

Country Development Strategy Statement

FY 1985



Rocap

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R O C A P

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FOREWORD

From its vantage point as a regional office, it is incumbent upon ROCAP to take a broad perspective in analyzing the development problems of Central America. As is clear from the following CDSS analysis, ROCAP is concerned about overall U.S. assistance policies for the region, the absence of well thought out approaches and alternatives, and the lack of a consensus within AID and other U.S. agencies on what needs to be done on key issues such as the survival of the intraregional trading system.

The ROCAP CDSS, therefore, focuses on an analysis of the region's critical economic and development problems and the CACM, outlines a proposed strategy for the region, and suggests U.S. policy decisions that would need to be taken to start to carry it out. These decisions have implications on how the U.S. interacts with the Central Americans and other donors, and on where U.S. assistance efforts would be focused at the policy level on many of the issues. Secondly, the CDSS provides the supporting analysis and framework for the ROCAP sector strategies and specific programs to deal with common problems. These programs would provide only a very small part of the total resource requirement needed from the U.S. and other donors to support the proposed strategy for the region.

I. THE NATURE OF THE CRISIS AND U.S. INTERESTS

The current crisis in Central America must be viewed in its historical perspective. In that light, the crisis is not merely the result of a confluence of adverse conditions in the world economy; nor can it be understood simply as a Marxist-Leninist conspiracy to subvert countries formerly in the domain of U.S. influence. The real crisis is in the viability of the established political and socio-economic system. Despite the unprecedented economic growth over the period 1960-1978 and the structural changes achieved so far, the system has not responded adequately to the needs of the vast majority of the people. Rapid population growth has eroded progress and has made solutions more difficult.

The demand for fundamental change in the traditional power structure is widespread and, as efforts for change have been turned aside or suppressed by defenders of the status quo, frustration has mounted and polarization has increased. The question of whether access to participation in the power structure can be achieved by means other than armed rebellion is fundamental. The Nicaraguan revolution and indigenous, but externally supported insurgencies in Guatemala and El Salvador have brought this question to the fore.

The socio-economic system of Central America developed around the export of a limited number of agricultural

commodities to the world market. The system encouraged the accumulation of extensive land holdings and led to the growth of a large class of underemployed agricultural laborers. For those who wish to exploit the parallel, the system comes remarkably close to fitting the Marxian description of capitalist economic development characterized by control of the means of production by a few and the creation of the "reserve army of the unemployed". In this process, the armed forces became the guarantors of internal security and "political stability", which often meant the brutal repression of all attempts on the part of campesinos and laborers to organize, the suppression of popular expressions of discontent and the elimination of many moderate proponents of reform. (This statement does not apply to Costa Rica).

The concentration on a few commodity exports brought about a condition of dependency on world market prices and the importation of most manufactured goods. The accumulation of land holdings and the absence of alternative economic opportunities for those displaced from the land concentrated wealth and political power in the hands of a few and widened the income gap between the "haves" and "have nots".

One of the most significant and best conceived attempts to attack some of these problems was the integration effort launched by Central Americans more than two decades ago. The

focus was heavily on strengthening and broadening the industrial manufacturing sector. Despite the many significant accomplishments of this effort, the structural change achieved was relatively modest since the dependency on exports of a few agricultural products still accounts for more than half of total export earnings. Moreover, the employment generation effect was small relative to the increase in the labor force, and the problems of underemployment and highly skewed income distribution were not noticeably altered.

The integration process was interrupted by the El Salvador-Honduras war of 1969 and its consequences. This event along with the outbreak of civil war in Nicaragua and El Salvador in 1978-1979 combined to impede the gradual evolution of a regional development policy that would have achieved a better integration of the agricultural and manufacturing sectors and developed a broader and less vulnerable structure of exports.

It is clear that the real crisis of Central America will not be resolved solely through short-term financial adjustments toward balance of payments equilibrium, nor as a functional response to a recuperation of the world economy. Neither will it be resolved merely by suppression of the armed rebellion which is under way in several of the countries. What is required is a new effort on the part of the Central Americans,

with substantial assistance from abroad, to revive and redirect the process of structural change in the system. This should be the goal of Central American regional development policy and of external development assistance efforts.

Given the importance of the region to U.S. strategic and economic interests, a restructuring of the system in its political and economic dimensions should be the overriding goal of U.S. foreign policy. Ideological differences are now dividing and polarizing the region into those who want no significant change in the power structure and those who advocate violent revolution as the only vehicle for change. If the current conflict appears to foreclose an option for change through a democratic evolutionary process, the outcome is predictable because the demand for change is pervasive.

In these circumstances, the key question for U.S. policy is how to keep open the avenues for change which preserve the social values and organizing principles of a democratic system -- the primacy and dignity of the human person and respect for basic human rights; participation in the process of political decision-making; and equitable access to work, social services and property which permit individuals to contribute to and share equitably in the benefits of economic and social development. It is important to the U.S. national interest that the social structures which evolve from the current process be ones which incorporate and defend these basic values.

Against this background, this document examines the current crisis of severe balance of payments constraints and negative growth and the fundamental structural problem of the regional economy that must be addressed if a self-sustaining process of economic and social development is to be achieved. The analysis highlights several fundamental development goals and outlines a regional strategy which ROCAP regards as being most appropriate for attaining those goals. The current crisis is treated as critical in its own right, but also as an integral part of the problem of long-term economic and social development of the region. The fundamental objectives of the proposed strategy are employment generation, better income distribution, and more adequate satisfaction of basic human needs for a larger segment of the population. The strategy is essentially export-oriented, sectorally-balanced, and consciously constrained by Central American factor endowments and the natural resource base.

The regional development strategy outlined in this paper reflects the general direction that the Central American regional policy makers are taking and represents a realistic and feasible approach to resolving the immediate crisis and reorienting the development process for the longer term. The strategy needs more detailed articulation and specification through dialogue among the policy makers and with the external

assistance agencies and it needs to be made operative through the appropriate adjustments of the regional policy instruments. The goals and characteristics of the strategy as presented here provide the framework for the proposed ROCAP development assistance strategy over the FY 1985-1989 planning period.

II. THE CURRENT ECONOMIC CRISIS: ITS DIMENSIONS AND CAUSES

Regional economic growth which was sustained at impressive annual rates during the 60's and early 70's began to falter in 1979 and, by 1980, the crisis was unmistakable. From 1960 until 1977, real GDP growth averaged between 5% and 6%, which represented about 3% real growth of output per capita. In 1979 and 1980, there was virtually no growth in the region's GDP and in 1981, it began to fall in absolute terms. By 1982, the combined real GDP for the CACM had fallen to the level attained in 1977.

The present economic crisis greatly aggravates Central America's persistent problem of unemployment and underemployment. Since 1977, approximately 1.5 million people have joined the ranks of the economically active population in the CACM. No real growth in the Central American economy between 1977 and 1979 means that the pool of open unemployment in the modern sector and the number of underemployed in the urban and rural sectors have increased substantially. Although

reliable data on unemployment and underemployment levels are scarce, in El Salvador the estimate for both categories combined is 37%. In Honduras, unofficial estimates put the unemployed and underemployed at 25% of the work force. In Guatemala, open unemployment has reached 11% but allowance for underemployment raises the total to over 40%.

In attempting to restrain growing unemployment governments throughout the region resorted to public sector expenditures to offset the slump in output and employment in the private sector. With tax revenues declining, the inevitable result was increasing public sector deficits claiming an ever larger share of domestic credit and foreign exchange resources. For the five CACM countries, the central government budget deficit doubled between 1979 and 1982, climbing from \$662 million to \$1,246 million.

Much of the current economic crisis confronting Central America is attributable to both external and internal factors. The world economic recession, the contraction of demand for traditional exports, the increased prices of imports, especially petroleum, increased foreign borrowing at high interest rates to cover trade deficits and, in some cases, government expenditures are some of the principal external factors which have drained international reserves, reduced fiscal revenues and constrained bank credit. Internal factors

such as political instability and violence have aggravated the economic problems as foreign investors, bankers and tourists have drastically curtailed their activities and as Central American funds have sought safe haven abroad. Thus contractionary economic forces and political uncertainties have combined to cause massive balance of payments problems and drastically reduced investment levels with a consequent decline in output, employment and per capita income.

A major casualty of the current crisis and also an important contributor to the seriousness of economic decline is the disruption of the regional trading system. Beset by balance of payments pressures and the loss of international reserves, the countries imposed trade and payments restrictions which had the effect of seriously reducing intraregional trade leading to plant closings and output reductions throughout the region and hence to increasing unemployment.

The combined result of these various external and internal factors is a serious worsening in the region's overall balance of payments deficit, which increased from \$320 million in 1979 to an estimated \$1,550 million in 1982, and a 5% decline in the region's real GDP. The decline in real per capita GDP since 1978 is estimated at 16%.

III. STRUCTURAL PROBLEMS IN THE REGIONAL ECONOMY

In addition to the external and internal factors just discussed, the region's current economic crisis is also partly attributable to a number of basic structural problems of the regional economic system which, despite the impressive achievements of the last two decades, have not yet been sufficiently attenuated.

- Agriculture remains the dominant sector in the regional economy. In 1980, it accounted for about 57% of the region's exports, employed over 50% of the labor force, and generated approximately 26% of GDP. It is in this sector that most of the poor, underemployed and malnourished are concentrated. Throughout the period of the 60's and early 70's, traditional agricultural exports contributed significantly to growth, thanks to favorable world market conditions; however, production of food for regional consumption did not receive policy attention so that the region's capacity to meet its increasing food needs declined. Within this sector high productivity in commercial export crops -- coffee, sugar, cotton and bananas -- exist side by side with low productivity in the small farm sector producing the bulk of the region's food crops and in subsistence agriculture. There has been little success in rationalizing the region's agricultural resources or in improving productivity in the

small farm sector. Not only has food production been unable to keep up with population growth, but agriculture generally has been unable to respond to the demand for non-traditional agricultural exports (e.g. fruits and vegetables, both fresh and processed). Of equal importance, the manufacturing sector has not established strong links with agriculture. With low incomes in much of the small farm sector, the rural areas have not provided much of a market for manufactured products and agriculture has not been stimulated to provide a broad range of agricultural inputs for industrial processing.

- Unemployment and underemployment persist throughout the region. There are no studies which provide a quantitative measure of this problem in the region but functional relationships such as population and GDP growth as well as anecdotal evidence suggest a problem of serious proportions. About 50% of the working population of Central America is in the agricultural sector and much of their activity is devoted not to wage or commercial activity, but to subsistence cropping and cottage industry. According to a mid-1970's survey in Guatemala such activities never account for more than 19% of total labor time available, even at the height of the harvest season. This same situation exists in the traditional urban sector where unskilled migrants from the rural areas spend much of their time unemployed or in low productivity service activities.

Economic growth over the last two decades has not been able to make serious inroads into the employment problem. Growth in modern manufacturing and in services has helped, but with a population growth rate approaching 3% annually and little growth in job opportunities in agriculture, the contribution of the modern sector has been swamped by new entrants into the labor force. The current economic crisis only magnifies the problem.

- The dependence on a narrow range of traditional agricultural products for export earnings remains. In 1980, 52% of total export earnings were accounted for by five products -- beef, bananas, coffee, sugar and cotton. Coffee alone accounted for almost 30%. Such a structure of exports places Central America at the mercy of cyclical swings in world commodity prices.

- Regional manufacturing has yet to move from the domestic and regional markets into broad based extraregional export growth. The manufacturing sector is relatively small, and not generally oriented to the export market. In 1978, 47% of all manufactured exports went outside the region; however, three-quarters of these were concentrated in only two industries, food products and chemicals. The industries that experienced the most rapid growth since 1960 -- textiles, clothing and shoes, paper products, metal products -- have yet

to claim a substantial share of extraregional exports. Their expansion is constrained by a shortage of capital for plant modernization and expansion, lack of marketing expertise, protectionist policies in the U.S. and OECD countries, and a currently unfavorable investment climate.

- Income distribution in Central America remains highly skewed. Reliable regional level data on income distribution are not available, but the scattered evidence that is available is sufficient to indicate the depth of poverty that existed in Central America a decade after the establishment of the CACM. Income distribution estimates for each of the five Central American countries, undertaken in 1974 by the United Nations FAO/GAFICA Advisory Team, indicated that, in 1970, the wealthiest 5% of the population commanded 31% of the national income, while at the other end of the income scale, the poorest 50% of the population controlled only 15% of total income. While the degree to which this distribution may have shifted over the past 12 years is not known, the improvement in the relative position of the poor majority is not believed to be substantial. As long as such a large percentage of the total purchasing power remains in the hands of relatively few, not only will the material well being of most of the population suffer, but the Central American market will remain too narrow a base on which to build a broad range of highly productive,

self-sustaining economic activity in both the industrial and agricultural sectors.

IV. THE CACM

1. Concept and Goals

The formation of the CACM was an attempt by the five member countries to address some of the major structural problems by integrating their economic systems. The conceptual basis for their effort was hammered out in the 1950's by the Economic Commission for Latin America (ECLA) under the intellectual leadership of Raul Prebisch. His thesis was simple and direct: the economic stagnation found in many LDC's was a result of the structure of their economies relative to those of the industrialized countries. With a large proportion of productive capacity devoted to production of primary products for export, developing countries were locked into a system from which they could not hope to escape by pursuing a strategy of international trade expansion in accordance with the traditional theory of static comparative advantage. It was argued that since the long-term trend in terms of trade was adverse to countries producing primary products, this dependency relationship could be overcome and more favorable terms of trade achieved only by industrialization. The "infant industry" justification for tariff protection was adopted

because of the competitive advantage of the industrialized countries. Due to the constraints on industrialization caused by the limited size of the individual national markets and low levels of national income, creation of a common market and progressive integration of the economic systems was the appropriate strategy for promoting industrialization.

This conceptual approach gained acceptance in Central America and, in 1960, resulted in the signing of the General Treaty on Central American Economic Integration. The Treaty established the Common Market by abolishing virtually all tariffs on merchandise trade among the member countries and by erecting common tariffs on imports from outside the region. A uniform system of fiscal incentives was subsequently agreed upon to encourage investment in manufacturing. The Treaty also created a number of regional organizations to institutionalize cooperation efforts.

2. Accomplishments

The result was the most successful of all LDC experiments in regional integration:

- In absolute terms intraregional trade grew from \$30 million in 1960 to \$1.1 billion in 1980.
- As a percentage of total regional exports, intraregional trade grew from 7% in 1960 to 24% in 1980.
- Under the regional trade stimulus, manufacturing in Central America grew at the annual average rate of 6.6% in

real terms (vis-a-vis 5.1% for the region's combined GDP) increasing manufacturing's contribution to GDP from 14% in 1960 to about 18.5% in 1980.

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

- The overall contribution of the integration effort to Central America's growth has been estimated at about 1 to 1.5 percentage point of the 6% real GDP growth posted by the region between 1960 and 1970.

- Brookings/SIECA studies indicate the welfare gains of Central American integration for the period 1960-73 to be in the order of 3 to 4 percent of the regional GDP.

Despite the heavy emphasis on import substitution of consumer goods, the growth and development of the region's manufacturing sector has been relatively balanced, gradually expanding from finished consumer goods and assembly operations to intermediate goods. In 1960, intermediate goods accounted for 20% of all manufacturing production, but increased production in textiles, metal and paper products, and chemicals raised this percentage to 33% by 1977. Equally important for the long-term growth of the region, many of the industries that have developed are labor intensive and draw on its abundant soil, water and forest resources.

3. Major problems in the CACM

The recent economic downturn has struck at the heart of the regional trading system in Central America. Since 1980, intraregional trade has sharply contracted. In 1981, total intraregional exports fell by 18% in nominal terms and, in 1982, they fell by another 16% leaving the value of regional trade lower than at the end of 1977.

As a consequence of the decline in the region's terms of trade, the acute balance of payments deficits and the contraction of private investment the payments mechanism upon which regional trade depends has collapsed. Historically, Guatemala posted surpluses within the Common Market while Nicaragua and Honduras registered consistent deficits.

These chronic imbalances posed no serious problems as long as the countries were experiencing equilibrium in their overall balance of payments and thus the deficits could be cleared in hard currency through the Central American Clearing House. However, with the substantial deficits experienced after 1979 came a shortage of hard currency with which to settle balances in the Clearing House and member countries were obliged to force bilateral balance through quantitative trade restrictions.

Aside from the current economic crisis and its paralyzing effects on regional trade, the CACM has had to contend with a number of other problems that have plagued the integration process since 1970. The first of these is the inequitable distribution of the gains from growth among the member countries. For example, a study commissioned by ROCAP determined that, although Honduras did gain in an absolute sense from the integration process, the net benefits* per capita accruing from regional integration were about twice as high in Guatemala as in Honduras. It has been evident to the member countries for some time that the structure of fiscal incentives and tariff protection should be revised not only to provide a more equitable distribution of the benefits among the

*The welfare gains from integration consist of foreign exchange saving, increased exports to new trading partners and increased levels of investment, both domestic and foreign.

members, but also to make Central American manufacturing more competitive in extraregional markets.

Political strife among the members has effectively derailed such needed reforms. The El Salvador-Honduran war and its aftermath resulted in the withdrawal of Honduras from the CACM and the closing of the Pan American Highway. The victory of revolutionary forces in Nicaragua has triggered an ideological struggle between Nicaragua on one hand and Honduras, El Salvador and Guatemala on the other. Finally, the deepening economic crisis has its part in impeding structural change in the CACM. The collapse of the payments mechanism has invited a spiral of trade restrictions followed by retaliatory measures which have aggravated the economic contraction in Central America.

4. The CACM's Role in the Region's Recovery

It has been argued by some that owing to the many problems that have faced the Central American Common Market since 1969, the market is no longer relevant to the region's recovery and continued development. Consequently, the revival of intraregional trade should not be a matter of primary concern to aid donors; rather all efforts should be concentrated on developing the region's non-traditional exports to the major world markets outside the CACM. We believe this view is incorrect and constitutes a false premise on which to base a development assistance strategy.

While it is unlikely that the CACM can be counted upon to act as the major engine of growth for the Central American region during the 1980's, there is general agreement that the long-term growth of the region must depend on its manufacturing sector becoming competitive in the world market. This does not mean, however, that the Central Americans can afford to sacrifice the gains they have achieved over the last two decades in the development of their manufacturing sector, the extent of utilization of their capital plant and physical infrastructure, or the extent of specialization that has occurred according to comparative advantage and economies of scale.

The basic rationale for establishing the Central American Common Market still remains valid: each country is too small in terms of population, natural resources, level of industrial development and size of national income and domestic market to provide a favorable base for sustained development. Developing the region as an integrated unit permits substantial benefits because of economies of scale and external economies in a number of areas, including manufacturing, power generation and sharing, road and port facilities, agricultural research, training of specialized personnel, and technology transfer.

In spite of the weakening which it has experienced since 1980, the following facts attest to the continuing

importance of the Central American Common Market to the regional economy:

- Manufactured products occupy a dominant role in the region's intraregional trade, accounting for 95% of total intraregional trade in 1978.

- Most of the region's exports of manufactured products are sold intraregionally. In 1978, 53% of total exports of manufactured products moved intraregionally. The ratio was as high as 75% for El Salvador and as low as 22% for Honduras.

- Contrary to popular belief, the substantial growth of manufacturing production since 1960 was not limited to final consumer goods. The production of intermediate goods (principally textiles, wood and paper products, chemical products and non-metallic minerals) increased at an average annual compound rate of 16.2% between 1960 and 1977. As a percent of total manufacturing production, the region's total output of intermediate goods increased from 20% in 1960 to 33% in 1977. For Guatemala in 1978, exports of intermediate manufactured goods to the CACM constituted 25% of intermediate goods production and 40% of total exports of manufactured goods.

- A number of key sectors are particularly dependent on the CACM. For the textile, clothing and leather goods category, the value of total production attributable to

intraregional trade in 1978 ranged from 18%-30%. For chemicals the range was 18%-22% (although Guatemala, at 79%, was much higher, it included petroleum exports), and for metal products it was 17%-40%.

- Similar comparisons can be made for individual firms. For example, a Guatemalan textile and apparel firm (selling mainly to lower and lower-middle income groups) produced 1.2 million yards of cloth a month over the period 1974-77, of which 70% was exported to the CACM and 30% was sold locally in Guatemala. By late 1982 monthly production had declined 90%, with all production sold in Guatemala. Exports to the CACM ceased completely mainly on account of the inconvertibility of Central American currencies and the contraction of the CACM market which rendered such exports unprofitable. As a result, the firm reduced the number of its employees from 385 to 57.

- Although the benefits of the CACM to the agriculture sector have been limited up to this time, it will have an important function in stimulating agricultural production as part of a broadened regional development strategy. The CACM can promote more rational production as well as specialization leading to greater efficiency. Also, it should result in a better integration of the agriculture sector in the regional economy, particularly through improved linkages with the industrial sector.

As these examples illustrate, the CACM continues to be a vitally important part of the regional economy which cannot be abandoned without giving up much of the progress achieved by the region over the past two decades. Efforts are needed first to restore intraregional trade to the 1980 level and then to promote its gradual expansion. While there is substantial scope for the continued expansion of import substitution in the intermediate and light capital goods categories, we fully subscribe to the view that for the long-term growth of its manufacturing sector, the region will have to rely increasingly on exports to the world market. Accordingly, the region's tariff structure and its tax and exchange rate policies should be adjusted to promote the development of extraregional manufactured exports.

The difficulties of this course of action should not be underestimated. The major obstacles include the current world recession, protectionist policies and stiff international competition in the region's areas of comparative advantage (e.g. textiles and leather goods), poor quality-control and the inability of producers to supply the large shipments demanded by U.S. purchasers. The region's ability to capitalize on the outside market, therefore, must be a gradual process. It cannot, however, be viewed as a substitute for the regional market. Collapse of the latter would not only set back the

cause of regional economic integration (with its positive implications for CA government cooperation at the political level), but would also impede the region's economic recovery.

Finally, irrespective of theoretical debates about the importance or relevance of the CACM, the Central Americans have clearly decided to make the preservation and recuperation of the Common Market a major policy objective.

V. A DEVELOPMENT STRATEGY FOR CENTRAL AMERICA

As we have indicated in the previous sections of the paper, the turmoil which Central America is currently experiencing revolves fundamentally around the issues of changing the structure of production and its political framework to one which is more open to broader participation and greater opportunities for the lower income groups to share equitably in the fruits of a renewed growth and development process. Based on our analysis of the present conditions in the region, we have identified the following as the major development goals to be achieved by changing that structure:

- halt the contractionary process and lay the groundwork for renewed growth;
- reduce the level of unemployment and underemployment;
- increase exports of non-traditional commodities;

- diversify agricultural production, especially into products with export potential or which are currently imported into the region, and pursue food self-sufficiency in the region;

- increase the availability of public sector services to lower income groups; and

- preserve the natural resource base;

To achieve these goals, a new regional strategy is needed which draws on the experiences and lessons of the past two decades. Also, because of the close relationship between the long-term structural balances and the immediate economic crisis, the strategy must provide for a coordinated effort in dealing with them.

A. Short-Term Strategy

Over the short-term, priority must be given to reducing the balance of payments deficits of the region. However, the sheer size of the deficits, plus the need to address the long-term structural problems, make it impossible for any single country or donor to assume the responsibility for assisting the region in overcoming the problem. The region's overall balance of payments deficit in 1982 was an estimated \$1.5 billion after allowing for disbursements of official long-term loans provided by AID, the IBRD and the IDB. Maintenance of the real GDP at the same level in 1983 would result in a gap of approximately the same magnitude.

ROCAP believes that this situation presents a clear opportunity for a donor consultative group to play a meaningful role. (Although previous ROCAP documents referred to a donor coordination group, the intention was that a group be established in which donors and recipients would have the opportunity to meet and work together on regional and national issues). We continue to support all efforts for the group, headed by IDB, established in late 1981 to assume that role.

The advantages of a consultative group are numerous.

It:

- promotes policy dialogue between donors and recipients;
- provides a forum for clearly defining the focus of donor attention;
- promotes improved analysis of the problem(s) through the pooling of the analytical strengths of the institutions;
- leads to a more coherent application of available resources, avoiding overlap and duplication;
- attracts new donors; and
- enhances the probability that the resource gap will be covered in a rational and more efficient manner.

Perhaps the most important advantage of a consultative group is that, due to the level of resources it

can muster, it can be much more effective in using those resources to achieve important policy changes. Recently adopted trade and payments restrictions, for example, could be reduced and mechanisms installed that would ensure that large intraregional trade imbalances do not reoccur. Leveraging such policy changes is a critical element of the short-term strategy. Stop-gap measures can provide temporary relief, but sustained long-term growth will not be feasible if the supporting policy framework is not in place.

The effectiveness of a consultative group is a function of the resources it commands and the self-help measures it can induce recipients to implement. The group now chaired by the IDB, with participation from the IBRD, the IMF, the UNDP and ECLA, should be expanded to include principal bilateral donors such as the U.S., Canada, Mexico and Venezuela. It must also work closely with the Central Americans in a consultative fashion to promote solutions which are mutually agreed upon and not imposed from the outside.

As a first step, the consultative group must coordinate efforts in providing fast-disbursing balance of payments assistance. A previously recommended agenda for the group remains valid and focuses on the following priority items:

- Determine the appropriate order of magnitude of each country's net foreign exchange resource gap over 1983-84.

The projection would assume that real GDP growth should be equal, at a minimum, to the rate of population growth to prevent further declines in the real per capita GDP.

- Estimate the magnitude of the private sector's credit requirements, particularly for working capital purposes in terms of both domestic currency and foreign exchange resources, and determine what measures international donors and the region's central banks could take to mobilize the necessary credit resources and channel them to the private sector to enable it to rebuild its working capital and replace cancelled foreign credit lines.

- Develop an agreed upon program (among donors) to help meet the region's foreign exchange gap which defines the amount each donor can contribute and the mechanisms through which the assistance will be channeled, for what purposes and on what terms.

Because of the nature of the problems, the group should focus on a regional approach to their solution. Even though some external assistance agencies may prefer to grant balance of payments adjustment assistance on a bilateral basis, this should not be an obstacle to defining a regional approach and developing a regional framework of policy within which bilateral adjustment assistance programs can be formulated. The reason for a regional approach is that some of the most

basic problems such as the internal trade and payments restrictions, the common external tariff, and the realignment of exchange rates are regional problems that can be addressed adequately only through a regional approach.

A major objective of the consultative group mechanism, therefore, is to arrive at an agreed upon regional policy framework. Another objective is to define the self-help measures that the Central American governments should adopt to cope with the current crisis in the balance of payments and fiscal accounts. Progress in both are needed to lay the groundwork for the longer term adjustments that are required to recover the growth process and to move toward long run balance of payments equilibrium.

An important short-run objective is to restore the functioning of the regional trading system because of its importance to output and employment in the near term, and its critical role over the longer term in providing a larger market and more favorable conditions for expanding output and employment and developing capacity for competing in world markets.

To restore the functioning of the regional market, the problem of the accumulated deficits must be addressed. Few external donors are likely to be willing to provide resources to pay off these accounts. Yet, if a way can be agreed upon by

the Central Americans to convert these debts to medium term dollar obligations, and devise a program which promises the eventual repayment of these obligations, the problem can be resolved. An immediate action the donor agencies should consider is the advisability of providing resources to the Central American Clearing House to help finance the resumption of intraregional trade, provided that the Central Americans adopt measures to limit the problem of chronic intraregional deficits and devise a plan to repay the loans extended over the medium term (5-10 years).

It is ROCAP's view that the U.S. should encourage and support the efforts of a consultative group to deal with this problem, as well as take a leading role in initiating and pursuing the policy dialogue which must accompany any resolution to the problem. U.S. influence through its bilateral relations with the countries, and through its representatives in the multilateral agencies could be substantial. It may not require an increase in the level of resources already contemplated for the region as a whole, but it will require that the programming of those resources be undertaken within the framework of a regional focus on the problem.

No matter what course of action the consultative group follows in addressing the short-term crisis, it must be

done with the basic objective of setting a policy framework that will ensure that the longer-term structural problems can be addressed in a satisfactory manner. Without this policy framework, any short-term assistance would essentially be stop-gap; it would not contribute to self-sustained economic and social development.

We again call attention to the fact that such a framework must be developed at the regional level. This will be the case as long as the Central American countries continue to abide by the General Treaty of the Common Market and the legal agreements established under it.

B. Long Term Strategy

The objectives of the region's long term strategy are increased employment generation, more equitable income distribution and more adequate satisfaction of the basic human needs of the population. To achieve these objectives, the strategy must be export oriented, sectorally balanced, and carefully related to the factor endowment and resource base of the Central American countries. It should consciously seek the changes in the productive structure which will reduce vulnerability to external conditions by achieving a more balanced and sustainable trade relationship with the rest of the world. And it must foster a growth process which permits lower income groups to participate more fully and equitably in the benefits.

The regional development strategy must be oriented heavily toward exports outside the region. It will require institutional mechanisms for identifying specific marketing opportunities which Central American producers can exploit with products which meet the price and quality conditions of those markets. Above all, it will require the policy framework which maximizes productive efficiency by directing resources to those lines of activity in which Central American producers have or can develop a comparative advantage.

In general, comparative advantage could be expected in productive processes that are relatively more labor intensive, that rely on regionally produced raw materials, and that are not heavy consumers of petroleum-based energy. Such a strategy will contribute to the goal of increased labor absorption and better income distribution. It will have important balance of payments adjustment effects by reducing the relative import coefficient of Central American production, including the coefficient of petroleum consumption, while generating exports with higher regional value added.

1. Industry

Given the importance of reviving and reorienting the industrialization process to achieve the required structural adjustments in the region, priority attention must be given to revision of the industrial development strategy.

To achieve the desired export orientation of the development effort, the policy instruments need to pursue and promote the efficiency and international competitiveness of Central American manufacturers.

An export oriented strategy does not mean that production for the regional market should be neglected or placed at a disadvantage vis-a-vis production for export to the rest of the world. An expanding regional market and considerations of location economics and transportation costs will mean that opportunities for expanding production or undertaking new activities to serve the regional market will arise. The focus should be on exploiting comparative advantage wherever it may be found.

The strategy should pursue linkages between sectors and within sectors. Emphasis on the use of domestic raw materials will promote linkages between the manufacturing sectors and the agricultural, forestry and fishing sectors. Service industries such as transportation, communication, warehousing, and marketing will also benefit from a better articulated productive structure. Many of these activities are labor intensive. Intrasectoral linkages should be sought by encouraging the growth of intermediate and simple capital goods industries where such goods can be produced at lower cost in the region than if imported from outside. Such activities

would lower production costs for final goods and enhance export possibilities.

Given the importance of increasing employment and generating income in the shortest possible time, consideration should be given to encouraging drawback industries, i.e., where one or more labor intensive steps of the production process are performed on goods which originate outside the region and are destined for a final market outside the region. These industries should not be considered as long-term solutions, however; they create no permanent linkages with the local resource base, and they generally are highly mobile and ready to move to where costs can be minimized.

Direct foreign investment and joint ventures take on additional importance in a shift from import substitution to an export orientation and changes in attitudes and incentives will be needed under a new industrial strategy to maximize their contribution.

2. Agriculture

In agriculture, diversification of production must be pursued. Two main approaches are suggested: 1) Identification of new products for extraregional export with a products system approach to production and marketing; and 2) production for regional food consumption. A diversified food production system, when all the attendant elements of the system are

considered, is highly labor intensive. Such an approach should be directed at enabling small farmers with only marginal commercial activities to increase their participation in the money economy. Support activities to raise the productivity of small commercial farmers, including research, extension, credit, and improved technology must be provided. A food processing industry with enforced standards of quality and nutritional content provides a commercial outlet and incentive to producers and better nutrition for consumers.

A regional approach to food sufficiency will encourage specialization in food production in accordance with the climatic and soil conditions of different areas in the region. To achieve this result, national government price and production policies must be coordinated and free trade of agricultural products within the region must be achieved.

3. Infrastructure

Basic infrastructure is essential to support industrial development and expanded commercial agriculture. Transportation capability, storage and marketing facilities, availability of energy supplies and other factors will influence the extent to which growth can be achieved. In general, the existing infrastructure in Central America is better than in many parts of the developing world, largely because of the integration movement, and thus constitutes a favorable condition to exploit. As part of a new development

strategy, the high priority given to infrastructure will need to be maintained, but with more emphasis on how such infrastructure can serve an export drive, particularly in terms of land transportation, ports and energy supplies. The area's hydroelectric and geothermal potential can be a significant resource as the region's electricity transmission grid moves into place and opens up the possibility of lower rates and selling secondary power at incentive rates for certain types of agro and drawback industries. The regional transportation system can play an important role in exporting by facilitating geographical access to raw materials and capital goods needed by industries.

4. The Resource Base

Preservation of the region's resource base is fundamental to a successful development strategy. The area has been relatively well endowed in terms of agricultural land, forest and water resources which have provided the basis for the development that has taken place. In terms of future development, the area's prospects depend heavily on improving its ability to conserve, effectively manage and develop these same resources with more emphasis on using its considerable water resources for energy and irrigation which would facilitate industrial growth and increased agricultural productivity.

The picture emerging from the country environmental profiles (CEPS), the MITRE Study "Energy

Development in Central America", and other analysis is that if the present trends in population growth and natural resource exploitation and misuse continue, by the turn of the century the Central American countries and Panama will be more crowded, more dependent on imported oil and food, more polluted and less stable both economically and ecologically than they are today. Even greater stresses originating from population growth, improper resource use, and environmental degradation, are clearly visible ahead. Within two decades the region's people, especially the rural small farmer, may well be poorer in many ways than they are today and the resource base for further development will have been seriously depleted.

Improved management and conservation of the region's resource base is therefore an important element of a regional development strategy.

There are other important development problems in the region -- e.g., population growth, education and training, and health and nutrition which, because of their intimate relationship to an improved standard of living, productivity of the labor force, and the distribution of real income, must receive attention, but which are not contemplated as objectives of a regional strategy. Although some aspects of these social constraints may be addressed from time to time by regional institutions, it is at the national level where they must receive priority attention.

VI. THE ROCAP STRATEGY

Over the CDSS period, the ROCAP strategy has a dual focus: first, to promote a continuing dialogue within AID and Central America on the key policy issues affecting the long-term development of the region; and second, to implement a program in selected sectors consistent with the regional strategy and aimed at common problems where economies of scale exist in a regional approach or when regional activities can support national programs.

A. Major Regional Policy Issues

The United States has supported, with varying degrees of enthusiasm, the economic and social integration of the Central American countries since the foundation of the CACM over two decades ago. Despite the difficulties which the integration movement has encountered during the past two or three years, remarkable progress towards the economic unity of Central America has been made over a relatively short time span. With AID and other donor support and substantial self-help measures, regional transportation and telecommunications networks have been created; multi-country power grids are now either in place or being installed; regional institutions in agriculture, industrial technology, nutrition, animal and plant sanitation have been established and are drawn upon by the member countries for policy and technical assistance; a

regional financial institution, CABEI, has been founded and has become a vital, powerful mechanism for the region; the few natural barriers isolating the countries from one another have been bridged or opened, facilitating travel and commerce among 20 million people who share the same language, much the same cultural heritage and the same basic aspirations for the future. Integration is a well established, if still not a completed process, which has provided substantial benefits in Central America, and the Central Americans know it. They believe that integration is still very much in their interest and that there is no better way they can achieve their economic and social development than through working together and perfecting the integration mechanisms. The countries do not believe there are significant advantages to turning back the clock and going it alone. They do not believe that, individually, they can or should try to model future growth after Taiwan or Korea even if the CBI trade legislation were passed and provided future export opportunities.

Given the importance of a sound and equitable economic system in Central America for easing social tensions and achieving political stability, it is clear that supporting the ongoing integration process is very much in the U.S. national interest. The key issues then are whether the U.S. is prepared to provide further encouragement and support to the Central

Americans in their attempt to address regional problems from a regional point of view and whether the U.S. will promote mechanisms and opportunities for pursuing a policy dialogue at the regional level. The consultative group approach which we have strongly recommended for the past several years is one element of this. Others are contacts, discussion and joint analyses with the Ministers of Economy, the Central American Monetary Council, the Vice Ministers of Integration and SIECA on policies related to the current crisis (e.g., the proposed new industrial strategy, reactivation of regional trade, and the changes required in integration mechanisms to accomplish these ends). The Agricultural Secretariat and the Council of Ministers of Agriculture, which deliberates on and defines regional agricultural policy, is another forum in which we can usefully participate in a more active way.

In ROCAP's view, the present economic crisis will not be resolved by an AID strategy focused almost exclusively on extraregional exports, bilateral policy discussions and the hope that the CBI trade legislation will be passed and will stimulate a fast export response. Rather, we strongly believe that the economic crisis presents an opportunity where a regional dialogue can be undertaken, through the proposed consultative group and other means, which can help restore the functioning of the regional trading system, bring about needed

CACM reforms and promote a new industrial strategy which would preserve the benefits of the CACM while shifting to an emphasis on extraregional exports. This approach would be consistent with historical support of the United States for the integration movement, economic realities and Central American aspirations.

B. ROCAP Program and Sector Strategies

During the CDSS planning period, ROCAP will support Central American efforts to address the immediate crisis by providing further assistance in export financing for disbursement through regional financial institutions, both public and private, such as BLADEX, CABEI and LAAD, and will continue to support studies and other analyses on regional issues.

ROCAP will also continue helping the Central Americans to strengthen the network of regional and national technical institutions, including SIECA, IICA, CATIE, INCAP and ICAITI, to improve their ability to address common problems. Much of our present effort and that planned for the future is based upon strengthening the technical and administrative capacity of the regional institutions to better serve national counterparts. This objective requires the transfer of relevant technology in a variety of fields -- e.g., energy conservation, fast-growing tree species for fuelwood, export promotion and

marketing, integrated farm production systems, and natural resource conservation -- to the regional institutions to develop their expertise. It also requires creating an outreach capacity in the same institutions to enable them to transmit the technologies to the appropriate institutions at the national level.

ROCAP will pursue this strategy through selected projects implemented by regional institutions. We will coordinate projects closely with the bilateral USAIDS and will encourage increased regional inter-institutional coordination in the implementation of such projects.

To maximize the effective use of its resources, the ROCAP sector programs will be limited to three major areas where we believe the best opportunities exist for regional assistance. These are: industry, agriculture and nutrition, and natural resources.

In each of these areas, policy dialogue will be an important element of ROCAP-financed projects and activities. The focus of the dialogue will be on identifying existing policy constraints and agreeing on the changes required to implement the regional strategy. The third phase of the dialogue will be promoting the necessary action for the changes to be instituted, and will involve not only the Central Americans but the U.S. and other donors as well. Active

support for the consultative group and using it as a forum to discuss a wide range of issues would, in ROCAP's view, maximize the possibilities for achieving effective results.

The private sector in Central America comprises the largest share of the business and agricultural communities, and it will be its willingness to invest in new technologies and accept the challenge of moving into new and non-traditional areas of production that will be the test of the success of a new regional strategy. An important objective of the dialogue, therefore, will be to create the policy framework and conditions which are likely to encourage the private sector to take on that role. To protect its own interests, and to contribute to shaping an appropriate framework, the private sector must also actively participate in the policy dialogue.

Institution building and technology transfer are also important elements of the ROCAP program and the means by which the regional institutions, in turn, can upgrade their capacities and fulfill their basic mandate of transferring technologies to the national level counterparts. The economies of scale obtained by maintaining core technical staffs in regional institutions to service the area, as opposed to creating duplicative infrastructure in each country, also applies to the ROCAP staff.

During the CDSS period ROCAP plans to maintain a key staff of direct hire and contract advisors who will work closely with regional institutions and provide support services to the Central America and Panama USAIDs. These specialists will respond to requests from the USAIDs for assistance in macro- and micro-economic analysis, financial analysis, private sector matters, pest management, environmental concerns, forestry, watershed management, energy, PL-480 Title II, and nutrition.

1. Industry

a. Sector Goal

ROCAP's major goals in the industrial sector are: 1) to preserve the established industrial manufacturing capacity of the region; and 2) to increase exports of manufactured products to extra-regional markets.

b. Strategy

The strategy seeks to achieve the first goal by reestablishing the regional system of free trade, by identifying export opportunities for existing firms, and by assisting them to take advantage of those opportunities by providing them with financing and technical assistance in production and marketing.

The second goal has both a short-run and long-run dimension. In the short run, increased exports will have to

come largely from existing firms and, thus our proposed approach has been discussed in the first part of the industrial strategy statement. The long term requires investment in new activities and new plant capacity. Until existing excess capacity is reduced, and until the investment climate improves, significant new investment is not a realistic expectation. Consequently, to the extent that the first part of the strategy is successful in getting existing capacity back to work, it contributes to creating conditions more favorable to new investment. Similarly, the extent to which the violence can be overcome -- a factor which is clearly outside the reach of ROCAP's development assistance strategy -- and the investment climate improved through a revived growth process, the strategy for general economic recovery supports our strategy in the industrial sector.

For the longer term then, the industrial development assistance strategy seeks to achieve an export-oriented industrial manufacturing sector through a revised industrial development policy. The policy objectives have been described earlier in the long-run regional strategy statement. To the extent that those objectives can be achieved, Central America will be able to develop efficient industries capable of competing in world markets.

C. Program

ROCAP is providing financing through BLADEX for existing exporters who, because of a lack of foreign exchange to purchase imported inputs, are unable to produce for export markets.

ROCAP has also contracted for studies of the existing industrial manufacturing sector to identify sub-sectors which would appear to be in condition to increase exports in the very short run because of comparative advantage, competitive prices, and excess capacity.

For firms in the sub-sectors so identified, ROCAP proposes to provide technical assistance in production and marketing at the firm level. More generalized training for export development and business management will be provided through INCAE.

Financing for agroindustries through loans to CABEI and LAAD has been a major component of ROCAP's loan portfolio over many years. While the early loans did not give heavy emphasis to exports, many of the agroindustries financed are excellent examples of what can be done at the micro level to increase extraregional exports while creating linkages to small commercial farms, using local raw materials and increasing employment. ROCAP plans new agribusiness loans which will place much more emphasis on subprojects to stimulate extraregional exports and related industrial changes.

ROCAP has initiated a dialogue with CABEI at the policy level, regarding the possibility of establishing a special investment promotion unit as a regular part of the Bank's institutional structure. CABEI is the strongest financial institution and we believe the Bank should increase its lending for productive investment and move into promoting major joint ventures in both manufacturing industries and new traditional export crops, financing related feasibility studies, etc.

2. Agriculture and Nutrition

a. Sector Goals

The goals of the agricultural sector, as established jointly by the Ministers of Agriculture of all five Central America countries in a February 1983 meeting and with which ROCAP concurs, are: (1) To expand exports of non-traditional agricultural commodities and processed agricultural goods from the region, and (2) to promote regional self-sufficiency in basic food crops.

Increased employment opportunities, reduced underemployment and improved nutritional well-being of the region's population will be significant results of the achievement of these goals.

Both of the goals are directed at reducing several of the long-term structural problems of the region's economy

which we have mentioned earlier: excessive dependence upon a few major export crops which are subject to wide price swings in the world market, low income levels and high unemployment and underemployment in the agricultural sector. These structural imbalances lead, in turn, to low nutritional levels and insufficient food production in terms of both quantity and variety.

b. Strategy

The ROCAP strategy for addressing these problems is based upon the following general lines of action:

- Diversification of agricultural production, particularly in non-traditional crops, for domestic and export markets.

- Creation of stronger linkages between the agricultural and the industrial sectors. (While we recognize that a large portion of the area's growth in exports has been in processed agricultural goods, there is still a large potential for further expansion of manufactured items based upon agricultural products).

- Improvement in small farm productivity and the expansion of small farm operations to bring the marginal commercial farmer more fully into the economy and the more efficient use of small and medium-sized land holdings for agriculture.

c. Program

Policy dialogue with the Ministers of Agriculture, as well as technical analysis of regional agricultural programs, is vital to the ROCAP strategy and is facilitated greatly since ROCAP partially finances policy studies and other activities of the Regional Council for Agricultural Cooperation, the forum within which the Ministers meet. This, quite naturally, provides an entree for us and provides an opportunity for policy discussion at the highest levels within the sector. We also partially support the operations of the Secretariat to the Ministers -- formed by a division of IICA -- which provides a further forum for agricultural policy and program discussion with the individuals who do the staff work and technical analyses for the Council of Ministers. We will continue to support the activities of the Agricultural Secretariat over the CDSS period, particularly studies and analysis which can provide a basis for decisions by the Ministers on agricultural policies which support the sector's strategic aims.

In support of an improved analytical capacity in agriculture, which has obvious implications for policy development, ROCAP will continue to provide assistance to regional organizations to strengthen their abilities to collect, manage, analyze and store agricultural data and

information. These improved abilities at the regional level serve, in turn, as a basis for technical assistance and information transfer to the national agricultural data and information centers in each of the countries.

The farm production and management systems developed over the past seven years are an attempt to carry out this strategic aim. They seek to examine and test the most effective mixes of crop and small animal production calculated to increase income and better utilize the factors of production available to farmers with small and medium-sized land holdings.

National policies to address the issues of income distribution, poverty and inadequate nutrition and food consumption will receive attention through INCAP's cooperation with its member countries in food and nutrition planning. INCAP has established information systems for each country which permits socio-economic planners to design programs to address the needs of poverty-level households and bring some of the poor into the economy to a greater degree and target food aid.

INCAP has been asked to take the lead in organizing a Regional Food and Nutrition Planning Council, composed of representatives of government Planning Offices, agriculture and health. ROCAP will use its close relationship with INCAP to make policy suggestions to this body.

The regional institutions with which ROCAP works are, generally, fairly well-organized and staffed, technically of good quality and, while their finances usually are, at any given time, in a precarious state, they have managed to survive and provide services for almost twenty years. Our assistance to their further institutional development is designed to assist them to upgrade their technical capacity and expand into new technological areas. In turn, they offer technical assistance to national organizations to address agricultural problems common to several member countries and transfer newly-acquired technological information and techniques to their national counterparts. This is the case in the program for coffee rust control with IICA/PROMECAFE where technology and research results are transferred from experimental operations in Brazil and Portugal, through IICA to the national organizations concerned with control of plant disease. ROCAP will continue this process of strengthening the institutional capacity in regional organizations to act as an intermediary of technological transfer as well as a source of technical assistance, new research information and on-site training in the application of improved agricultural techniques at the national level. Programs in crop diversification, small farm production systems, plant and animal pest management, export promotion and marketing of agricultural products and

experimentation with fast-growing tree species for fuelwood production will all be financed by ROCAP during the CDSS period. All of these activities depend heavily on improved institutional and administrative capacities of regional entities and the transfer of appropriate technologies to the national organizations responsible for delivering it to the end users.

Each of these projects has one final goal -- to assist the private agricultural producer to produce more, to produce efficiently and to receive a reasonable return for his effort. We will attempt to improve performance toward the accomplishment of this goal and, in particular, will seek ways to insure a fair return to, and higher level of employment for the small commercial farmer by promoting programs designed to better link him with other elements in the private sector -- agricultural marketing outlets for domestic consumption, agroindustries and export firms.

3. Natural Resources

a. Sector Goal

The ROCAP assistance goal for this sector is to help the Central Americans better develop, manage, and conserve the region's natural resources.

b. Strategy

ROCAP recognizes that natural resource management is a broad and difficult area and that care must be taken to

develop programs in close cooperation with the existing and planned programs of the bilateral USAIDs. In general, ROCAP seeks to develop programs which will be complementary, offer economies of scale in dealing with common problems, and have a high probability of success and high economic payoff for the region. Programs will have the following strategic aims:

- To create an awareness of the importance of proper management of the resource base (forests, water and land) to the future development of the region.

- To promote improved planning and analysis for rational use of the resource base.

- To adapt and transfer technologies to insure that the area's natural resources are used efficiently, in a sustainable form, for maximum developmental impact in the agricultural, industrial and energy sectors.

- To emphasize using water resources for energy and irrigation, conserving forest resources to protect watersheds and reduce soil erosion, and using biomass resources, including waste products, to meet needs for energy, feed, and fertilizer.

c. Program

This sector brings together existing projects in energy (Fuelwood and Alternative Energy Sources Project and the Regional Industrial Energy Efficiency Project); a proposed new FY 1983 project in watershed management; and new initiatives

during the CDSS period to strengthen existing efforts and add new programs to deal with other aspects of the natural resource and energy problems. Many of the natural resource and energy problems are interrelated and efforts within the AID framework of policy dialogue, institution building, technology transfer and working with the private sector will be complementary and mutually reinforcing.

Some of the key issues in resource depletion and conservation, energy efficiency or environmental degradation, require more information in order to better understand the causes, trends and possible solutions to these problems. An improved data base is being developed in order to refine policies and define appropriate development assistance requirements. The CEP's together with a regional assessment, which will be completed by the end of 1983, will be important steps in bringing about a greater awareness of the problems and establishing the information and data basis. Several existing or planned ROCAP projects also include components to generate the data needed for analysis and policy discussions. For example, the CRIES Environmental Information System, developed under an earlier ROCAP project, has been adopted in several countries and the analyses produced by that system will form a solid base for discussion of resources utilization. ROCAP plans to sponsor a regional conference on the use and abuse of

natural resources in 1984 as part of the awareness effort which will use these materials.

Donors will be invited to participate in the conference and will be provided with the CEPs and other natural resource information and data as they are developed. Far too often the IFIs ignore the environmental impact of their large hydroelectric or other construction projects, or do not provide funding for natural resource conservation aspects, such as watershed management, while the recipients are generally unaware of the potential danger or see any additional funding for environmental aspects simply as an additional cost to them.

The development of trained manpower working in effective institutional settings will be the key factor in bringing about rational resource conservation and utilization, halting environmental degradation, and in reducing of dependence upon imported fuels. Because the Central American countries are small and beset with other pressing and immediate problems, we feel that regional institutions, created and funded by the C.A. countries, should play an important part in addressing the longer-range problems. These institutions, because they are not subjected to the day-to-day immediate pressures that national institutions are, generally have a broader view and longer-range vision of priorities. In addition, they are not subject to the constant, abrupt

personnel changes which disrupt national organizations so frequently. For these reasons, we feel that there is justification for creation of a corps of highly-trained technical personnel familiar with the problems who will be available to assist national level counterparts and institutions. They will be used primarily to provide multidisciplinary training (which should insure that ROCAP assistance will have a strong multiplier effect), to provide technical assistance and to carry out research. In general, research will continue to be adaptive since technologies appropriate for managing the region's resource base have been developed elsewhere and require site context testing to assure their usefulness in the Central American context. For example, the Fuelwood project is testing combinations of fast-growing tree species for use as fuel as well as fuel efficient stoves. And the Industrial Energy Efficiency project will demonstrate potential energy savings through the utilization of existing technologies and efficient machinery associated with energy conservation.

Regional institutions are expected to use the technical capacity developed through ROCAP programs to carry out one of the basic functions for which they were established -- to transfer technology to their national level counterparts. Some efforts have already been initiated in this area and, it

will receive more emphasis during the CDSS period. There is now a strong demand for CATIE's and ICAITI's services under the Fuelwood project. Training programs to introduce fast growing trees and demonstrate stove construction are expanding rapidly and the pilot projects now being completed are being used in that effort. More formal training for regional institution staff and the development of teaching materials and visual aids are planned to facilitate this type of effort in watershed management and other natural resource areas. By the end of the CDSS period, the regional institutions will have in-depth technical expertise to assist national counterparts and the USAIDs in developing plans and investment programs and other efforts related to rural and industrial energy conservation, watershed management and other natural resources areas.

Within the natural resource sector, a possible new area for assistance over the planning period is in the development and use of biomass waste products. There are enormous quantities of these products in the region including coffee pulp, bagasse, banana, cotton and sugar cane stalks, sawdust, manure, etc. Many of these become a source of pollution, particularly to water supplies, and constitute a considerable expense in disposal, which adds to production costs. According to research results from experiments by regional institutions, these waste products offer real

potential as sources of energy, as well as for feed and fertilizer. ROCAP proposes to examine possible activities in this area to determine the prospects for technology transfer.

The private sector has a critical role in both of ROCAP's energy projects. PVOs and other private sector organizations are cooperating in the promotion of fast-growing tree species and fuel efficient domestic stoves as part of ROCAP's rural energy efficiency project. Small businessmen are being trained to construct the stoves, as well as brick kilns, bakery ovens, biogas plants and other energy-saving devices using models which incorporate fuel-saving designs. In industry, engineers from the private sector will be trained to conduct industrial energy use audits and to provide recommendations on how the industry can reduce the amount of imported fuel consumption. This project is being implemented with the enthusiastic and active cooperation of various private sector organizations, for example the Chambers of Industry in each country, and this is certainly an area where private and public sector interests coincide. A 10% increase in energy efficiency by industry would save the region \$40 million per year in its imported oil bill. In other areas, such as watershed management, the private sector is not so directly involved, but promotion and educational efforts are aimed at improving understanding and generating active support by the business community.

PART III: Program Resources
Proposed Assistance Planning Levels
(\$000)

	<u>1983</u>	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>
<u>Agriculture, Rural Development and Nutrition</u>	<u>3,237</u>	<u>2,350</u>	<u>18,100</u>	<u>4,250</u>	<u>14,400</u>	<u>19,050</u>	<u>3,550</u>
Research/Training/institution Building	2,787	2,350	1,250	2,250	2,250	2,750	2,350
Diversification/Agro-Industry	-	-	16,100 ^{1/}	1,250	11,150 ^{1/}	16,300 ^{1/}	1,200
Agricultural Policy	450	-	-	-	-	-	-
Nutrition	-	-	750	750	1,000	-	-
<u>Private Sector</u>	<u>12,350</u>	<u>11,400</u>	<u>-</u>	<u>15,000</u>	<u>-</u>	<u>750</u>	<u>17,500</u>
Export Promotion	10,500 ^{1/}	10,500 ^{1/}	-	15,000 ^{1/}	-	-	17,000 ^{1/}
Management Training	1,850	900	-	-	-	750	500
<u>Natural Resources, Energy and Environment</u>	<u>2,900</u>	<u>3,300</u>	<u>4,000</u>	<u>3,355</u>	<u>8,150</u>	<u>1,750</u>	<u>1,500</u>
Fuelwood and Alternative Energy	900	1,200	1,500	955	-	-	-
Energy Efficiency and							
Alternative Fuels	1,300	1,000	1,100	1,000	6,000 ^{1/}	500	500
Environment	700	1,100	1,400	1,400	2,150	1,250	1,000
<u>Project Development and Support</u>	<u>363</u>	<u>400</u>	<u>400</u>	<u>395</u>	<u>450</u>	<u>450</u>	<u>450</u>
Total Grants	8,850	7,450	7,500	8,000	8,000	7,000	6,000
Total Loans	10,000	10,000	15,000	15,000	15,000	15,000	17,000
TOTAL	18,850	17,450	22,500	23,000	23,000	22,000	23,000
TOTAL BY AID FUNCTIONAL ACCOUNT							
Agriculture, Rural Development and Nutrition	5,050	4,850	21,200	6,800	16,800	20,500	4,800
Education and Human Resources	1,850	900	-	-	-	800	500
Selected Development Activities	11,950	11,700	1,300	16,200	6,200	700	17,700
TOTAL	18,850	17,450	22,500	23,000	23,000	22,000	23,000

^{1/}Includes Loan.

USDH Staffing Requirements

ROCAP's staffing requirements must be examined in light of the two basic functions which it carries out: managing a sizeable regional project portfolio and providing services to the bilateral USAIDs. Approximately one-half of the 16 USDH staff is devoted to the latter function. Of the remaining staff, only seven (two of whom are senior management) are directly involved in designing, implementing, monitoring and evaluating the project portfolio. While the size of the portfolio has grown considerably in the past three years, the size of the staff available to work with the projects on a day to day basis has not kept pace.

The capacity of the staff to handle the increased portfolio has been severely taxed, and with the size of the program expected to continue at existing or slightly higher levels over the planning period, an increase in the program-oriented staff is called for. An additional three USDH positions are requested.