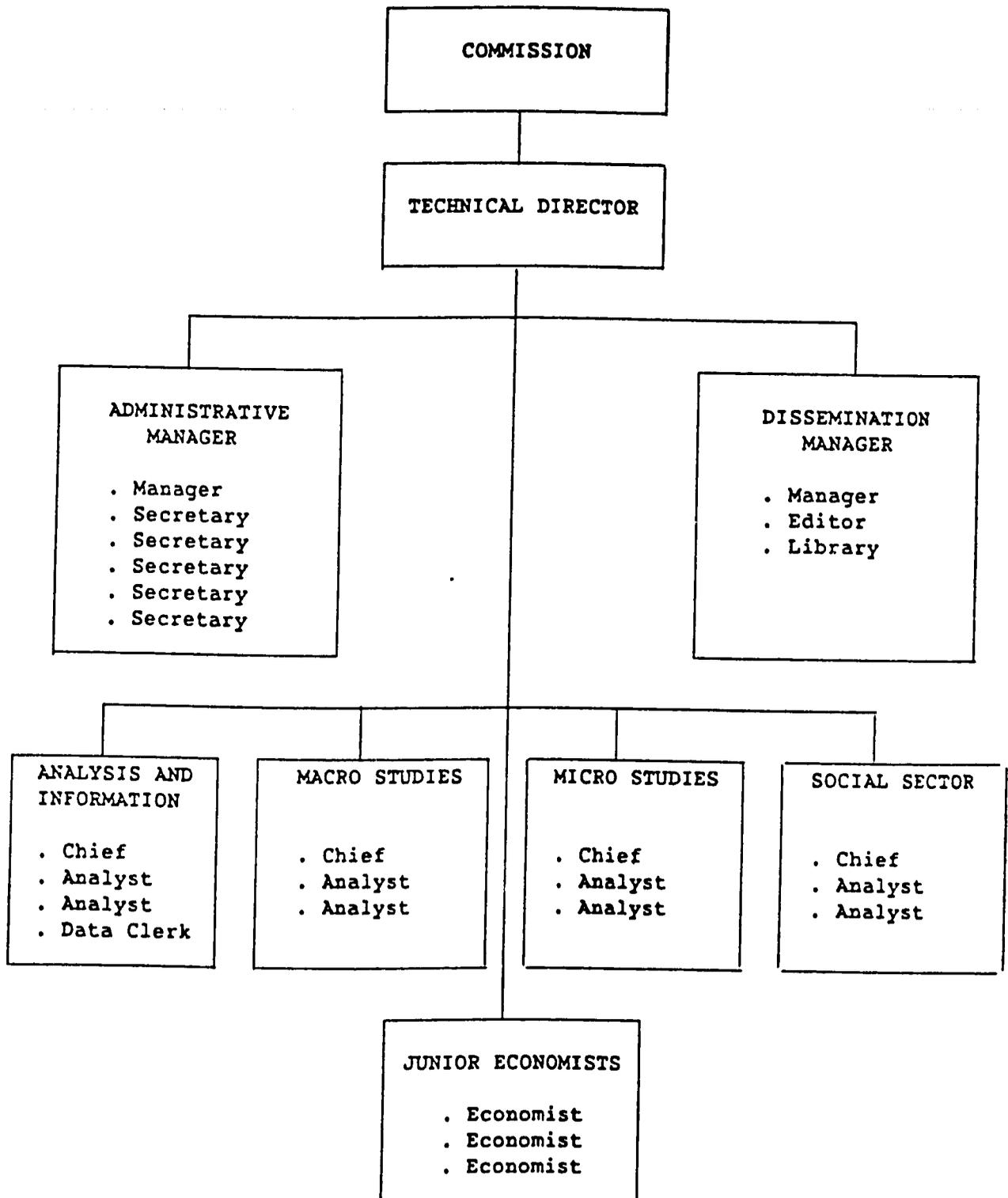
#### F. 1991-1994

To enhance its future effectiveness, the DEES is adjusting its program to take into account new priorities emerging from a changing environment. The major goals established by the DEES --to become the best "think tank",--to publicize free market concepts, and to influence government policies-- have already been substantially achieved. The current government has accepted free market concepts, and former FUSADES employees in key economic policy positions have implemented many reforms. Further consolidation and improvement is being pursued by the DEES. It is important to note that the need for the DEES will continue, even though it has achieved significant success. If future governments have different orientations, for example, DEES efforts would be even more critical.

The DEES will shift some of its resources to meet new priorities. One such priority will be to mobilize the private sector to respond positively to government reform measures as well as to other changes in the environment.

Reduced United States national security concerns, new Eastern European aid priorities, and improved peace prospects for El Salvador all translate into declining United States aid levels for Central America in future years. El Salvador needs to adjust and take steps to reduce dependence on United States aid for its economic and social development. New objectives under consideration include: to provide supporting analysis for initiatives designed to attract international financing; and to advocate policies for increasing domestic savings and for channeling them to more efficient uses.

**DEES ORGANIZATIONAL  
CHART**



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## ANNEX G ECONOMIC ANALYSIS

The purpose of this analysis is to determine if investment in Project activities will yield a rate of return that justifies this use of scarce resources. To accomplish this, the overall economic impact, a sector overview, and the rate of return likely to accrue to investments in the non-traditional industrial export sector were examined. First, the overall economic impact of the additional resources provided in this PP Supplement was determined to be approximately 23,500 jobs, \$110 million in investment and \$132 million in export sales. Next, the industrial sector overview revealed that, due to recent reforms in the economic policy regime, private profitability in manufactured exports has increased, allowing El Salvador to realize its comparative advantage in this sector. Lastly, using illustrative budgets for typical investment projects, the microeconomic analysis shows that the economic internal rate of return to the Project could be as high as 41%.

### Overall Economic Impact.

The total number of investment projects (modules) expected to result from FIDEX/PRIDEX initiatives is indicated in the portfolio table below, together with the aggregate impact from these projects. A total of 149 projects are projected over the remaining life of the Industrial Stabilization and Recovery Project, generating 23,500 jobs, \$110.4 million in investment and \$131.6 million in export sales.

### A Sector Overview.

Before 1989, there was a wide divergence between private and social profitability of investments in manufactured products for export in the Salvadoran economy. It could always be argued that investments in this sector were economically or socially profitable: the abundance of skilled and semi-skilled labor gave the country a comparative advantage in the manufacture and export of a wide variety of labor intensive, light manufactures.

Private profitability, however, was so low that it discouraged investment in manufactured exports. An overvalued exchange rate, quantitative controls on imports, price controls on a wide range of final and intermediate products, and a structure of nominal import tariffs that produced a wide dispersion of effective rates of protection all distorted domestic prices to the point that NTE investments were simply not profitable to many potential investors.

With the implementation of the GOES structural adjustment program in 1989, many of these distortions have been removed. The anti-export bias inherent in the old policy regime was attacked through a sweeping liberalization of the foreign trade market. These reforms included: the substitution of a flexible exchange rate regime for the prevailing overvalued fixed rate regime; a compression in the range of nominal tariffs on imports; and the elimination of numerous nontariff barriers (NTB) to imports (e.g.,

quotas, import prohibitions and prior deposits for foreign exchange permits). These measures were designed to increase the profitability of exports, thus enhancing incentives to invest in the sector that holds the greatest promise of higher growth rates for the Salvadoran economy -- the export sector.

The most noteworthy accomplishment was the adoption of a new exchange rate regime. The GOES gradually moved away from the fixed exchange rate, progressively passing more foreign transactions to the free market. After this, the GOES implemented a fully flexible exchange rate system in 1990. This has not only halted the growing overvaluation of the colon, but has achieved an estimated 20% devaluation of the real exchange rate through September 1990.

To complement and reinforce the beneficial effects of the new exchange rate system, the the distorting effects of import tariffs and NTBs were reduced. The elimination of most nontariff barriers and the adjustment of import tariff rates to narrow the difference between the minimum and maximum tariff rates supported the new exchange rate regime. The Mission estimates that with the new 5-35% range of nominal import tariff rates and the abolition of many NTBs, the average effective rate of protection (i.e., the protection given to value added in the production process) has fallen from 47% to 33%. These changes have not only exposed domestic production to the healthy effects of international competition, but have led to less dispersion of effective protection among productive activities, significantly reducing disincentives for investment in a wide range of profitable export activities.

The GOES also swept away a host of price controls and state trading that posed serious constraints to increased investment in the productive sectors of the Salvadoran economy. Price controls were removed for 230 items. Only a few essential items now remain under price controls: wheat flour, edible oil, refined petroleum products, sugar, cement and public services such as electricity, water and port charges.

In sum, the divergence in social and private rates of return to investments in the target sector has been significantly narrowed. The incentives to investments in manufactured products for export has increased, allowing the Salvadoran economy to realize its comparative advantage in such products.

#### A Microeconomic Analysis.

In this section, the likely rate of return that will be encountered in investments associated with FIDEX/PRIDEX activities is presented. To accomplish this, sample budgets for various investments have been constructed. This is always a perilous exercise due to the heterogeneous nature of manufacturing output. Nonetheless, it serves to illustrate the possible returns to investments in the target sector.

Due to the nature of its activities, quantification of the contribution of the DEES component (and of the GOES, which will be financed with previously obligated funds) was not practicable. Nonetheless, the success of the DEES

and of CONAEXI in ensuring a continuing improvement in the policy environment will be an essential condition to the achievement of the rates of return to FIDEX/PRIDEX investments.

There are other externalities that will accrue to DEES and CONAEXI activities. By encouraging a favorable policy climate, the DEES and CONAEXI will indirectly stimulate investment in export production in addition to the investment projects promoted by PRIDEX and FIDEX. Positive policy signals will reach numerous investors (especially domestic investors) who will invest in export projects without necessarily obtaining support from PRIDEX or FIDEX. While difficult to quantify, it can be safely assumed that the externalities will generate an overall rate of return and economic impact much higher than those produced by FIDEX/PRIDEX alone.

The principal thrust of both PRIDEX and FIDEX is to facilitate and promote new investment in export production. Both foreign and local investment will be promoted. The profiles in the FIDEX/PRIDEX portfolio table indicate the characteristics of three types of companies which are likely to make up most of the combined PRIDEX/FIDEX portfolio.

Consistent with most studies, as well as the National Export Strategy, it is assumed that "maquila," especially in apparel, will represent the largest share of new investment and exports. However, two distinct profiles have been prepared: one involving direct foreign investment and the other local investment. The foreign firms are assumed to be larger, have slightly higher productivity and repatriate most profits (thus lowering the proportion of value added accruing to the Salvadoran economy). Local firms are expected to have to invest in new modules or plants in order to produce for export. Experience has shown that these firms cannot utilize existing capacity for both local and export sales. Thus, all of the costs and output indicated are incremental. It should be noted that the profiles can be considered as modules, with any one firm possibly developing several modules. Note also that it is assumed that all materials are imported on consignment. Any production utilizing local textiles would generate additional benefits.

The third profile is for export firms based on local materials (apparel with local textiles and other sectors being promoted by PRIDEX). In contrast to the "maquila" operations, this type of firm utilizes more materials/inputs (local and foreign), while labor represents a lower percentage of total costs. These investments also tend to be somewhat smaller, in part because only the new, export line (module) is considered. Many of these firms will have other plants (modules) producing for the local market.

The stream of economic benefits from the FIDEX/PRIDEX portfolio are presented in the following table. The gross benefits are assumed to be the export sales. Two scenarios have been prepared for the cost assumptions. The first assumes that a free exchange rate will be maintained, and that the rate will continue to reflect the true market rate. The second scenario assumes that the colón becomes overvalued by 20%. Since the earnings of the export projects are in dollars, the principal impact is on the cost of local labor and wages. Some other key assumptions on costs include the following:

- The economic (shadow price) of labor has been assumed to be 50% of commercial site. This is consistent with high unemployment and underemployment rates, and the low skills requirements for many of the "maquila" jobs.
- Costs are shown in constant dollar terms, based on current market rates for the colón.
- Investment does not include the construction of factories or basic infrastructure. It is assumed that companies will pay rent for free zone space, which is shown in local inputs.
- Total PRIDEX costs are incorporated, including both costs funded by this Project and fees paid by clients. An overhead rate for FUSADES management is also included. In the case of FIDEX, 1991 operating costs and \$6.5 million for loans have been included as costs.

Assuming that the investments promoted by FIDEX/PRIDEX continue in business for 6-10 years, the economic rate of return based on these assumptions and scenario 1 is 41%. However, if the economic cost of labor is assumed to be 75%, the EIRR drops to 25%. In Scenario 2 -- assuming a 20% overvaluation of the colón, the EIRR drops to 24%.

In the AID/W guidance cable following the review of this Project in March 1991, AID/W asked the Mission to critically examine the benefit stream in the economic analysis of the project and to clarify the base year. The benefit stream consists of non-traditional exports that will result from the investments made under this project. In 1990, exports of non-traditional, non-agricultural products to extra-regional markets (including drawback) were approximately \$140 million. What the economic analysis implies is that this Project alone will result in a growth of such exports by approximately 19% annually. This is an optimistic, but reasonable, assumption given the recent reforms in the exchange and trade regimes, historical performance, and the experience of regional competitors in similar endeavors.

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PRIDEX/PIDEX PORTFOLIO

VALUE PER  
PROJECT YEAR 1 YEAR 2 YEAR 3 YEAR 4 TOTAL

MAQUILA/APPAREL-FOREIGN

	PROJECTS	YEAR 1	YEAR 2	YEAR 3	YEAR 4	TOTAL
PROJECTS		8	9	10	12	
EMPLOYMENT	300	2400	2700	3000	3600	117
INVESTMENT	1200000	9600000	10800000	12000000	14400000	4680000
EXPORT SALES	1500000	12000000	13500000	15000000	18000000	5850000
WAGES/BENEFITS	530000	4240000	4770000	5300000	6360000	2067000
FOREIGN WAGES	150000	1200000	1350000	1500000	1800000	585000
FOREIGN INPUTS	160000	1280000	1440000	1600000	1920000	624000
LOCAL INPUTS	360000	2880000	3240000	3600000	4320000	1404000
PROFIT	300000	2400000	2700000	3000000	3600000	1170000
VALUE ADDED	890000	7120000	8010000	8900000	10680000	3471000

MAQUILA/APPAREL-LOCAL

	PROJECTS	YEAR 1	YEAR 2	YEAR 3	YEAR 4	TOTAL
PROJECTS		14	15	16	18	
EMPLOYMENT	150	2100	2250	2400	2700	94
INVESTMENT	450000	6300000	6750000	7200000	8100000	2835000
EXPORT SALES	600000	8400000	9000000	9600000	10800000	3780000
WAGES/BENEFITS	250000	3500000	3750000	4000000	4500000	1575000
FOREIGN WAGES	40000	560000	600000	640000	720000	252000
FOREIGN INPUTS	70000	980000	1050000	1120000	1260000	441000
LOCAL INPUTS	120000	1680000	1800000	1920000	2160000	756000
PROFIT	120000	1680000	1800000	1920000	2160000	756000
VALUE ADDED	490000	6860000	7350000	7840000	8820000	3087000

INDUSTRY-LOCAL MATERIALS

	PROJECTS	YEAR 1	YEAR 2	YEAR 3	YEAR 4	TOTAL
PROJECTS		10	11	12	14	
EMPLOYMENT	50	500	550	600	700	23
INVESTMENT	750000	7500000	8250000	9000000	10500000	3525000
EXPORT SALES	750000	7500000	8250000	9000000	10500000	3525000
WAGES/BENEFITS	140000	1400000	1540000	1680000	1960000	658000
FOREIGN WAGES	25000	250000	275000	300000	350000	117500
FOREIGN INPUTS	125000	1250000	1375000	1500000	1750000	587500
LOCAL INPUTS	310000	3100000	3410000	3720000	4340000	1457000
PROFIT	150000	1500000	1650000	1800000	2100000	705000
VALUE ADDED	600000	6000000	6600000	7200000	8400000	2820000

TOTAL

	PROJECTS	YEAR 1	YEAR 2	YEAR 3	YEAR 4	TOTAL
PROJECTS		32	35	38	44	1
EMPLOYMENT		5000	5500	6000	7000	235
INVESTMENT		23400000	25800000	28200000	33000000	11040000
EXPORT SALES		27900000	30750000	33600000	39300000	13155000
WAGES/BENEFITS		9140000	10060000	10980000	12820000	4300000
FOREIGN WAGES		2010000	2225000	2440000	2870000	954500
FOREIGN INPUTS		3510000	3865000	4220000	4930000	1652500
LOCAL INPUTS		7660000	8450000	9240000	10820000	3617000
PROFIT		5580000	6150000	6720000	7860000	2631000
VALUE ADDED		19980000	21960000	23940000	27900000	9378000

FOREIGN INPUTS INCLUDE ALL FX COSTS, EXCLUDING INVESTMENT FOR MAQUILA,  
MOST MATERIALS PROVIDED ON CONSIGNMENT.  
FOREIGN WAGES INCLUDES FOREIGN TA.  
INVESTMENT EXCLUDES INDUSTRIAL BUILDINGS FOR MAQUILA--THESE FIRMS WILL RENT.



## ANNEX B FINANCIAL ANALYSIS

This annex consists of a total of seven tables, which present the financial projections for activities funded under the Project. Consolidated projections for FUSADES, which were prepared in the process of analyzing institutional long term financial viability once AID funding terminates in 1994, have also been presented.

Tables I, II and III show the four year budgets for the three principal programs (DEES, PRIDEX and FIDEX) funded under the Project Paper Supplement. These budgets reflect the total operating costs of the programs, of which significant portions are funded by A.I.D., as detailed in the bottom portion of each table. These tables also reflect an overhead charge, which averages about 9% over the four years, which contributes to the central administrative and service costs that FUSADES provides the different projects. The concept of the overhead charge is also in line with the desire of A.I.D. to assist FUSADES in adopting a cost-center accounting system.

Table IV is a detailed breakdown of the overall Project costs for the main components financed under the A.I.D. grant and non-A.I.D. sources of funds through 1995. It also provides a detail of the total AID grant support to FUSADES which complements the activities financed under this Project.

Given that one of the objectives of the Project is to ensure the future financial viability of FUSADES, a detailed analysis was carried out on the level of internal funding that FUSADES would be able to generate with its own funds after the Project Assistance Completion Date of September 30, 1994. Table V presents a detailed projection of FUSADES' core program costs in 1995. The institution will be able to generate an annual level of funding equal to about \$5,000,000, enough to fund the reduced level of program activity.

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INDUSTRIAL STABILIZATION AND RECOVERY  
PROJECT NO. 519-0287  
1991 PROJECT PAPER SUPPLEMENT  
PROJECTION OF EXPENDITURES BY YEAR  
US (\$)

PRIDEX	PP SUPPL AID FUNDS 1991	PNOR YEAR FUNDS 1991	PP SUPPL AID FUNDS 1992	PNOR YEAR FUNDS 1992	PP SUPPL AID FUNDS 1993	PNOR YEAR FUNDS 1993	PP SUPPL AID FUNDS 1994	PNOR YEAR FUNDS 1994	TOTAL PP SUPPL FUNDS	TOTAL PNOR YEAR FUNDS
TECHNICAL ASSISTANCE	100,000	783,000	909,500	0	966,000	0	769,400	0	2,764,900	783,000
SEMINARS AND CONFERENCES	22,800	90,200	110,100	0	111,900	0	40,700	0	285,300	90,200
COMMUNICATIONS/DISSEMINATION	49,000	200,000	275,200	0	291,200	0	250,800	0	874,200	200,000
TRAVEL/TRAINING	49,000	200,000	235,900	0	239,700	0	215,600	0	739,300	200,000
SUPPLIES AND EQUIPMENT	26,000	290,700	260,200	0	335,600	0	301,400	0	923,200	290,700
SALARIES	94,000	349,600	482,800	0	561,700	0	579,200	0	1,717,700	349,600
PROMOTION OFFICES ABROAD	120,000	271,300	589,700	0	600,000	0	611,000	0	1,812,700	271,300
CONTINGENCIES	12,179	39,564	147,031	0	160,760	0	140,416	0	469,404	39,564
SUBTOTAL	472,979	2,224,364	3,010,431	0	3,266,660	0	2,925,536	0	8,695,864	2,224,364
OVERHEAD (7.896%) 1991	37,346	175,636							37,346	175,636
OVERHEAD (8.757%) 1992			263,623	0					263,623	0
OVERHEAD (8.871%) 1993					291,577	0			291,577	0
OVERHEAD (10.694%) 1994							312,657	0	312,657	0
SUBTOTAL OVERHEAD	37,346	175,636	263,623	0	291,577	0	312,657	0	905,404	175,636
TOTAL AID	510,325	2,400,000	3,274,054	0	3,578,417	0	3,238,301	0	10,601,208	2,400,000
DIRECTORS IN-KIND CONTRIBUTION	17,000		36,000		36,000		36,000		145,000	0
SERVICE CONTRIBUTION BY BENEFICIARIES	411,000		320,000		541,000		432,000		1,970,000	0
TOTAL PRIDEX		0		0		0		0		0

TABLE II  
INDUSTRIAL STABILIZATION AND RECOVERY  
PROJECT NO. 519-02A7  
1991 PROJECT PAPER SUPPLEMENT  
PROJECTION OF EXPENDITURES BY YEAR  
US (\$)

INDEX	PP SUPPL AID FUNDS 1991	PIOR YEAR FUNDS 1991	PP SUPPL AID FUNDS 1992	PIOR YEAR FUNDS 1992	PP SUPPL AID FUNDS 1993	PIOR YEAR FUNDS 1993	PP SUPPL AID FUNDS 1994	PIOR YEAR FUNDS 1994	TOTAL PP SUPPL FUNDS	TOTAL PIOR YEAR FUNDS
<b>TECHNICAL ASSISTANCE</b>	30,000	0	0	0	0	0	0	0	30,000	0
SEMINARS AND CONFERENCES	1,000	0	0	0	0	0	0	0	1,000	0
COMMUNICATIONS/DISSEMINATION	20,000	0	0	0	0	0	0	0	20,000	0
TRAVEL/TRAINING	20,000	0	0	0	0	0	0	0	20,000	0
SUPPLIES AND EQUIPMENT	35,000	0	0	0	0	0	0	0	35,000	0
SALARIES	185,000	0	0	0	0	0	0	0	185,000	0
CONTINGENCIES	67,981	0	0	0	0	0	0	0	67,981	0
INVESTMENT FUND - CREDIT	6,500,000	0	0	0	0	0	0	0	6,500,000	0
<b>SUBTOTAL</b>	<b>6,878,961</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>6,878,961</b>	<b>0</b>
OVERHEAD (7.89%) 1991 (Excl. credit)	29,924	0	0	0	0	0	0	0	29,924	0
OVERHEAD (8.75%) 1992	0	0	0	0	0	0	0	0	0	0
OVERHEAD (8.87%) 1993	0	0	0	0	0	0	0	0	0	0
OVERHEAD (10.69%) 1994	0	0	0	0	0	0	0	0	0	0
<b>SUBTOTAL OVERHEAD</b>	<b>29,924</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>29,924</b>	<b>0</b>
<b>TOTAL AID</b>	<b>6,908,905</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>6,908,905</b>	<b>0</b>
DIRECTORS IN-KIND CONTRIBUTION	37,000	0	36,000	0	36,000	0	36,000	0	145,000	0
CONTRIBUTION OF FUSADES OWN FUNDS	625,000	0	0	0	0	0	0	0	625,000	0
CONTRIBUTION OF MAQUILA CLIENTS	2,500,000	0	500,000	0	500,000	0	625,000	0	4,125,000	0
<b>TOTAL FIDEL</b>	<b>2,537,000</b>	<b>0</b>	<b>536,000</b>	<b>0</b>	<b>536,000</b>	<b>0</b>	<b>661,000</b>	<b>0</b>	<b>4,895,000</b>	<b>0</b>

INDUSTRIAL UTILIZATION AND RECOVERY  
PROJECT NO. 519-0287  
1991 PROJECT PAPER SUPPLEMENT  
PROJECTION OF EXPENDITURES BY YEAR  
US (\$)

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DUES	PP SUPPL AID FUNDS 1991	PRIOY YEAR FUNDS 1991	PP SUPPL AID FUNDS 1992	PRIOY YEAR FUNDS 1992	PP SUPPL AID FUNDS 1993	PRIOY YEAR FUNDS 1993	PP SUPPL AID FUNDS 1994	PRIOY YEAR FUNDS 1994	TOTAL PP SUPPL FUNDS	TOTAL PRIOY YEAR FUNDS
<b>TECHNICAL ASSISTANCE</b>										
SEMINARS AND CONFERENCES	0	0	150,000	0	117,500	0	105,000	0	369,500	0
COMMUNICATIONS/DISSEMINATION	0	0	20,100	0	20,900	0	22,800	0	63,800	0
TRAVEL/TRAINING	0	0	36,300	0	39,900	0	43,800	0	120,000	0
SUPPLIES AND EQUIPMENT	0	0	23,600	0	26,000	0	28,600	0	78,200	0
SALARIES	0	0	74,400	0	79,800	0	65,500	0	219,700	0
CONTINGENCIES	0	0	400,000	70,156	334,200	0	507,600	0	1,531,800	70,156
SUBTOTAL	0	0	45,060		41,714		43,548		130,322	0
OVERHEAD (7.824%) 1991	0	0	749,460	70,156	857,014	0	896,848	0	2,503,322	70,156
OVERHEAD (8.757%) 1992									0	0
OVERHEAD (8.871%) 1993			65,430	6,844					65,430	6,844
OVERHEAD (10.697%) 1994					76,026	0			76,026	0
SUBTOTAL OVERHEAD	0	0	65,430	6,844	76,026	0	95,909	0	95,909	0
TOTAL AID	0	0	815,090	85,000	933,640	0	992,757	0	2,740,857	6,844
DIRECTORS IN-KIND CONTRIBUTION	37,000		36,000		36,000		36,000		145,000	
CONTRIBUTION WITH FUSADES OWN FUNDS	15,000		15,000		15,000		15,000		60,000	
TOTAL DUES	52,000		51,000	0	51,000	0	51,000	0	205,000	0

TABLE IV

SOURCES OF FUNDS: 1991 - 1995

(U.S. Dollars)

	1991	1992	1993	1994	1995
I. TOTAL FUSADES BUDGET	13,069,756	10,093,386	10,147,086	9,429,497	5,350,772
II. SOURCES OF FUNDING:					
- AID	11,429,210	8,055,618	8,022,541	7,478,927	0
- PROGRAM INCOME	919,500	1,066,000	1,143,500	1,044,500	1,300,000
- DONATIONS (1)	60,000	65,000	70,000	75,000	80,000
- INTEREST ON DEPOSITISTS (2)	340,000	590,000	910,000	1,275,000	1,510,000
- INTEREST ON 0287 LINE	875,000	1,361,400	1,376,300	1,366,100	1,348,000
- INTEREST ON 0327 LINE	125,000	428,700	732,600	1,042,575	1,263,563
- INTEREST ON 0303 LINE	1,500,000	1,353,838	1,356,313	1,354,300	1,348,750
- INTEREST ON PROPEMI LINE	225,000	310,000	375,000	450,000	490,000
- FIDEX DIVIDENDS	0	95,650	127,525	108,150	135,500
TOTAL SOURCES OF FUNDS	15,473,710	13,326,206	14,113,779	14,194,552	7,475,613
III. NET INCOME	2,403,954	3,232,920	3,966,693	4,765,055	2,125,041

NOTES: (1): Represents donations by FUSADES Members and by sponsoring local companies.

(2): Includes FUSADES and PROPEMI deposits. Interest earned is base on average deposits during the year, assuming a 8% rate for Dollar deposits and 18% for Colones deposits.

(3) 1995 Net income may be applied to increased program assistance. If program income is less than expected, it provides a reserve.

TABLE V

CORE PROGRAM BUDGET: 1995

(U.S. Dollars)

	DEES	PRIDEX	DIVAGRO	PROPEMI	TOTAL
Technical Assistance	90,000	550,000	575,000	15,000	1,230,000
Seminars & Conferences	18,600	25,000	20,000	5,000	68,600
Travel	17,600	80,000	30,000	12,500	140,100
Demonstrations Plots	0	0	150,000	0	150,000
Communications/Publications	44,300	100,000	12,500	47,500	204,300
Equipment and Assets	2,000	5,000	40,000	5,000	52,000
Salaries & Related Costs	552,800	420,000	572,700	445,000	1,990,500
Services and Supplies	75,000	250,000	335,000	90,000	750,000
Promotional Office Abroad	0	400,000	150,000	0	550,000
Sub Total	800,300	1,830,000	1,885,200	620,000	5,135,500
Overhead Charge (11.0%)	88,033	201,300	207,372	68,200	564,905
GROSS PROGRAM BUDGET	888,333	2,031,300	2,092,572	688,200	5,700,405
Program Income:					
- Seminars & Publications	65,000	10,000	20,000	25,000	120,000
- Client Contributions		400,000	450,000		850,000
- QAP Services			250,000		250,000
- Produce Sales			80,000		80,000
- Interest on PROPEMI Credits				490,000	490,000
- Interest on PROPEMI Deposits				210,000	210,000
Total Program Income	65,000	410,000	800,000	725,000	2,000,000
NET PROGRAM BUDGET	823,333	1,621,300	1,292,572	(136,800)	3,700,405

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**ANNEX I**  
**INSTITUTIONAL ANALYSIS**

**1. FUSADES**

FUSADES was established in mid-1983 by a group of progressive businessmen for the purpose of promoting the economic and social development of El Salvador according to the principles of free enterprise and a free-market economy. It engages in a wide array of economic and social development activities. It is an unusual organization in that it combines in one institution programs and functions that would normally be found in several. FUSADES' organizational structure consists of a central administration and seven programs administered in a collegial style.

Over the past seven years, FUSADES has grown from a narrowly focused economic policy research institute with a total staff of 14 to a multi-purpose organization employing over 200 people. Program and operating costs have increased from \$2.16 million in 1984 to almost \$9 million in 1989. Membership has increased from the original 156 founders to approximately 250 in 1990. Its leadership has presided over very rapid growth in terms of the scope of program activities, budgetary expenditures, and levels of personnel. Individually, FUSADES' programs have proven to be effective implementors of A.I.D. development projects. FUSADES is now moving forward into a new phase in its institutional life -- concentration of programmatic activities in support of export and investment promotion in a more favorable political and economic life.

FUSADES has been able to manage successfully its rapid expansion and diversification of program activities because of three principal factors. First, as the Foundation added program activities, it created a series of commissions, each headed by a member of the Executive Committee, to provide advisory and administrative guidance. Each Commission meets frequently to review and approve program activities. Second, FUSADES has been able to rely on a core group of 25-30 dedicated members who have given tirelessly of their time to guide the development of the Foundation. In this effort, they have been supported by a generally very able and professional cadre of program managers. Third, beginning in late 1988, FUSADES initiated a process to improve its centralized administration, including contracting external consultants to assist in the development of a strategic planning process and a reorganization of administrative and financial operations. The goal of this process was to provide greater coherence and direction to FUSADES' activities, given its evolution into a decentralized organization.

As part of the Project Paper Supplement process, the Mission conducted an intensive review of FUSADES' organization and management structure, based on previous evaluations and interviews with key FUSADES directors and personnel. The review was motivated by a perceived need to accelerate and enhance administrative changes already in process, particularly

given the Mission's intention to decrease its support for central administrative costs. The Mission identified several issues regarding the administration and management of FUSADES, each of which was discussed with the Executive Committee of the Board during two strategic retreats, one in Guatemala in early September 1990 and one in San Salvador in mid October 1990. The major areas of discussion were:

Strategic Planning. Although FUSADES has initiated efforts at strategic and operational planning (including contracting U.S. consultants in 1988 to assist it in the development of a strategic plan), more work needed to be done. In particular, FUSADES needed to focus on instituting a planning process to guide its development over the next four years, including reviewing and updating program specific plans, and on addressing the issue of developing a sustainable, financially viable core program beginning in 1995. The Board of FUSADES agreed with the need to enter into a strategic planning exercise, and did so. This resulted in a clarification of goals and objectives, an assessment of organizational capacities and resources, and an agreement on a core program of activities beyond 1994, complete with budget projections.

The strategic planning process is ongoing and includes not only FUSADES plans for the period 1991-1994, but also the initial planning for 1995 when A.I.D. resources are not projected to be available. FUSADES has projected that its major activities in 1995 will be DIVAGRO, PRIDEX, and the DEES. FIDEX will be divested in 1991, becoming an independent, privately owned financial institution with its own portfolio and managing the FUSADES credit portfolio (see Annex F.2). PROPEMI is projected to be financially self-sufficient.

In preparing for 1995, FUSADES projected non-donor income at \$5 million, and has based its program projections on that level of income. In 1991, FUSADES will shift from A.I.D. support of its administrative costs and, instead, charge overhead to its individual programs. In its financial projections for 1995 (see Annex H), FUSADES projects a core program consisting of the DEES, PRIDEX, and DIVAGRO. DEES will be maintained at current nominal levels, while the budgets for PRIDEX and DIVAGRO are significantly reduced. The major reduction in these programs will come in the area of cost-shared foreign technical assistance to clients, and in the case of DIVAGRO, the expiration of long-term foreign technical assistance. These reductions reflect an effort over the next four years to improve internal technical staff capacity, and the hard reality that neither program will be able to provide cost-shared technical assistance, absent donor funding. Both programs will, however, have the capability to contract technical assistance and could appeal to donors with compatible programmatic interests.

During the 1991-1994 period, FUSADES and A.I.D. will conduct annual reviews of A.I.D. funded programs, and FUSADES will continue its strategic planning exercise. Depending on the findings of these reviews, the projections for funding levels and the distribution of funds among core programs will be adjusted.

Governance. FUSADES is a decentralized organization, relying heavily on the work of the various program commissions to provide overall administrative and advisory guidance. The consultants felt that this organizational structure, while permitting rapid program expansion, also tended to blur internal lines of authority and decision-making, and hindered greater integration and communication among the program components. FUSADES' Directors believe that the current organizational structure works well, and point to the successes of DIVAGRO, DEES, and PROPEMI, as well as their ability to restructure PRIDEX to take account of changing circumstances. In addition, they feel that better planning and oversight will improve governance.

Membership. FUSADES has increased its membership significantly since its creation, demonstrating that it is open to individuals who share the goals and objectives of the organization. Moreover, FUSADES has benefitted from the dedication and commitment of founding members who are still very active in governing the Foundation. However, this raises issues of whether FUSADES should actively seek to expand its membership base and to create mechanisms to increase the participation of existing members. Membership is open to all individuals who meet the Foundation's criteria, and that potential new members are routinely presented and discussed at Executive Committee meetings. The Directors did, however, acknowledge that a statement of membership policy would help to clarify public perceptions of the organization. They also point out that access to FUSADES' services and programs are provided on a non-discriminatory basis.

Administration. FUSADES is a reasonably well administered organization in terms of personnel and finances. However, there is a need to better integrate central administrative and financial operations with the needs of the various programs. One important step in this direction is the introduction of a cost-center accounting system to distinguish between overhead costs and projects or program costs. FUSADES has accepted the idea of shifting to a cost-center accounting system, and now is making financial projections on this basis. Further, greater efficiency and program integration will be achieved once all the separate programs are located in the same physical space in the new FUSADES building.

Financial Viability. Given its rapid growth, FUSADES has understandably developed with little apparent attention to the issue of optimal (or sustainable) size and financial viability. FUSADES is focusing on defining and funding a core program, on developing non-A.I.D. sources of funding, and on increasing attention to cost recovery and income generation. In addition, FUSADES has indicated its intention to strengthen its project development and funding capacity, assisted by a committee of the Board.

The above discussion focusses largely on the central administrative capacity and organizational structure of FUSADES. At the same time, the institutional capacities of the key individual programs involved in activities under this Project were also assessed. These three programs --PRIDEX, FIDEX, and the DEES-- are each well managed by very competent individuals, staffed by able and experienced professionals, and achieving stated objectives.

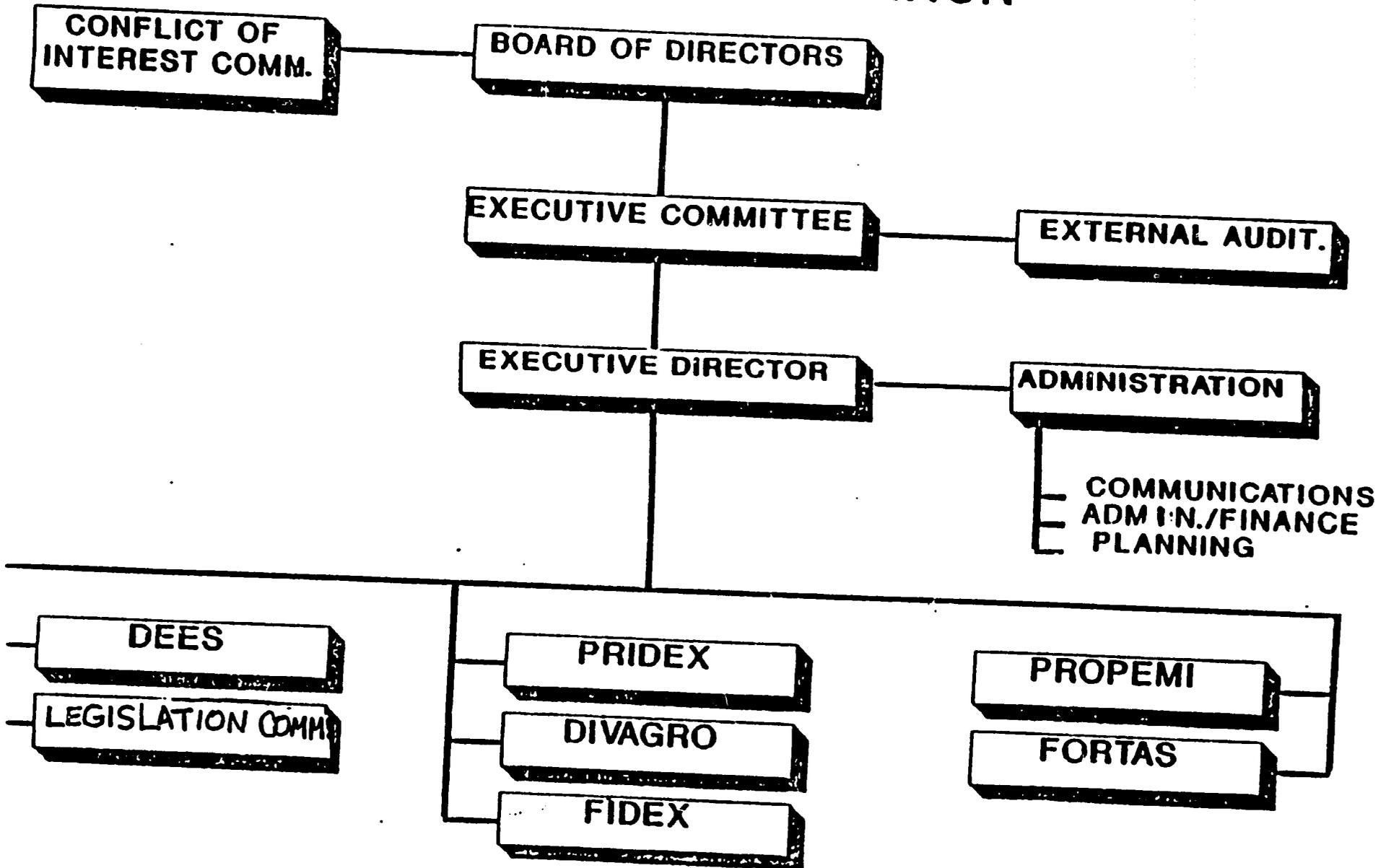
The modifications to the PRIDEX organization and program summarized in Section III and discussed in Annex G should enhance PRIDEX' performance. There are no foreseen organizational changes for the DEES. The remaining Project-financed program, FIDEX, will be spun off from FUSADES and established as a private development finance institution.

Although the new institution --FIDEX, S.A.-- has not been formed yet, its general functions are discussed in Sections III and VI and at length in Annex F. It is envisioned that the initial organization of FIDEX, S.A. will consist of the existing staff of FIDEX. An organizational chart is included in Annex F. The Cooperative Agreement Amendment to be executed with FUSADES upon approval of this PP Supplement will stipulate that A.I.D. will review the timetable, organizational structure, and charter for FIDEX, S. A.

Based upon the Mission's review and analysis of FUSADES, it is confident that FUSADES will continue to be an affective implementor of this Project. The Mission will continue, however, to work with FUSADES to enhance the viability of FUSADES beyond the life of the Project, as it shares the view that FUSADES is a high quality institution making valuable contributions to the country's development.

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# FUSADES ORGANIZATION



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## 2. CONAEXI

Although CONAEXI is still in its early organizational stages, it is envisioned that it will be made up of high-level representatives, in equal number, from the private and public sectors. The representatives of the public sector are expected to come from the Central Reserve Bank and the Ministries of Economy, Finance, Agriculture, and Planning. Representatives from the private sector are expected to come from the business organizations that are related to exports (Exporters Association, Industrials Association, and others). The Chairman will be a prominent private sector individual selected by the President. To carry out the activities in support of the National Export Strategy, CONAEXI will rely on a support unit formed by an executive director and a small staff. It is possible that the chairman of CONAEXI may also act as the executive director. The Commission will act both as coordinating, monitoring, and mobilizing support committee for public and private sector activities in the areas of investment and export promotion, as well as advocate of specific actions that would improve: the policy and regulatory framework, the development of infrastructure (free zones, transportation), and others that will allow for the successful implementation of the National Export Development Strategy.

CONAEXI, with the assistance of the support unit, will be responsible for: following up on changes in the economic policies to identify possible problems which may arise; developing, in coordination with other private and public sector institutions such as the Central Reserve Bank (BCR), the Advisory Group to the Minister of Planning in Social and Economic Matters (GAES), and the DEES, an information system to monitor the implementation of the priority activities identified in the strategy and to measure results; coordinating the efforts of the public and private sectors to assure the channelling of funds to priority activities; identifying and taking the necessary steps for the elimination of key obstacles for the development of the priority sectors; and, very importantly, evaluating the implementation of the strategy and making adjustments if necessary.

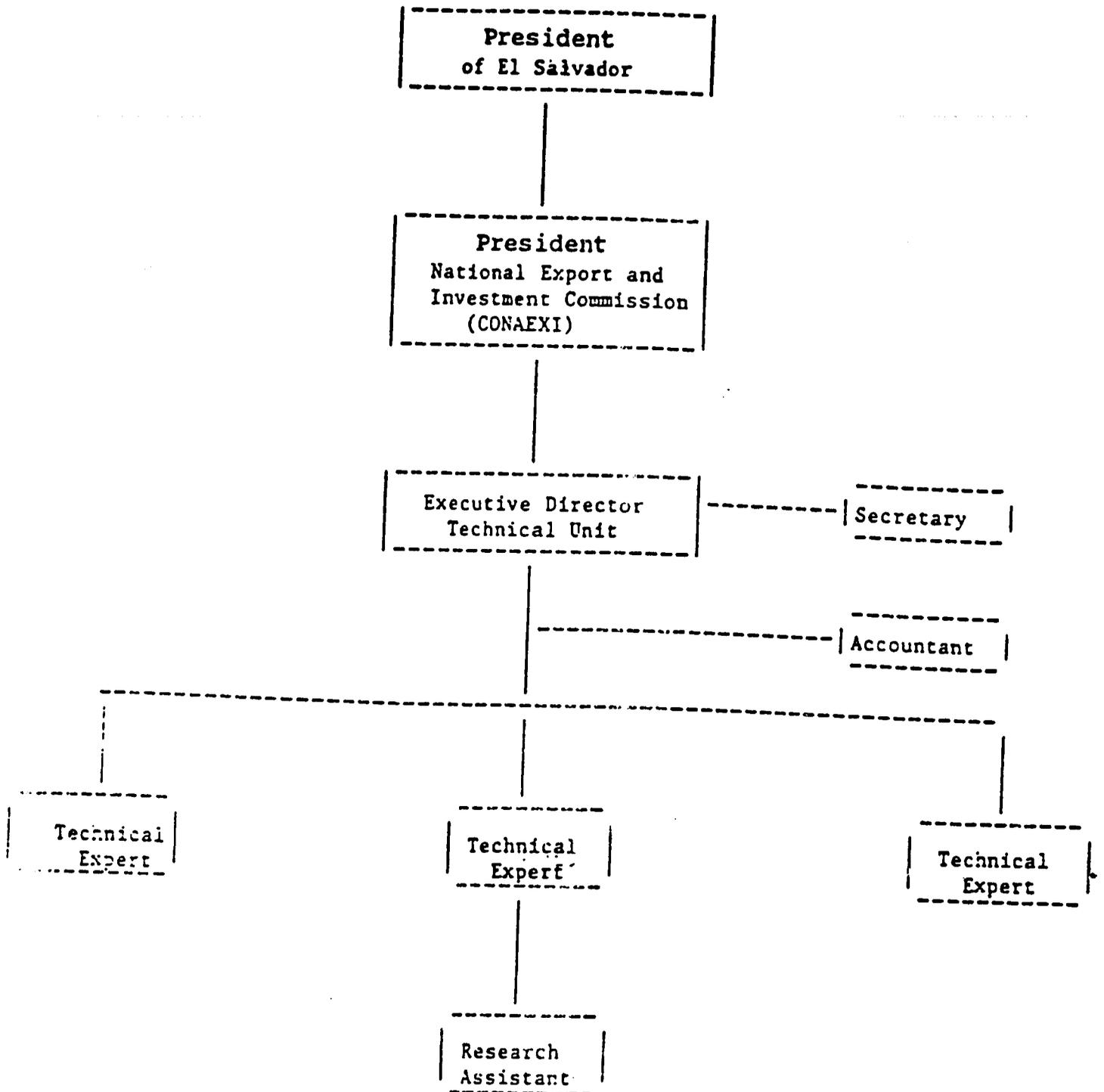
It is expected that CONAEXI and the support unit will require outside technical assistance in carrying out the above mentioned responsibilities, as well as in the consolidation of its organizational structure. Approximately \$895,000 of the remaining dollar funds under the Project for the public sector component will be utilized for this purpose. Funds will also be used to train selected staff from different GOES export related agencies in the most up-to-date date practices in export and investment facilitation (\$150,000). Total GOES counterpart contributions derived from ESF local currency resources are estimated to be £10,000,000, and will be used to staff and equip the CONAEXI support unit, and to cover its operational expenses during the extension of the Project (four years). In addition, £8,000,000 of the above GOES counterpart funds will be reserved to establish a fund to provide timely financial assistance to GOES entities in the implementation of priority activities crucial to achieving the targets established in the National Export Strategy.

The support unit staff is envisioned to consist of three senior technical experts, a research assistant, and a secretary, in addition to the Executive Director. The professional staff will be principally monitoring four major areas: economic policy and trends and their impact on exports; paper work (red tape), laws and regulations that affect the export process, general international trade issues and their impact on El Salvador and the development of infrastructure to permit/facilitate the achievement of much greater volumes of trade as contemplated in the National Export Development Strategy. The professional staff will interact closely with their counterparts in the public and private sectors.

The following is an illustrative organizational chart for CONAEXI. While the staff is relatively small, the Mission is confident that it is adequate to enable the entity to fulfill its coordinating role.

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**ANNEX J:  
PROCUREMENT WAIVER**

**ACTION MEMORANDUM FOR THE DIRECTOR**

**FROM:** James Stephenson, PRE 

**SUBJECT:** Waiver of Source, Origin and Nationality Requirements for the Industrial Stabilization and Recovery Project, No. 519-0287.

**Problem:** Your approval is required to waive the authorized geographic code from A.I.D. Geographic Code 000 to allow for local and Central American Common Market (CACM) procurement of the following categories of expenses up to the amounts estimated below under the 1991 PP Supplement for the subject Project:

- a) **Project:** Industrial Stabilization and Recovery
- b) **Authorizing Document:** Project No. 519-0287
- c) **Nature of Funding:** Grant
- d) **Description of Goods and Services:** Salaries, up to \$3,424,500;  
Training and Travel, up to \$503,040;  
Technical Assistance, up to \$910,000; and  
Overhead, up to \$1,172,893.
- e) **Estimated Total Value of these Procurements:** \$6,010,433
- f) **Source, Origin and Nationality:** El Salvador and the CACM

**BACKGROUND:** The subject Project contains both public and private sector grants; this waiver, however, applies only to the private sector component implemented by the Salvadoran Foundation for Economic and Social Development (FUSADES). FUSADES is a private, non-profit, non-partisan organization whose main objective is to contribute to the physical, intellectual, social and economic well being of the Salvadoran people, within a framework of economic and individual freedom. The goal of the Project is to accelerate economic growth and diversify the economy to attain higher levels of economic well being. The purpose is to stimulate growth in the non-traditional export sectors of El Salvador, resulting in increased levels of employment, investment and foreign exchange earnings.

Activities under the Project Agreement with FUSADES can be divided into three main sub-components: (1) support for FUSADES' export and investment promotion efforts (PRIDEX) in El Salvador and abroad; (2) dollar denominated credit to facilitate investment in non-traditional industrial and drawback/assembly operations via FIDEX; and (3) support for FUSADES' social and economic research program (DEES).

This PP Supplement proposes an increase in the authorized life of project funding of \$21.0 million in Economic Support Funds and Development Assistance (PSEE) grant monies, for a total A.I.D. contribution to the Project of \$50.46 million. The counterpart contribution under the private sector component consists of cost sharing from sub-borrowers, contributions received from beneficiaries of technical assistance and training activities, and in-kind volunteer time of the FUSADES commissions and Board members. The A.I.D. funds will be used to finance technical assistance, seminars and conferences, invitational travel/training, equipment and supplies, personnel, overhead costs, promotion offices located in the United States, A.I.D. project management, audit and evaluation, contingencies, and credit.

**DISCUSSION:** The authorized geographic code for the Project to date has been 000 and the CACM. However, under the final "Buy America" guidance, a waiver is required at this juncture because of the increase in LOP funding in this Amendment. U.S. source, origin, and nationality will be utilized to the maximum extent possible throughout the remaining life of the Project for such expenditures as: office equipment which can be ordered from the U.S., U.S. air carriers for international travel, U.S. technical assistance, etc. However, some expenditures preclude procurement of services from the United States, as discussed below. Specifically, a source, origin and nationality waiver is required under this Project for non-U.S. local expenditures financed with A.I.D. funds for: FUSADES' salaries and overhead, travel and training to the CACM region; and local and regional technical assistance.

The remaining host country expenditures that were identified during the PP Supplement development do not require a waiver per the "Buy America" guidance. These are: commodities and services available only locally, i.e. utilities, communications, local publications, etc.; local commodity purchase transactions that do not exceed \$5,000; local purchases of U.S. origin equipment under \$100,000; professional services contracts that do not exceed \$250,000, etc.

**SALARIES:** FUSADES' staff consists of high quality program managers, export and investment promotion officers, experienced economists, legal advisors, consultants, support staff, and others all of whom uniquely experienced with the language, culture, legal framework, governmental procedures, infrastructure, investment climate, and the economic and social problems facing El Salvador. No equivalent experience can be obtained from the U.S.; even if were it available, it would not serve to facilitate the process of institutionalizing these functions, so that Project activities are sustained after the LOP. These professional and support staff represent institutional memory and experience not replaceable over the remaining life of Project. The estimated costs for services under this budget item is \$3,424,500; the source is El Salvador. Handbook 1, Supplement B, Section 5D10a(1)(d), provides for a waiver from the authorized code for procurement of locally available services (where the cooperating country is not already eligible) would best promote the objectives of the foreign assistance program."

**OVERHEAD EXPENSES:** FUSADES is in the process of shifting to a cost-center accounting system which will allow the institution to define and fund a core program. The new system will include the introduction of cost-center accounting and overhead rates to be charged to each Program. FUSADES' administrative expenses (Central Management, Planning and Development, Communications and Administration and Finance), will be charged to PRIDEX and DEES for the remaining life of the Project, and to FIDEX for the first year only. Since the Grant is being made to a local PVO, the overhead is a necessary expense. Moreover, the cost-center accounting system will assist FUSADES in controlling costs, which will help the institution remain sustainable after the Project. The estimated cost of these services is \$1,172,893; the source is El Salvador. Handbook 1, Supplement B, Section 5B4a(7) permits waiver from the authorized code for "such other circumstances as are determined to be critical to the success of project objectives."

**TECHNICAL ASSISTANCE:** Non-U.S. technical assistance is contemplated for special local and regional expertise developed in the CACM region in the areas of export and investment promotion and research analysis. In addition, there is a need for native Spanish speakers totally familiar with export and investment programs in the CBI region and with the economic and social research of the DEES who can provide required technical assistance to FUSADES clients and/or personnel. The overall purpose of providing non-U.S. technical assistance is to exploit the local and regional expertise available and, at the same time, develop local capabilities so the Project can be sustained after the PACD. The estimated value for the services is \$910,000, the source is El Salvador and the CACM. Handbook 1, Supplement B, section 5B4a(7) permits waiver from the authorized code for "such other circumstances as are determined to be critical to the success of project objectives."

**INVITATIONAL TRAVEL AND TRAINING:** Invitational travel and training seminars for FUSADES' clients and personnel will be conducted in-country and in the CACM region, using local and regional experts in the areas of export and investment promotion, and economic and social research analysis. The estimated cost for these services is \$503,040; the source is El Salvador and the CACM. The basis for this waiver is Handbook 1, Supplement B, Section 5B4a(7), which states "such other circumstances as are determined to be critical to the success of project objectives."

**AUTHORITY:** Handbook 1, Supplement B, Chapter 5B2, states that a waiver of the authorized list of eligible countries or geographic code may be based upon the following, among other, criteria: the commodity is not available from countries or areas included in the authorized geographic code; or procurement in the cooperating country (where it is not already eligible) would best promote the objectives of the foreign assistance program. Delegation of Authority No. 752, dated April 7, 1989, provides you authority to waive source, origin or nationality requirements to permit the procurement of commodities and services in countries included in A.I.D. Geographic Code 941, 899, or 935, up to \$5 million per transactions.

**RECOMMENDATION:** That you approve a limited waiver of source/origin/nationality requirements of the Industrial Stabilization and Recovery Project, No. 519-0287, to permit host country and CACM procurement of the following categories of expenses, up to the following estimated amounts: salaries, up to \$3,424,500; overhead, up to \$1,172,893; invitational travel and training, up to \$503,040; and technical Assistance, up to \$910,000; for a estimated total value of \$6,010,433.

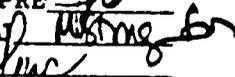
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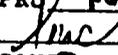
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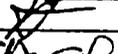
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Cleared by: JStephenson, PRE 

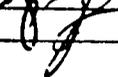
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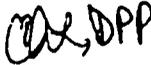
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