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EL SALVADOR

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The attached is a revision of Part I of the 1973 Development Assistance Paper (DAP) for El Salvador. While the basic concepts have not changed from the earlier paper, parts of the analysis are made more succinct based upon several analytical papers submitted by the Mission in recent years. The revised paper is also somewhat broader in scope, covering more completely some areas which were treated more lightly or not treated at all in the previous analysis although they are of considerable importance to the realization of El Salvador's development targets. In effect, the revised DAP is designed to give implicit, if not explicit, rationale for all the types of programs and projects likely to be necessary to achieve stated objectives. It also takes account of changes which took place during the interim, such as the introduction of an agrarian reform program. Finally, and most important, it emphasizes the need for similar strategies in all five country programs and ROCAP, if objectives are to be achieved.

This paper consists of four sections. Section A, Problems, and Section B, Major Causes of Problems, provide a succinct background analysis pointing to what is wrong and what has to be done to change it. Section C, Objectives and Strategy of U.S. Assistance Program, states the objectives in each major sector and indicates the strategy which the Mission is pursuing to achieve these objectives. For convenience, a brief summary of this strategy is provided under Section D, the final section of Part I.

Part II of the DAP will provide more details on problems and strategies by sector. The Health & Population Section was prepared late last year as an amendment to the 1973 DAP. The Mission is now in the process of reviewing that Section to determine what changes, if any, need to be made. Several drafts of the Education & Agriculture Sections were prepared and these are still being revised. However, we expect that all of Part II will be completed by the end of the calendar year.

Development Assistance Paper - El Salvador

Part I

A. Problems

El Salvador's major economic and social problems center around the low level of income and general living standards for a large part of the population, with a sharply skewed distribution of income. Since the beginning of the 1960s, the GOES has been striving to increase economic growth rates and reduce income distortions, but despite these efforts the situation appears to have worsened. According to official census and other data, reported unemployment as a percent of the labor force rose from 5% in 1961 to about 13% in 1971; by mid-1974 it reached about 20%. Underemployment (defined as less than full time employment) appears to have increased more during the same periods. While the accuracy of these statistics may be questioned, the situation is undoubtedly bad and the trend has not been consistent with objectives. Also, economic gains (averaging no more than 5-1/2 to 6 percent annually) have been largely offset by the population growth (3.7 to 4 percent). What gains did take place seem to have resulted in a further spread between the high and low income earners.

Although fixed investment in manufacturing during a large part of the 1960s was running about four times the level in agriculture, according to the 1961-1971 census employment in manufacturing rose only 4,500 compared with 127,500 in agriculture. (The major part of the latter probably reflects underemployment.) Thus, the value of the contribution of labor (and therefore the wages of labor) in the agriculture sector (about 47% of the labor force in 1961) probably declined significantly, while in manufacturing (8% of the labor force in 1961) it apparently increased. Agriculture sector output rose only 39%, the smallest sector growth for that period, and its contribution to GDP declined five percentage points, while output in manufacturing rose 100% and its contribution to GDP rose four percentage points. From these developments, it seems likely that the spread in income distribution probably widened during the 1960s.

Similar disturbing trends in foreign trade also reflect the developments noted above. Total exports in 1971 were up 95% (due to a combination of price and volume increases), or $111 million over 1960, but the major part of this eleven year expansion was for production which does not make the heaviest year round use of labor. Of the $111 million increase, $67.5 million was to Central America (which, in regional terms, should be considered as import substitution rather than exports), and this increase was due almost completely to manufactured goods exports (agriculture exports and imports are controlled under high nominal and effective tariff rates; as noted earlier, this protection may not always be sufficiently labor intensive to maximize achievements of employment targets. Moreover, $37.5 million of the remaining $43.5 million of export expansion to the rest of the world (the non-CACM area) represents traditional crops--coffee, sugar, and cotton--while nontraditional exports outside of the CACM rose only $6.1 million annually between 1961 and 1971.

Imports expanded $125.2 million from 1962 to 1971, which is not large for a developing country, but the composition of goods imported changed considerably; consumption good imports rose only 57% while capital and intermediate good imports rose 96% and 143% respectively. It also seems likely that the structure of capital good imports changed with greater emphasis on more sophisticated goods which reduces the need for labor. The increased reliance upon imported intermediate goods more than likely retarded the use of domestically produced intermediate goods which resulted in a further reduced demand for the services of labor, and it made the economy more sensitive to foreign economic disturbances which reflect on the balance of payments; e.g. reductions in imports tend to put a strain on the manufacturing sector and thus on urban employment.

The import expansion, therefore, was dominated by intermediate and capital goods from outside CACM while export expansion was dominated by manufactures to the CACM (import substitution for the region), with some increase in traditionals (reflecting both volume and price increases). The overall effect on labor was the reverse of the intent. While manufacturing grew, the increased use of labor was small and reported unemployment and underemployment rates rose; again, this would imply a spreading in income distribution.

It should be noted that the underemployment and unemployment problem is critical in the urban as well as in the rural areas. The flow of people to the urban areas probably reflects the rapidly rising urban wage levels for skilled labor, but the migrants lack the skills needed to realize these benefits and they therefore usually join the underemployed or the unemployed. It seems likely, therefore, that the incentive for moving to the city already exists, although the means have not been provided to assure benefits to the migrants.

In short, both population and labor force growth were high through the period. On the other hand, economic growth rates were not impressive, and a major part of the labor force experienced little benefit from the economic growth which did take place. Exports increased, but they seem not to reflect very much labor intensity. Imports grew, but mostly for capital and intermediate goods, which resulted in (1) the use of raw materials from outside rather than inside the country, and (2) an increased use of capital equipment relative to labor. Unemployment has increased in both the urban and the rural areas.

B. Major Causes of Problems

While a number of forces undoubtedly contributed to the developments noted above (some of which will be discussed below) at least two have had a major influence; inappropriate economic policies, especially tariff and exchange rate policies, and inefficient investment in human asset development. For the longer run, two other forces must be considered; the problem of rapid population growth and the effects of the present distribution of non-human wealth.

1. Tariffs and Exchange Rates--Growth and Income Distribution

The tariff structure in El Salvador is the one agreed upon in the CACM and is therefore in effect in all five of the CACM member countries. Most tariffs among the five were either eliminated or greatly reduced to increase trade among them (although direct import and export controls set a new barrier). However, there is a critical question with respect to the change in the CACM tariffs vis-a-vis the rest of the world. According to studies made by McCleland of AID, and by SIECA, the overall tariff was increased; McCleland estimates an increase from 42% to 48%, the SIECA from 35% to 45%. (On the other hand, according to a study financed by ROCAP, Cline (Brookings Institute) estimates that the weighted average declined from 40% in 1958 to 27% in 1968. However, this weighted average decline probably does little more than indicate that substitution took place with CACM production replacing imports from the rest of the world; i.e. imports were reduced because of tariffs thus the tariff with lower weights was reduced. Indeed, this weighted average calculated by Cline continues to decline even with the introduction of the 30% San Jose Protocol.) Even if one assumes that there was little change in the tariff on finished manufacturing (as against the more likely increase estimated by the two earlier studies), adding to that the 30% San Jose Protocol, we see little possibility of any reduction in the nominal rates. Moreover, combining this with the virtual elimination of tariffs on capital and intermediate goods (new industries are excused for five years and this exonoration may be extended another five years by request) one must conclude that effective rates probably increased rather substantially. Under these circumstances, the assertion that economies of scale are largely responsible for increased internal CACM trade seems to fall away to a poor rationalization. (How many of the industries developed in CACM over the last decade would experience downward slopping cost curves over any significant area? We see no evidence of this in El Salvador.)

Under any circumstances, and whatever happened in the past, the present tariff schedule is high for finished manufactures, and the tariff on capital equipment and intermediate goods is low or nonexistent. Therefore, the effective rates are also high, and there is a strong incentive to produce for import substitution. High tariffs tend to hold down imports, thus they reduce the demand for foreign exchange. Accordingly high tariffs tend to permit or maintain a higher than "natural" value of the domestic currency. This means, of course, that the price of domestic goods and services (and factors of production--including wages) in the world market are raised above what they would be without the tariff. As a result, exports are discouraged and foreign trade takes place at a lower level. Producers will be producing in areas where they are less competitive and, therefore, total output will be less and growth rates will be smaller. Since countries tend to be more competitive in production which requires or permits greatest use of the production factor which is most abundant, it follows that the reverse is also true; i.e. a high tariff will reduce the use of the most abundant production factors (low or unskilled labor) and thus reduce their value in the domestic market.

In summary, then, current tariff and exchange rate policies tend to hold down the demand for labor relative to what it would be (1) if CACM trade vis-a-vis the rest of the world was made more free, (2) if the spread between tariff rates (on capital and intermediate goods as against finished manufactures) was reduced, and (3) if the exchange rate was permitted to adjust to a new equilibrium level. This would help to increase growth rates and benefit labor. First, capital equipment would become a relatively more expensive production factor thus encouraging the use of less sophisticated equipment and thus more labor relative to a unit of capital equipment. Second, investment and production would tend to increase in areas using domestically produced intermediate goods, while production utilizing intermediate goods imports would be discouraged. Finally, by producing in areas where El Salvador's competitive advantage is greater, growth rates would be increased (compared to what they would otherwise be). These factors--increased growth rates and increased demand for labor--would increase real wages and thus benefit laborers. These measures would also tend to make the economy less sensitive to adverse balance of payments movements because of a smaller dependence upon imported intermediate goods for the manufacturing sector.

All of this implies that, under the current tariff schedule, employment increases per colon of investment are smaller and there is a lack of incentive to produce and to export goods produced under more labor intensive conditions or to export more outside of the protected area. El Salvador's traditional exports are heavy users of labor, but this use is very seasonal, and therefore leaves many workers idle during most of the year. Indeed, the traditional exports presently depend upon low levels of demand for labor (high levels of reported unemployment and underemployment); to hire a coffee, cotton, or sugar harvester away from other activities for about four months, one must pay the salary which will assure the worker's current annual income in both money and leisure.

Some have noted that El Salvador has benefited more from the common market than have some of the other CACM countries. Yet, even if true (and it may be true), it does not necessarily follow that it is therefore the best policy for El Salvador or for CACM, since growth could be greater, and--perhaps more important--a larger share of the increased resource availabilities could go to the lower income earners; those who gain from high effective tariffs are a small group in the higher income levels and the small group of more skilled laborers rather than the larger group of unskilled very low income earners; indeed it hurts the latter. Furthermore, it should be clear from what already has been said that free trade in the CACM area should be encouraged (it is now controlled by each of the five governments). This freeing of internal CACM trade does not, however, reduce the need to free trade vis-a-vis the rest of the world. Indeed, given the nature of the five Central America countries, it seems very probable that a freeing of CACM outside trade would have even more dramatic results than freeing internal trade, but the freeing of both would be most beneficial to the region as a whole (even if not for each individual or even for each country), especially for the lower income earners.

2. Investment in Human Asset Development

(a) Education

Under any given set of economic policies, labor--as with any production factor--will be more or less productive depending upon the amount and kinds of investments made in it. Economic policies can and should be used to increase growth rates (and thus increase the total availability of resources), and they can and should be used to increase the demand for labor and thus the value of labor. However, the quality of labor must also be increased if the lower income earners are to maximize benefits; i.e. if they are to realize benefits from economic growth. Insufficient training of labor has resulted in a considerable increase in wages only for a small group of skilled and semi-skilled, but it has not had any strong upward effect on total employment and the total wage bill. This, in turn, reflects a long period of insufficient and inefficient investment in education over past decades (although the amounts increased sharply just a few years ago from about 24% of the 1960 budget to about 32% in 1973, in response to an increased GOES priority for education and to supporting AID education grants and loans, which is expected to increase the value of labor in future years). It is estimated that almost 50% of the population is illiterate. Dropout rates in the public schools have been large, the curricula has been far from adequate, textbooks have been scarce and below suitable standards, and teacher training has been less than adequate. These factors tend to hold down the value of labor and result in low wages for a large part of the labor force. As industrialization progresses, large segments of the labor force are unable to meet the requirements for skilled and semi-skilled positions. Many unskilled workers remain underemployed or unemployed, and they drift back to the rural areas in response to seasonal demands, thus pushing down the rural wage. Wages rise for only the small group of skilled and semi-skilled, and investors in the manufacturing and processing industries are again encouraged to turn to more sophisticated labor-saving capital equipment. This will soon become more critical following the expansion and growth of industries in the new free export processing zone.

To repeat, investments are encouraged in more sophisticated capital equipment rather than in equipment which requires increased use of labor, first, because of the tariff and exchange rate structure, and second, because of insufficient training of the labor force (investment in people). That is, increased demand for skilled labor without equivalent increases in supply forces up the price of the more skilled workers, while reduced tariffs on capital goods make capital equipment relatively less expensive and thus more dominant in the factor mix; the ratio of labor to capital equipment tends to decline through the use of more sophisticated capital equipment.

(b) Health and Nutrition

Education, even when provided, can contribute little when health and nutritional conditions preclude effective participation in the learning system by a large part of the population. In El Salvador, a serious short-fall exists in protein and caloric intake, especially for lower income pre-school children. The resulting brain damage, much of which apparently is irreversible, seriously reduces learning ability. In short, pre-school child malnutrition has a permanent adverse effect on the labor force, reducing its usefulness and value, and thus holding down wages for a large segment of the population. Even without severe brain damage, insufficient nutritional intake lowers stamina and thus productivity. Since malnutrition usually affects only the lower income group, it contributes toward a further widening of dispersion of income distribution.

3. Population Growth

High population growth rates, on the other hand, tend to increase the supply of labor, and this also tends to hold down wages. A number of factors have tended to encourage the high rates of population growth which prevailed over the last half century. High child mortality rates (because of poor medical services and low levels of nutrition) have encouraged the growth of families to assure sufficient children for family income security. Low income levels have been known to be associated with large families, with one influencing the other. A high correlation exists between levels of educational achievement and family size; other things being equal, the more educated the family members (excepting the very wealthy, of course) the more likely they will find methods to limit family size. Also, higher levels of female employment opportunities are usually associated with lower birth rates. In short, high rates of child mortality, and poor health and nutritional conditions in general, combined with low incomes and insufficient education, and high female unemployment, have tended to increase the rate of population growth and the burdens of Government to provide the services required by the general public. Unlike economic growth and distribution policies and labor training, the population problem tends to be more longer run, but it is a serious problem which hampers continued long run development and tends to hold down growth in per capita income for the lower income earners.

4. Ownership of Wealth

Finally, there are sharp distortions in the ownership of non-human capital assets, including land. According to official census data, about 96% of the farms are under 20 hectares and about 71% are under two hectares. According to government estimates, 60% of the farm land is owned by 2% of the population; 91% of the population owns only 22% of the farms. About 40% of all farmland is dedicated to the traditional export crops. Most of the small farms are on the poorest land, which permits little more than subsistence farming. High population density, of course, brings a need for more intensive use of existing land but techniques used for intensive farming as practiced in El Salvador need improvement. The "poorer" people who could and would use the land more intensively do not have the capital to purchase it. Many rent land, but these people tend not to make investments which are longer-run, since their period of occupancy is always in doubt. Even the forced three-year lease does little to alleviate this problem, since it is usually not enforcible. When it is, the result is a decreased supply of rental land and, of course, a consequent rise in the rental price. Therefore, wealthy land owners often hold land which is not fully utilized. Nevertheless, the GOES has just introduced a new land reform program which has been passed by the legislature, and which permits considerable flexibility in the government's ability to redistribute land ownership; the law has been highly praised by experts in land reform matters, and implementation is about to begin. Nevertheless, especially in its early stages, any land reform program is likely to have both positive and negative effects on overall production; it is probable, however, that the lower income earners will realize a net gain.

<u>In summary</u>, then, <u>the major problems</u> for El Salvador are (1) the low economic growth rate which limits the total resource availabilities, (2) the large population growth rate which increases the supply of labor, (3) the relatively low demand for labor which holds down wages, (4) the low levels of investment in people, including training, education, health, and nutrition; for a large part of the population which results in a lower quality of labor and thus lower wages, and (5) the distortion in land ownership. Together, these have contributed to severe income distortions with low income levels for a very large part of the population.

C. <u>Objectives and Strategy of the U.S. Assistance Program</u>

The <u>objectives</u> of the U.S. assistance program in El Salvador--that is, <u>the thing or things it aims to achieve</u>--are to (1) provide for a more rapid growth of gross national product and (2) raise incomes--both absolute and relative--for the lower income earners. Most important here is the objective to create a continuing process such that foreign assistance can be discontinued at some future date without any slowdown or discontinuation of the improved income distribution and growth targets. To do this the five basic problems noted above (at the least, the first four) must be overcome.

<u>The strategy--the way to achieve the objectives</u>--then, is primarily to assist the GOES in increasing and improving investments in human wealth at varying levels, and secondarily, to provide whatever further non-human capital assistance is necessary in support of these investments in people. A part of this is at a level of more direct investments in the lower income earners; this includes primary, secondary, and vocational education as well as population, and health and nutrition, and advice to small farmers. Most of this assistance is educational

in nature with some supportive capital assistance from time to time. The other part is at a level perhaps one or two steps removed from those who will receive the final benefit, although it too is basically investment in people. This is the area concerned with gathering data, analyzing it, making recommendations aimed at accelerating growth and affecting the distribution of that growth; in general, this includes improving the quality of government officials whose job it is to determine GOES priorities and develop programs and projects to bring about economic and social development. It also involves other higher level training related to the factor demands derived from this in other activities in the economy. The details of this strategy are outlined below, first in a discussion of economic policies and then in the more direct investments in lower income earners (all of this is a matter of degree, though throughout there is the implicit concentration on investments in human capital as against non-human capital).

1. Economic Policies

Ideally, to get the quickest results, measures should be introduced to encourage investments which will maximize economic growth and, at the same time, increase the demand for labor. These measures would help to reduce unemployment and underemployment, and eventually pull small farmers off the most inefficient land. To do this, economic policies must be changed rather drastically. In particular, nominal and effective tariff rates would have to be reduced and the exchange rate would have to be depreciated so that any dampening of imports would be accompanied by incentives to export (by decreasing export prices in terms of foreign currencies), particularly the non-traditional and more labor intensive production techniques. (On the other hand, given current rates of world monetary expansion, the CACM could substantially reduce tariffs and avoid exchange rate changes by holding monetary expansion below world levels. This would permit CACM countries to avoid exchange rate changes or a decline in domestic income by decreasing tariffs to off-set the balance of payments surplus caused by increasing world demand as a result of world monetary expansion.)

Obviously, any change in the tariff and tax structures and thus in the exchange rate, or any hold-down in the rate of CACM monetary expansion, would have to be a gradual process; but even a set direction over a given period would probably encourage anticipatory investments which could have relatively quick results and ease the frictions that accompany structural change. The more formidable obstacle, however, is that a change in the tariff schedule and the effective exchange rate or monetary restraint would require agreement with the other four members of the Central American Common Market (CACM). Because of differences in the timing of elections in each country, and thus the differences in the timing of readiness for hard development steps as against short-term politically motivated actions, joint decisions of this nature become difficult. Moreover, the influence and the technical understanding of each of the country representatives probably differ, thus making the effectiveness of the established operating committees more problematical. While the source of a country's push and strength for development (the Ministry or agency) usually makes little difference within each individual country, with the formation of the common market this can become important. It could mean that an established committee representing, say, Central Bank Directors, would consist of some who are the active development forces in their respective countries, while others are somewhat (or even far) removed from these activities; the result is that the committee is made much less effective. (In El Salvador, one of the most important ministries influencing economic development policies--the Planning Ministry--does not even have direct representation in CACM committees.) Instead, the most effective influence may come from outside the formal committees or the formal governmental network. Finally, it takes time to convince each of the five countries that such drastic changes are needed, and that these changes can help to achieve stated objectives. Witness the time needed to establish a common market in Europe, where differing comparative advantages were greater because of resource diversification (and thus favored even more the elimination of internal tariffs), and where political sensitivities--although considerable--were probably less prevalent. To achieve progress in this area, then, takes the efforts of all five countries and the appropriate regional organization, not just El Salvador alone.

For El Salvador, therefore, we do not see any likelihood of very sharp upward movements in economic growth rates. Nor do we see any possibility for a dramatic improvement in income distribution. Indeed, what must be accepted from the outset for El Salvador--and probably for all of the CACM countries--is that the results will be far less dramatic, and thus the returns per unit of investment will be much less than with these reforms. To change this situation we must (1) convince each individual country of what the problem is and what is needed to bring a change; (2) develop the regional agencies, especially SIECA, to convince the participating countries that this must be done; and (3) provide the regional and bilateral technical assistance necessary to accomplish these objectives.

Recognizing that dramatic steps forward are not possible at this time, our strategy with respect to economic measures (such as tariff and exchange rate, monetary, and fiscal policies) is to continue to provide whatever assistance is necessary to help the GOES to: (1) gather information necessary to permit analysis of problems, (2) better analyze and understand the basic problems which are confronting the country, (3)recommend action programs to achieve regional and individual country objectives, (4) design tax and expenditure programs to help overcome domestic problems, and (5) present to the appropriate regional organizations convincing evidence of the need for change in regional policies. This continues to be a program of education, which should be of great benefit to the country even under current conditions. It would be especially effective if and when CACM restructuring takes place; indeed, it aims also at influencing this change. However, just as the problem is a common problem for the five countries which must be attacked by all five together, so is it necessary for all five USAIDs and ROCAP to pursue a similar strategy if noticeable growth and distribution targets are to be achieved. Without this joint effort, achievement of the Congressional mandates in Central America seems, at best, far off.

2. More Direct Investment in Lower Income People

Beyond these economic policy measures, however, the GOES must continue, and even expand, activities designed to increase the share of income going to lower income earners by increasing the value of the services of this group. As noted previously, high nominal and effective tariff walls, combined with an over-valued exchange rate, tend to hold down the demand for labor relative to other factors of production and thus hold down the total wage bill. However, we also noted another factor which affects the total wage bill: the quality of the labor force. Over the recent past, those industries which have developed in El Salvador have increased the demand for the available supply of certain skilled and semi-skilled labor. As a result, wages for these more skilled workers in the manufacturing sector have moved upward (sometimes to well above the officially established minimum wage), and this is another important factor which encourages changes in factor mix or discourages certain kinds of investments, both at the expense of labor. In effect, a small group of skilled and semi-skilled laborers experience rising real incomes while unemployment and underemployment grow. To overcome this problem within the constraints noted previously with regard to economic policies and incentives, the GOES must increase the supply of skilled and semi-skilled labor to increase the use of labor (both male and female) relative to more sophisticated capital equipment. Even if much less dramatic than a combination of this measure with appropriate economic policy measures, increased attention to education programs would still contribute to the objective of reducing distortions in income distribution. Investment in education would: (1) increase the supply of skilled and semi-skilled labor, and thus (2) increase wages by increasing the value of labor, (3) encourage domestic and foreign investment to produce in areas where labor is a relatively more important production factor (where the degree of labor intensity is greater), and (4) for all economic activities it would encourage a mixture of production factors which favor labor rather than more sophisticated machinery.

In the past, our strategy in education has been confined largely to longer-run investments. This involves improvements in the formal public primary and secondary education system by (1) raising the quantity of education through the provision of more and better equipped schoolrooms, and (2) raising the quality of education through reorganization, teacher training, curriculum reform, and materials production. A major part of the reform program contributing to increase the quantity of improved quality is the introduction of more capital intensive techniques in education; good teachers cannot be induced to live in the backward rural areas at prices which the society is willing or able to pay. The introduction of TV and radio permits wider distribution of better quality lectures and demonstrations with the use of lower level trained people to follow with discussions in the individual classrooms. As the number of students covered by this system increases, the cost per student declines, and the higher quality benefits a greater number of people. However, while this program should and will be continued, the major impact will not be realized for some years; even after it covers all twelve years of the public school system, graduates of this program will only gradually reflect the improvement as more and more students benefit from the full program and as methods are improved through experience.

In addition to continuing the efforts noted above to further expand the formal education programs, and as a part of AID strategy, the GOES is now in the process of carrying out a sector analysis with the assistance of AID. This exercise will provide the information necessary to maximize the effectiveness of the education system to meet the government's income distribution goals. Moreover, it has spurred the Planning Office of the Education Ministry and has provided some assurance that sector analysis will not be a once-and-for-all exercise, but that it will be a continuing effort of the Ministry. Additionally, as part of that study, a task force was organized to determine (1) private sector needs for certain skills, (2) existing training institutions which provide these skills, (3) other new training requirements, and (4) ways to assure continued coordination between providers of education and users of the finished product (labor services). With this study as a guide, AID is now beginning to assist the government to improve the training of its labor force to increase its value in the labor market and to encourage more labor intensive industries. This effort concentrates on shorter term vocational type training for both sexes and all ages, with the GOES and the private sector aiming at training of skilled and semi-skilled persons, while AID and GOES programs are aimed at training unskilled persons; the lowest 68% of the labor force. The institutional mechanism to assure coordination between the providers of education and the users of these production factors will also be able to encourage increased training and employment of women as well as men.

Attention will also be given to means for increasing the higher level University training requirements for those who cannot afford such training. The Ministries and agencies of El Salvador have a substantial number of middle income people whose university training is limited to either a local private university offering few graduate courses or to the National University (at almost no cost) where the graduate level (although good) is not of sufficiently high standards to meet GOES and private sector needs for certain essential skills. As a result, many of the GOES officials in important positions lack sufficient technical training to best guide the executive branch in achieving stated development objectives or make maximum use of foreign assistance and domestic revenues. There is, therefore, a need for a program which will provide better training for both men and women to maximize the effectiveness of government and private activities. While certain programs of this nature are available for the special areas of concentration, these are project oriented and not broad enough to meet overall country needs.

A recent program that will be funded by ROCAP and was developed through the initiative of the Mission Directors' Coordinating Committee, is the Rural Sector Management Project. Its purpose will be to increase the awareness of selected public sector officials of impediments to effective management and of modern management concepts. The Central America Institute of Business Administration (INCAE) will be the implementing agent. Although initially started with rural sector managers, if successful the project would be extended throughout the government.

At the risk of repetition, then, what we are saying is that the most effective and dramatic way to solve the basic problem of low employment levels and wide dispersions in income is to change basic economic policies (especially tariff, tax, exchange rate, fiscal, and monetary policies) combined with intensive education programs at all levels. However, short of this, one can at least conduct a program to assist the Government in carrying out the necessary analysis and planning to maximize use of available resources within existing constraints and to encourage changes in regional policies which will benefit the CA region, and to assist in increasing the value of labor, and thus increase wages and, at the same time, encourage more labor intensive industries through an expanding supply of labor with the degree of skills required to satisfy expanding industrial sector needs.

This more limited approach, of course, will do less to affect significantly the overall unemployment and underemployment levels, which probably total about 400,000 persons. (Inclusion of the subsistence farmer would probably more than double this amount. The inclusion of women presently insufficiently trained to apply for most jobs would raise this amount even more drastically.) However, it would seem logical that a labor training program which also includes the skilled and

and semi-skilled would result in shifts to higher categories such that while annual unemployment and underemployment levels declined by only, say, 20 to 40 thousand, the number of workers receiving higher real incomes could be several multiples of that amount. (Assume training starts at the higher ranks which leaves vacancies at lower levels, such that each level of workers moves up slightly.) Nevertheless, to significantly reduce unemployment, underemployment, and subsistence farming, would require more dramatic economic policy measures and this requires similar efforts throughout the CA region.

As noted before, investment in people involves more than just investment in education. Programs are therefore being prepared to assist and support the GOES to improve health services and conditions, and to increase the nutritional intake of the lower income groups. As a result of a very recent ROCAP project, the Mission will be calling upon the technical services of the Institute of Nutrition for Central America and Panama (INCAP) in the preparation and implementation of the health sector analysis currently underway and in the proposed FY 1978 nutrition project. These programs aim at reducing the degree of malnutrition and reducing health hazards, and thereby improving the learning (and thus earning) capacity of these less-fortunate people. The health and nutrition programs, which will be extended to the rural and village level through the use of para-medical personnel, combined with the education programs, should encourage some redistribution of the benefits realized from any increased growth. Because of its positive effects on learning capacity, it should also contribute to the encouragement of investment and production of a more labor-intensive nature, which will benefit the lower income earners; healthier people produce more and better quality goods and services.

To assist the small and medium farmers (who represent a large part of the lower income earners) the USAID is supporting the GOES in more direct programs. The strategy here is to aim at factors which will encourage small farmers into highest profit uses and increase the degree of labor intensity. These programs contain an important education element including an increase in the production options available (through research) to the farmer so as to increase his earning capacity. Again, these will fall short of the dramatic potentials of economic policy changes (and thus result in lower returns per dollar of U.S. and other investments), but they can make an important contribution to improve income distribution through increased productivity and thus higher income for the rural farm sector. These programs also aim at a more intensive use of labor; i.e., more labor per unit of land. One on-going project provides assistance in research, education and extension to improve conditions for these small farmers. The research and delivery aims at finding more and better production possibilities for the very labor intensive multiple cropping; this encourages increased units of (low skilled and unskilled) labor (El Salvador's most abundant production factor) per unit of land (El Salvador's relatively scarce factor). Another on-going project, in nonhuman capital, aims at increasing grain storage capacity, reducing grain losses, and avoiding sharp grain price fluctuations through the year so that (1) the small and medium farmer will have a higher income and (2) eventually the farmer will be encouraged to try new crops under the influence of (a) an expectation of a higher income and (b) the assurance that there is adequate domestic storage of grains to meet his food needs should foreign supplies of basic grains--their basic food requirement--be cut off.

A review of the agriculture sector is underway for the purpose of developing a series of programs to promote more rapid development of the sector. The Tripartite evaluation (by AID, BID, and IBRD) is just one part of this exercise. Perhaps more important, the Mission is also financing a number of studies of small farmer problems, aimed at assisting the government to maximize the effectiveness of its agrarian reform program. Additionally, a joint working group has been formed (GOES and AID) to determine what technical assistance needs exist (1) to help the GOES in developing specific criteria and guides for the implementation of its agrarian reform program and (2) to develop a loan program in support of these efforts. The project to develop an ability to carry out household surveys will be of invaluable assistance in developing a better understanding of the characteristics of the small farm workers, and thus in designing measures to increase their incomes.

Over the last few years, TAB research projects have been carried out in weed control and irrigation. These programs are being cntinued and their research should be made available to farmers. However, new research under these programs should be oriented more toward the small farmer needs and to delivery systems which will best accomplish this. At present, they are not so oriented.

Population control is by far the longest range problem, but it is equally important in terms of longer run economic and social development; it affects per capita family income and the size of the labor force. It is also one of the most difficult to accomplish because it relates so closely to a number of factors, including income, female employment, and education levels, as well as health and nutrition. Per capita income is held down by population growth, while population growth is highest for the lowest income earners. Similarly, while the higher the level of education the greater the emph[illegible] on family planning, high rates of population growth make public educ[illegible] more expensive. Poor health decreases chances of survival and ea[illegible] higher birth rates to achieve a desired family size. For emp[illegible] males, the cost of having children is far greater than for unemp[illegible] males. Unfortunately these bring conflicts and tend toward the problem [illegible] "vicious circle." Yet this problem can be attacked on all fronts s[illegible]neously and this is the strategy outline here.

Despite the usual political difficulties [illegible]ciated with population and family planning programs, this is an [illegible] in El Salvador where there has been a growing awareness and conc[illegible] in which substantial progress is being made and where further progress is expected in the coming year. There are clear indications [illegible] greatly heightened Government concern (including the personal attention of the President and his Cabinet) with the population problem, an[illegible] Population Council has been established at the ministerial level. [illegible]pulation Unit was established in he Ministry of Planning, and a pop[illegible]tion policy was prepared and announced. The policy provides the [illegible]rmation necessary, and the alternative methods available, for each [illegible]son to decide whether controlling family size is desirable and if so what [illegible]vantages and disadvantages each method presents. However, ev[illegible] rapid progress is made by the Government in improving and expanding [illegible]pulation programs, they are not likely to have a significant effect [illegible] the economy for at least ten years. Our strategy is to accept the [illegible]ship of the GOES in this area and provide whatever assistanc[illegible] advisable to support population programs developed by the [illegible] and to help in planning their programs when that help is requ[illegible]. In this respect, a recently approved project paper, prepared join[illegible] the Ministry of Health and the USAID, is aimed at reducing the [illegible]tion growth rate from 3.1% per year (1975) to approximately 2.5% [illegible]79.

In conclusion, the Mission's Special [illegible] Activities project seeks to promote the economic and socia[illegible]lopment of marginal people in both urban and rural areas. The Miss[illegible] places particular stress on projects that will (1) increase the [illegible] earning position of the participants so as to permit them to partic[illegible] in the money economy and improve their position in the econ[illegible]ucture of the country, and (2) improve the living standards o[illegible] community through non-pecuniary measures such as potable water, rural electricity, better sewerage, etc. Among the several criteria [illegible] by the Mission for SDA projects are the following: (1) assist [illegible] businessses, cooperatives, and cottage industries with little [illegible]al or credit

(2) establish vocational training programs that will assist participants to obtain better jobs; (3) assist in the introduction and utilization of technological innovations that have a direct impact on the standard of living: and (4) introduce or expand production employing women.

D. Summary of Strategy

El Salvador's economy over recent decades has been characterized by severe income distortions and low income levels for a very large part of the population. These income patterns reflect (1) inadequate economic growth, (2) relatively low demand for labor, (3) insufficient amounts of well trained labor, (4) large population growth rates which result in a greatly expanding supply of labor, and (5) distortions in land ownership. The GOES has been and is trying to reverse past trends and bring about improved conditions for the lower income earners in both the absolute and relative sense. To accomplish this El Salvador must increase its investments in people and revise its major economic policies.

Economic policy reform is a must if dramatic increases in growth rates and in the demand for labor are to be achieved. This would directly benefit the lower income earners. However, these policies are always difficult to change, and when tied to a five country agreement they are almost impossible to change in any short period of time. Nevertheless, our strategy is to provide assistance in this area to maximize economic growth and labor demand under current exchange rate and tariff constraints and to encourage analysis which will lead to eventual change in CACM policies. To realize any success in this area, however, these activities must be given highest priority in all five countries and in all five Central America AID missions, as well as in the Central America regional organizations and ROCAP.

At the same time, and to maximize the benefits to labor under these constraints, our strategy also includes direct investment in people--education, health, nutrition, and population--to hold down the growth of the labor force and increase the quality of the labor force; rural, urban, male, and female. By this technique labor will be more valuable on the labor market. We are also providing more indirect assistance to improve data collection and thus better know what problems exist and what can best be done to alleviate them. Also, we are assisting the GOES to increase revenue collections to finance necessary public investments.

While dramatic short-time results are [illegible] as a result of these programs alone, lower income earners w[illegible] some and the economy will be made more ready for more dra[illegible] when appropriate economic policies are introduced. That is, a[illegible]ate economic measures will provide for a greater distribution of the [illegible] of growth; rather than a "trickle-down" we would get a "[illegible]ow-down."