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EVALUATION OF THE  
NATIONAL ECONOMIC REACTIVATION PROGRAM  
FOR EL SALVADOR

Presented to the  
Agency for International Development  
San Salvador, El Salvador  
No. AID/SOD/PDC-C-0399

by  
Checchi and Company  
1730 Rhode Island Avenue, N.W.  
Washington, D.C. 20036

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CHECCHI AND COMPANY

1730 RHODE ISLAND AVENUE, N. W.  
WASHINGTON, D. C. 20036-3193

TELEPHONE  
202 452-9700

CABLE ADDRESS  
"CHECCHI"  
TELEX 440157

March 21, 1983

Mr. Martin Degada  
Mission Director  
U.S. Agency for International Development  
San Salvador, El Salvador

Dear Mr. Degada:

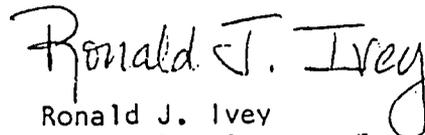
Attached you will find our evaluation of the National Economic Reactivation Plan for El Salvador.

We believe that our evaluation and recommendations can serve as a guide to Salvadoran policy-makers in the resolution of critical economic problems which they face. For your staff, we believe there are useful, new data and analyses found in this report in the areas of foreign exchange, agriculture, and construction, along with a broad coverage of all the major aspects of the economy.

The composition of the team which worked on this assignment were: Mr. Ronald J. Ivey, Team Leader and Macroeconomist, Dr. John Strasma, Agricultural Economist; Dr. Julio De Andrea, Industrial Specialist; and Mr. Daniel Coleman, Housing Specialist.

It has been our pleasure to serve your Mission through the preparation of this report; and we want to thank you and your staff, especially Mr. Lars Klassen, for your fine assistance. We wish you every success in your excellent endeavors in El Salvador.

Sincerely,



Ronald J. Ivey  
Senior Development Economist

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## SECTION I

### SUMMARY AND RECOMMENDATIONS

This report evaluates five short-term reactivation plans prepared by the Salvadoran public and private sectors, makes recommendations for the plans' improvement, and cites areas requiring further analysis, given El Salvador's medium and long-term development needs.

The plans together are known as the PREN (National Economic Reactivation Program). The five plans reviewed focussed on global aspects, industry, agriculture, housing, and social aspects. The four-man team (macroeconomist, industrial specialist, housing specialist, and agricultural economist) divided the work along sub-sectoral lines, interviewing representatives of both public and private sectors. To carry out this assignment, the team worked closely with professionals of MINPLAN (Ministry of Planning) and the USAID Private Sector Development Office.

To reactivate the economy, the CREN (Committee for National Economic Reactivation) was created as the result of the desires of President Alvaro Magana for a high-level commission comprised of public and private interests. The CREN is comprised of the president of the BCR (Central Reserve Bank); the Minister of Planning; the Minister of Economy; the President of the Salvadoran Chamber of Commerce; the President of ASI (Salvadoran Industrial Association) and ANEP (National Association of Private Entrepreneurs); and the President of FENAPES (National Association of Small Businesses).

The concept of the reactivation plans presents a classic example of allocation of very scarce resources. The plans establish only the broadest parameters for allocating resources and taking action. It is ominous that although the original drafts of the plan were issued in October 1982, as of this writing, little movement toward reactivation has resulted. At a minimum, the plans should provide a basis for a discussion of the issues and alternatives for reactivation -- and the most desirable would be that they capture a sense of what can be done in such a way that decision-makers take actions which will begin to resolve the economic problems facing the country. The PREN was described to us as a 'working document', but we did not sense that it has stimulated much discussion, nor has it influenced decisions. The key to transforming it from a working document is to more fully define the parameters involved in reactivation, and to convert the plan into a series of smaller, feasible projects.

As is well known, and explained in some detail below, the Salvadoran economy has continued its decline from 1978 levels with little hope in sight for a reversal. There is considerable pessimism regarding investment on the part of the private sector, and the GOES large budget deficit prevents it from undertaking many new investment projects. While AID and other external donors have provided a large infusion of resources, the magnitude of the fiscal and balance of payment deficits and the high level of unemployment seem intractable.

We believe that the analysis of each plan will be helpful to MINPLAN and the CREN, and that the recommendations cited below are sound and innovative, and can, if pursued, lead to positive results in terms of employment, income, and investment. The GOES and the private sector need to consider them, make final refinements to a reactivation plan and act quickly.

#### What is Reactivation?

Understanding the definition of reactivation is important to the process of planning for it. If economic reactivation is defined as those actions required

to stimulate production over and above present levels, then the PREN, as prepared by the Ministry of Planning, is too widely focussed. Almost every government or private sector activity has some economic outcome or impact; therefore, listing all categories of these activities is not appropriate for planning reactivation.

The economic reactivation of El Salvador will be the result of an agreement made by the Government, the entrepreneurs, and the developmental and financial institutions. A review of the important economic indicators reveals such declines that if that agreement is not reached and the economy is not stimulated above present levels, there may arrive a time when enough credit is refused, enough spare parts and raw material do not arrive, enough unemployed are found hungry in the streets, that the economy will fall apart at the seams, causing undesirable repercussions.

The plan was drafted in October 1982 and the process could have provided a useful framework for allocation of resources presented in the 1983 GOES Budget. The Ministries and Agencies reported to MINPLAN what they were going to do, and MINPLAN presented it as the PREN, with little effect upon the budgeting process. The desired plan would have presented a strategy and criteria for economic improvement, selected projects given their various characteristics and likely impacts, and recommended what could be done differently within the short run.

#### Methodology

Given the brevity of the assignment, no attempt was made by the team to survey and quantify responses of public and private sector members. In fact, our opinion is that certain areas and persons have been over-interviewed and over-surveyed. We thoroughly read and critiqued each plan, prepared various hypotheses regarding reactivation, and tested those in numerous interviews. Observations of typical reactivation projects were, in some cases, viewed first-hand.

The review of social aspects was given special assistance when the Human Resources Officer of AID coordinated a "Delphi" session to develop planning criteria and social priorities. This planning exercise which took place simultaneously with our own activities enabled us to compare the social plan with the priorities established by health and educational specialists from all Departments of the country.

It should be noted that Checchi and Company, under another contract, estimated 1983 credit demand levels for major users. Considerable information-sharing and cross-fertilization between both teams took place, and has enhanced both reports.

## Findings

### Global Aspects

1. The Global Aspects Plan makes two estimates regarding GDP, balance of payments, and the GOES budget deficit. Given the decline in real GDP during the past four years, and the current state of the economy and resources available to improve it, the zero growth estimate in the plan appears to be realistic, and provides a good target for reactivation.
2. The Global Aspects Plan does not discuss important macroeconomic parameters with desirable specificity: unemployment, foreign exchange, taxes, exchange rate policy, IMF stand-by agreement, wage and price policies, and external donor infusions. It does not face certain problems which have emanated from the economic reforms, and will influence any reactivation efforts.

3. The objectives and goals of the Global Aspects Plan are vague, without sufficient description of how to reach them. It does not narrow the plan down to specific activities which will be key to reactivation. The plan does not state who will direct and coordinate reactivation or the schedule for the activities. It gives no indication of why one activity might be more important than another; and it does not state whether there are resources to do anything other than 'business as usual'. Most importantly, there is no strategy for reactivation, i.e., how does this all fit together and if done well, to what extent can it reverse the decline of the economy?

4. It is our general observation that the civilians in the country, especially those in San Salvador, do not want to admit to themselves that their country is in a war. Few sacrifices in consumption have been made by the upper and middle classes; and the lower classes are indifferent to the struggle for power. The economy is therefore not a 'wartime economy' where resources are marshalled to win the conflict while maintaining the productive base to the extent possible to avoid the undermining effects of unemployment and declining real incomes. There seems to be no political leadership or direction to organize resources and efforts, and uplift spirits in the face of guerrillas who can systematically and patiently destroy productive resources and confidence of the country.

### Industry

1. Industry appears to be one of the sectors most affected in the Salvadoran economic decline; since 1978, it has experienced a 36 percent reduction in output. In addition to reduced output, 70 factories have stopped production. Industrial unemployment is high; some figures show that in 1982, unemployment reached 32 percent of those employed in 1978. Capital goods and industrial raw material imports were less than 33 and 66 percent respectively of 1978 levels. Manufactured exports dropped faster than industrial output; from 25 percent of total production in 1978 to 22 percent in 1981, while industrial output dropped by more than 30 percent in those years.

2. Some major constraints affecting the industrial sector are: political uncertainty, declining demand in internal and external markets, lack of

foreign exchange from importing capital goods and raw materials, shortage of some local raw materials and low availability of credit.

3. If necessary measures are taken to raise confidence in investment and production, industrial reactivation--which is crucial in any national economic reactivation program--can be achieved in the following phases: (1) stop the deterioration and fall of industrial production; (2) achieve 1981 output levels by the end of 1983; (3) achieve 1979 output levels by the end of 1984; (4) and in 1985, surpass 1978 production by 10 percent.

### Agriculture

1. Private sector agriculturists who had read the plan divided into two groups: (a) those who were not going to invest until the guerrilla activities were terminated, Phase Two of the Land Reform was repealed, the Decree 207 program was stopped, and INCAFE and INAZUCAR were returned to private hands and (b) others who have decided to live with land reform and the ongoing conflict, and will try to do something productive and constructive, if given a chance.
2. There is a lack of foreign exchange for the purchase of key imported inputs, namely fertilizers and insecticides, medium-term credits are not available, and there are many debts in arrearage.
3. El Salvador's food imports have increased dramatically within the last four years. Guatemala has widened its Salvadoran market considerably with processed foods and its fresh fruits and vegetables. Guatemalan fresh foods are of better size, quality and appearance than national produce, and the very competitive pricing of Guatemalan produce indicates that it may be very difficult to stimulate Salvadoran production of fruits and vegetables in the short-term.
4. Basic grain production is severely impeded by the poor functioning of IRA. General mismanagement and disorganization indicate that a massive overhaul is in order.

5. There is currently \$125 million being held in coffee inventories by INCAFE. Coffee growers are compelled to pay interest on their crop credit while waiting for INCAFE to sell their production. There are no grower or beneficio operators represented on INCAFE's Board. No one is allowed to export coffee except INCAFE.

6. There is a series of pressing issues as seen by both the campesinos (beneficiaries) and the former land owners related to the land reform program which are not addressed by the PREN:

- a) Review and reduction of outstanding debts of many Phase I cooperatives where there is real doubt as to their legitimacy or as to the ability of the cooperatives to pay them off for reasons quite beyond their control.
- b) Definition and implementation of a policy regarding the future of land holdings between 100 and 500 hectares per landowner (Phase Two).
- c) Creation of the agrarian tribunals already contemplated by law to resolve conflicts arising over land and related problems.
- d) Creation of an insurance system that will compensate in part those cooperatives that suffer grave losses from weather, accident or military actions by guerrillas and the armed forces.
- e) Issuance of needed regulations for the use of agrarian reform bonds for the purchase of state-owned factories or other assets which the GOES wishes to privatize; and to enable reform beneficiaries to pay their agrarian debt with bonds acquired in the market.

7. For the current growing season, the policies, support prices and input prices for cotton have not yet been set. In March the Constituent Assembly will decide whether cotton will not be included under Decree 207 for another year. Cotton farmers crops and cotton gins continue to be the most vulnerable to guerrilla attack, and there is no mechanism which allows these farmers to share their risks. The Cotton Growers Cooperative (COPAL) is arranging for an external line of credit through a major foreign commercial bank to finance a portion of the cotton crop.

8. Although the burning of sugar cane by guerrillas was reported to be a problem, it was learned that harvesters actually burn the fields themselves, to speed up the harvest and although sugar content may be lost there is no difference between what is paid by INAZUCAR for high and low sugar content of cane.

9. Cattle production is seriously reduced and will be so as long as the problem of cattle rustling continues unabated.

### Construction

1. The construction sector has deteriorated substantially. Private sector construction dropped from ₡225 million in 1978 to ₡170 million in 1981. Only 40,000 workers are employed whereas 70,000 were employed at the peak a few years ago.

2. The construction plan is a listing of the projects delineated in the 1983 GOES budget. The PREN almost completely excludes mention of commercial development and construction activities. A serious bottleneck is ₡139 million of unsold upper income real estate.

3. The private sector is very concerned about ₡80 million owed to private contractors and suppliers by the GOES. This includes bids submitted but not adjudicated, contracts awarded but not contracted, suspended contracts, and final payments for projects completed.

4. Given the lack of private investment in commercial and industrial ventures and the aforementioned over-supply of upper income housing, low and middle income housing is the only area in which to reactivate the private construction sector. An increase of 5 to 6,000 units annually appears possible if funds are available.

### Social Aspects

1. This plan lists all the social programs destined to be carried out by GOES in 1983. Some of the activities seem to emanate from a fictional full-employment situation, rather than from the reality of an economy where over 350,000 persons are unemployed. Some planned activities might actually reduce private efforts for reactivation: for example, increased union formation, collective bargaining, and improvement of working conditions. One important area for improving investment and reactivation climate, justice administration, is treated superficially. Quantitative goals are provided for only education and health projects; otherwise, goals are non-quantitative and quite nebulous.

2. With so many unemployed and displaced persons, a further deterioration of social services could prove to be explosive. There seemed to be very little import given to the difference which reactivation can make in the life of the common person.

### Recommendations

1. All in all, the PREN serves as a useful document in that it begins to outline the task of national economic reactivation. Its major problem is that it defines the task so broadly that it is not an action plan. We do not recommend that the PREN be re-drafted, but that the CREN move to adopt a reactivation program based on the steps delineated below.

2. Our recommended program is based upon enhancing investor confidence and economic impact. If confidence in the economy is not improved, no amount of external assistance will keep it from declining further. After a review of the resources and options available to the GOES, we recommend that the program be divided into an emergency action plan (steps to be carried out in the remainder of 1983) and medium-term reactivation (steps to be carried out through 1986). A recommended timetable is included below.

3. We suggest that a person of very high stature who is competent, well-respected and apolitical be appointed by the President of the Republic as the Administrator and Coordinator of the National Economic Reactivation Program.

He should be given sufficient authority to implement and coordinate reactivation efforts, and he should be provided with a competent staff of sufficient size to assist him. The Administrator will work closely with the CREN, the Junta Monetaria, the Central Bank, the Ministries, Agencies and the private sector. This position and those of the staff will have a term only through 1986, by which time reactivation should be well underway. Given the size of the task, the CREN members and staff would do well to set their priorities and try to accomplish one major action per month.

4. We recommend that the CREN set up a timetable of six to eight major problems which will be considered during the remainder of 1983. This schedule would be publicized and adhered to for maximum impact. The problem would be researched by CREN, MINPLAN and AID-supplied short-term staff prior to hearings and a discussion of the issues by the CREN. After hearing and considering all the important facts, CREN would vote on a recommendation regarding the issue which would be passed on to the President and the Constituent Assembly. We believe that this procedure will break up the logjam which currently exists at high political levels.

5. We suggest that the reactivation effort be explained to Salvadorans in clear and effective terms. They will respond more positively if they understand what is expected of them, and they can be educated in the ways they can support economic reactivation. Each major action taken by the CREN would be widely publicized in all media. Press releases should provide information on accomplishments to date. A public relations campaign similar to the one carried out prior to the 1982 elections is highly desirable.

6. The CREN should recommend an intensified austerity program immediately. This program would reduce the current level of petroleum and processed food imports by \$20 million during the remainder of 1983. Petroleum consumption decreased by \$15 million during the past year and can be decreased further by totally closing service stations both Saturday and Sunday and by 7:00 p.m. on weekdays. Taxis would be exempted from these controls.

Non-essential items which are entering as contraband would be identified, confiscated, and auctioned off for the benefit of the public treasury. Public employees would receive no pay increase during 1983 as a part of the overall austerity program.

7. The CREN should recommend that each Ministry review its budget carefully, especially the Ministries of Economy, Agriculture and Public Works because of their great importance to the reactivation process, in order to effect shifts in 1983 activities which can lead to a higher level of reactivation. Use the following criteria to select priority projects: (a) generation of employment compared to project cost, (b) relationship to production, (c) utilization of existing, but unused capacity, (d) utilization of a low level of imports, (e) short start-up time, and (f) identification of critical inputs.

8. The economic problems recommended for consideration by the CREN during the remainder of 1983 are as follows:

May Make a final determination regarding the use of Phase One Land Reform bonds. Investigate the possibility of allowing bond-holders to use them plus some 'earnest' money to invest in CORSAIN assets. The GOES is planning to sell some deficit-ridden industries back to the private sector, and persons in charge of this liquidation are definitely interested in selling them to persons holding land reform bonds. Bondholders would be given the important social role of making these industries profitable. AID and MINPLAN have already arranged for some short-term technical assistance to study this question.

An objective appraisal of the assets of the firms should be allowed by parties interested in their acquisition and procedures set up for these transactions. Firms which cannot be sold to the private sector and which have no financial viability should be liquidated.

At the same time, we would suggest that recommendations be made regarding campesinos' use of bonds to pay their agrarian debt and the original 1980 loans. There presently exists a small market for these land reform bonds, and campesinos can purchase them for this use.

June

Study the feasibility of setting up in the BCR a foreign exchange fund especially for exporting industries in the amount of \$60 to \$120 million. Use the IDB Industrial Loan funds for this purpose and augment it with the next AID balance of payments disbursement. There will be some resistance by the IMF to this concept, as it wants AID funds to be used to reduce arrears, at least to \$45 million, before it will disburse its funds. The counter-argument is that the country must have the means to generate foreign exchange to eventually bring these arrears to zero.

Therefore, give firms which are foreign exchange generators access priority to this foreign exchange fund, and have these firms replenish and increase the fund by ten percent on each turnover. Make sure that all the potential fund users understand the rationing procedure and stick to the rules set up. Urge the Inter-American Development Bank to make \$20 million more available for this fund and urge the World Bank to accelerate its contemplated loan in the amount of \$40 million.

July

Study the problem of INCAFE's \$125 million in unsold coffee inventory and seek means to sell it outside the ICO as soon as possible. These funds are crucial to alleviating the foreign exchange shortage and providing resources for reactivation. Based on the results of these sales, recommend a policy to INCAFE which in the future will blend the quota coffee price and the price it has to take in order to sell coffee production. New financing for coffee should be restricted to growing areas in higher elevations, to maximize the amount of high quality coffee which is grown. This practice will bring higher returns even within the quota system.

Study a change in policy wherein the grower be allowed to deliver his product to INCAFE whenever he desires to, but after delivery INCAFE pays the crop credit interest until such time that the coffee is sold. This would stimulate INCAFE to move quickly to make coffee sales, and would help growers to maintain their creditworthiness at the banks.

August Make recommendations regarding the naming of a private coffee grower and a representative of coffee grower cooperatives to the Board of Directors of INCAFE and a private sector representative to the Board of INAZUCAR so that the organizations can be helped to become effective components of the economic reforms.

Make recommendations regarding the naming of private sector representatives to commercial bank boards. Urge the sale of bank stock to complete the reforms.

September If guerrillas continue operations in the country, study the organization of a mutual insurance company to cover grower risks, especially those of cotton growers. Such a program will involve a sizeable guaranty fund set aside by the Salvadoran government and premiums paid by individual growers.

At the same time, make recommendations for a mutual insurance plan to cover industrial losses resulting from terrorism.

October Investigate BCR or CORSAIN acquisition of the immobile portfolio of the commercial banks. Immobile portfolio would be defined as those loans uncollectible from active and operating enterprises, and whose current ratio (current assets to liabilities) is no more than 1.2. The BCR (or CORSAIN with BCR financing) would pay the bank in cash for the principal amount due, but not for the accumulated interest; and would have recourse to the bank after a three-year term. The BCR (or CORSAIN) would then grant an interest-free moratorium on debt repayments for three years after the date of the refinancing contract.

November Review the situation regarding unsold housing inventories. Legislation has been drafted allowing for reduced payments during the early years of mortgage. If inventory has not moved, recommend a program in which 'work-out' experts are brought in to assist the developers and the savings and loans in moving this inventory and to develop other solutions, including foreclosure on developers to bring prices down to the point where the real estate will be saleable.

December Review the existing laws governing land reform and make recommendations regarding modifications which would speed up the titling process. Such modifications might allow ISTA and FINATA to complete the process of land appraisal and deposit the resulting bonds and cash with a bank, in the name of the former landowner, who could claim them as soon as he is willing to sign a settlement. Meanwhile the GOES would be legally empowered to transfer title to the reform beneficiaries.

9. The GOES should request the following financial assistance from AID:

- a) An increase in the authorization of the Housing Investment Guaranty by \$20 million. The current HIG level is \$5 million and additional low-cost housing can be constructed with these funds.
- b) An additional \$9 million for the Employment Generation Program in the Ministry of Public Works. In 1983 AID will make available another \$4.5 million under this program, but the Ministry can absorb at least \$1 million per month.
- c) An additional \$13 million to generate employment on health projects:
  - (1) \$3 million to develop a labor intensive rural latrine program.
  - (2) \$6 million for the design and implementation of rural water systems. There are 35 such water systems already designed whose construction would employ 7,000 and would benefit 70,000 persons.
  - (3) An additional \$4 million for a PL-480 type drug and medicine program.
- d) Assistance for the Ministry of Education to carry out a school building and furniture repair program in the amount of \$2 million. There are 1,750

public schools (approximately 50% of the total) which need repair. This could be a medium-sized employment program with high social visibility.

e) Assistance to the General Prosecutor in the amount of \$1 million to begin to restore the criminal justice system. AID-supplied experts will have made recommendations on this subject within the near future. Strong efforts in this area will do much to increase social tranquility and enhance investment climate.

f) Seek AID funds specifically for activities which are crucial for reactivation and medium term growth:

- Technical assistance to the Ministry of Foreign Commerce to continue its efforts in developing non-traditional export growth. AID will provide \$1.5 million this year, but technical assistance is necessary to strengthen MICE's capabilities. Areas for development are honey, beeswax, cardamon, melons, shredded cocoanut, sesame seeds, castor beans, okra and ornamental plants.
- Roya eradication program.
- Marine fishery resources development (shrimp, tuna, lobsters and oysters).
- Dairy cattle, rabbit and poultry development.
- Grain, vegetable and agroindustrial development.

g) The small business sector tends to be dynamic because of low entry costs, and presents interesting possibilities at this time because their owners do not have the same options as do the owners of large enterprises. Request AID to continue financing of Small Producer Credit Programs beyond its fiscal 1983. Rural microenterprises offer interesting possibilities for business development--4,500 such businesses have been started during the past two years. Seek an additional \$1.5 million in external donor financing to provide technical assistance for their formation.

Also request AID or another external donor to provide technical assistance for developing handicraft guilds or cooperatives. This program could perhaps use rural schools as sites for activities. Seek \$1.5 million in international donor financing to provide technical assistance for their formation.

10. The reactivation steps to be taken during 1984-86 are as follows:
- a) Decide the final status of Phase Two of land reform. Set a date certain by which time landowners may sell off property in excess of their appropriate reserve limits. Provide assistance to the formation of campesinos cooperatives who can buy the land and cultivate it.
  - b) Study various tax reform alternatives for increasing tax yield. At the present time certain laws require clarification in order to maximize yields of certain taxes. Strengthen tax collection services.
  - c) While devaluation is not a presently popular idea, it should be contemplated if foreign exchange shortages are not resolved as a result of the rotating fund and austerity measures recommended above. Be aware that an abrupt devaluation will prompt further capital flight and possible retaliation in the form of tariffs by CACM trading partners. Therefore, if devaluation is undertaken, it can be done prudently with gradual pegged devaluations of 10 to 15 cents (colon) every quarter. Probably both official and parallel rates should be devalued simultaneously on random days during the quarter. This implies that the parallel rate should also be pegged by the BCR. We do not recommend devaluation until other measures have been taken and a return of investor confidence has been noted.
  - d) As economic conditions improve, continue to pressure such entities at the Export-Import Bank, the Overseas Private Investment Corporation and the Federal Credit Insurance Agency to extent guaranties to cover commerce and investment in El Salvador.
  - e) Make recommendations which will result in a differential pricing system based on the sugar content in cane.
  - f) Undertake a re-organization of IRA in order that it provide better incentives for the cultivation of basic grains.

## SECTION II

### GLOBAL ASPECTS

#### A. Summary and Critique of the Reactivation Plan

Global aspects refer to macroeconomic projections along with the setting of some general priorities, objectives and guidelines by MINPLAN. The Global section also recommends a series of agricultural, industrial and construction-related activities to bring about the desired economic reactivation.

The PREN lists a series of basic priorities apparently in order of perceived importance:

- national defense
- health
- relocation of displaced persons
- increase of employment
- reconstruction of damaged infrastructure
- reduction the fiscal deficit
- increase of exports
- improvement of foreign exchange reserve position
- implementation of existing projects in irrigation and agro-industry
- encouragement of "profit" in public enterprises
- provision of better access to agricultural and industrial inputs

And it suggests the following objectives:

1. Halt the decline in production and employment.
2. Reduce problems due to strangulation of foreign commerce.
3. Reduce the fiscal debt and financial requirements of autonomous public enterprises.

Further, the plan offers guidelines to meet those objectives:

1. Carry out the established reforms to raise national production.
2. Stimulate the supply of goods and services.
3. Concentrate the reactivation effort in the agricultural, industrial and construction subsectors.

4. Increase utilization of installed capacity.
5. Provide foreign exchange financing to purchase necessary imports.
6. Refine the monetary and credit systems.

The plan then proceeds to make a series of nominal and real projections of GDP, and its components of consumption, investment, government expenditures, and balance of payments. It also estimates revenues and expenditures of the Central Government. These projections are summarized in Tables 11-1, 11-3 and 11-6.

### GDP Estimates

GDP calculations involve two outcomes for 1983, one resulting in a three percent drop in real GDP, and one estimating zero real growth. These estimates are perhaps optimistic in light of real GDP decreases of 1.7, 9.0, 9.5, and 5.4 percent during the previous four years<sup>1/</sup>, but we are fully cognizant of the difficulties in predicting such outcomes. Either result would certainly indicate an economy undergoing reactivation. Components of the estimates are not particularly imaginative, as public consumption and investments, private investment, inventory variation, and exports remain the same in both cases. The only difference between the two cases is the assumption that an increase in imports will lead to an increase in private consumption (as opposed to a more desirable increase in private investment, for example).

Table 11-2 allows us to understand some of the basic shifts in the composition of the GDP, which have occurred or are predicted. One can readily note that private sector investment has dropped off sharply, private consumption has amounted to a greater and greater share of GDP, public capital formation commands a slightly smaller share due to declining revenues, imports have dropped sharply due to lack of foreign exchange and exports are down due to a lack of goods to export and the deterioration of CACM trade. In very simple terms, the task of reactivation is to regain the proportional relationships of a 'normal' year. Given three major reforms undertaken in 1979, there may

<sup>1/</sup> Central Reserve Bank data, quoted in AID briefing book.

be some difference in the GDP composition but unquestionably there needs to be an increase in private investment, imports and exports in order that reactivation take place.

The PREN recommends the following actions be undertaken to achieve economic reactivation:

#### Agriculture

1. Deliver the financing necessary to implement the Integrated Production Plan.
2. Ensure the timely availability of adequate volumes of fertilizer and pesticides according to areas and crops.
3. Effect a complete evaluation of the Agrarian Reform and begin to train technicians and cooperatives in administration, commercialization, and legal aspects, to consolidate the reform and achieve profitability.<sup>1/</sup>
4. Provide technical assistance to reform and non-reform sectors, and increase the coverage of the roya eradication program.
5. Create mechanisms for institutional coordination.

#### Industry

1. Establish a program of import financing for export industries.
2. Establish special lines of financing through the banking system.
3. Stimulate the use of national inputs and employment generation.
4. Finance pre-investment studies.
5. Support small industry.
6. Support artisans and family industries.
7. Support rural mini-industries.
8. Provide support to agro-industries.
9. Effect modifications in the law which impedes rehabilitation of industries.

#### Construction

1. Facilitate external financing for middle and low-income housing.
2. Provide inputs for housing while supporting the industries which manufacture these inputs.
3. Provide ANDA (Administracion de Acueductos y Alcantarillados) with greater resources to self-finance part of its new investments.
4. Establish differential systems for the acquisition of low-income housing.
5. Readjust some programs under execution by the public sector to facilitate external financing.
6. Include greater labor intensity in construction projects.

<sup>1/</sup> AID efforts have been considerable in this area, including not only a complete evaluation, but also large amounts of technical assistance to bring about the consolidation of the agrarian reform.

These recommendations for action are generally sound, but overlook certain major problems in each area.

In agriculture, for example, there is no mention of the huge glut of coffee on the world market, the large unsold inventory which INCAFE is carrying, or the credit problems this is causing for coffee growers. There is no mention of the lack of action on Phase II of the land reform, and the subsequent uncertainty of landowners resulting in decreased levels of investment. The vulnerability of cotton fields to guerrilla activity is given no attention.

Under industry, it is well to recommend import financing for export industries but there is no presentation of the relationship between credit demand and foreign exchange availability. Financing pre-investment studies is appropriate for medium term economic development, but not for a reactivation plan, at least not the first steps. Credit to artisan and mini-industries is a good step because this sub-sector has demonstrated that it can rapidly absorb the unemployed industrial labor force and provide employment for those who have had some type of vocational training.

The construction activities do not include mention of currently huge unsold upper income housing inventory, the number of building material manufacturers who have already closed their doors, or means to include the paralyzed private building contractors in the program.

#### Balance of Payments Estimates

As can be noted in Table II-3, El Salvador has had a prolonged pattern of negative balances on the trade and current account. In 1979 and 1980, because of historically high coffee prices and an increased volume of coffee sales, these accounts turned positive. In 1981, sharp decreases in cotton and coffee earnings returned the trade and current balances to negative numbers.

The Salvadoran economy is dependent on international trade to provide markets for its industrial and agricultural production, and, in return, supply it with imports basic to production and consumption, such as raw materials,

Table 11-3

## REACTIVATION PLAN

BALANCE OF PAYMENT PROJECTIONS  
(Millions of Current Colones)

	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1 9 8 3</u>	
				<u>Case 1</u>	<u>Case 2</u>
Exports	2,680.2	1,982.8	1,845.6	1,927.1	1,927.1
Imports	<u>2,429.4</u>	<u>2,452.1</u>	<u>2,400.0</u>	<u>2,514.1</u>	<u>2,608.5</u>
Trade account	250.8	(469.3)	(554.4)	(587.0)	(681.4)
Net services	(329.0)	(319.0)	(323.0)	(336.0)	(336.0)
Transfers	<u>122.3</u>	<u>70.4</u>	<u>400.0</u>	<u>400.0</u>	<u>400.0</u>
Current account	44.1	(717.9)	(477.4)	(523.0)	(617.4)
Private capital	(1,001.0)	(112.6)	(147.4)	(109.0)	(104.4)
Official capital	214.9	435.5	491.3	419.7	419.7
Bank capital	<u>251.5</u>	<u>197.2</u>	<u>242.5</u>	<u>200.0</u>	<u>200.0</u>
Balance of Payments	(490.5)	(197.8)	109.0	(12.3)	(106.7)

Source: Reactivation Plan, Global Aspects

capital goods, replacement parts, petroleum, fertilizers, wheat, and medicines. Every major sector depends on imports, and there is a high correlation between the level of real imports and national output and employment.

The balance of payments estimates in the PREN are based upon the performance of major export activities, such as coffee, cotton, sugar, shrimp, and tuna. As can be seen in the table below, some of these estimates appear to be quite viable, others rather implausible. The coffee estimate is seen as quite reasonable given price levels and estimated planting areas and yields. The sharp drop in cotton may also be reasonable given the high risk in growing cotton in guerrilla-dominated areas, but the planting area for cotton is estimated to increase by 8.7 percent in 1983<sup>1/</sup>. Sugar, on the other hand, will most likely not increase by 84.5 percent. Sugar planted will increase by 3.1 percent in 1983 with yields projected at 1983 levels (of course, there is no direct correlation here because the amount of sugar available for export depends on whether the cane is actually harvested and the internal demand levels).

Table 11-4

PREN ESTIMATES OF MAJOR EXPORT PERFORMANCE IN 1983

Coffee	2.6%	Increase
Cotton	25.0%	Decrease
Sugar	84.5%	Increase
Shrimp	5.5%	Increase
Tuna	60.0%	Increase
Other products	7.9%	Increase
Total Goods & Services	3.7%	Increase

---

Source: PREN, Table 9

<sup>1/</sup> Ministry of Agriculture estimates

Although shrimp has increased strongly during the past four years, two of the major exporters are reorganizing their operations. Licenses have been issued to three new operations and it would be reasonable to assume the shrimp will continue as a strong export. It is our understanding that the government-operated tuna industry has not gotten off the ground, and the 60 percent increase may be overly optimistic.

Given the high dependence of the Salvadoran economy on imports, for reactivation purposes it is important to look carefully at the estimated structure of imports. The projected increases in imports in nominal terms can be seen in Table 11-5. The implication is that imports in real terms will be maintained at or below their 1982 levels, leading us to conclude that output will be greatly impeded by lack of raw materials and intermediate goods. This theme will be addressed in the section below on foreign exchange, but if the supply of productive inputs cannot be increased, we foresee little hope for an advance in the economy.

Table 11-5  
 PREN ESTIMATES OF IMPORT PERFORMANCE IN 1983  
 (nominal values)

	Case 1	Case 2
Consumer Goods	3.7% increase	5.8% increase
Intermediate Goods	6.1% increase	11.7% increase
Capital Goods	0.0%	0.0
Services	.5% increase	.5% increase
Total Goods & Services	4.0% increase	7.2% increase

Source: PREN, Table 10.

## Fiscal Deficit and Policy

The PREN also estimates the level of the fiscal deficit. MINPLAN in October only had available preliminary estimates of the Central Government Budget, the level of external donor assistance, and the amount of the unfinanced deficit from 1982. Nevertheless, the Budget estimates for current revenues and expenditures are quite accurate as can be seen by comparing Tables 11-6 and 11-7. There is a much greater variance between capital expenditures and revenues.

The most notable step taken by the GOES has been to bring under control the rapidly expanding deficit experienced in 1981 and 1982. This has been accomplished primarily through strong austerity measures, a wage and hiring freeze on all public employees, and a decrease in the number of public employees through attrition.

The 1983 fiscal deficit is being partially covered by an increase in a series of stamp taxes from 2 to 4 percent. This step, which is being presented to the Constituent Assembly in mid-February, is expected to yield an additional ₡217 million if passed.

## General Observations on the PREN

1. From the economic estimates we receive a sense of the forces which must be at work to achieve economic reactivation. Either GDP estimate would indicate that the economy was gaining strength, and zero growth is a good target.

There seems to be no urgency on the part of the GOES to expand non-traditional exports which continue, according to conversations with industrialists, to have markets in Central America, USA, Europe, and Japan. The Global Aspects plan does not actually overlook the manner in which foreign exchange constrains the import of raw materials and intermediate goods. But it does not seem to

Exhibit 11-6

REACTIVATION PLAN CENTRAL GOVERNMENT  
FINANCIAL PROJECTIONS

	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>
Current revenues	1,019.7	1,089.6	1,145.0	1,360.3
Current expenses	<u>1,077.3</u>	<u>1,233.5</u>	<u>1,342.2</u>	<u>1,378.9</u>
Deficit	(57.3)	(143.9)	(197.2)	(18.6)
Capital revenue	1.2	6.0	106.7	40.8
Capital expenditure	<u>457.4</u>	<u>446.8</u>	<u>593.6</u>	<u>491.4</u>
Net concession from loans	3.1	36.0	2.7	0.0
Budget deficit	(516.9)	(620.7)	(686.8)	(469.2)
Financing:				
External	135.2	202.3	363.2	--
Repayments	<u>(9.3)</u>	<u>(11.2)</u>	<u>(24.0)</u>	<u>--</u>
	125.9	191.1	339.2	105.6
Internal:				
BCR	346.7	439.7	375.0	390.2
Banks	.6	47.2	--	--
Other sources	<u>(6.3)</u>	<u>(57.3)</u>	<u>(27.4)</u>	<u>(26.6)</u>
	391.0	429.6	347.6	363.6

Source: Reactivation Plan, Global Aspects

Table 11-7

CENTRAL GOVERNMENT BUDGET 1983  
(millions of colones)

Current revenues	1,457.4
Current expenses	<u>1,472.3</u>
Deficit	(14.9)
Less carry-over deficit	<u>(250.0)</u>
	(264.9)
Capital revenue	586.4
Capital expenditures	<u>586.4</u>
	0
Other revenue to finance budget	265.0

Source: Ley de Presupuesto General y de Presupuestos Especiales de Instituciones Oficiales Autonomas 1983, December 23, 1982.

come to grips with the further sacrifices which may have to be made by the Salvadoran populace to expand foreign exchange availabilities.

2. Besides the foreign exchange constraint, the Global Aspects Plan does not address the investment climate, the foreign exchange rate policy, monetary policy, taxes, details of the GOES budget, wage and price policies, unemployment, external donor resources, and the IMF agreement. These important areas will be discussed in some detail below.

3. In addition, the plan does not provide answers to an additional series of questions related to the implementation aspects of the reactivation plan:

- a. Who is going to execute the economic reactivation? Can we assume that the various Ministries and Agencies involved will adjust their activities quickly and support the reactivation effort? What will be the role of the private sector? Where do private firms stand regarding willingness and ability to expand their output?
- b. When will these reactivation activities start? Obviously, the answer should be immediately, yet, since the plans were published, no overt action has been taken on them. What is the timetable for activities? What are the first steps which should be undertaken? Given certain realities, constraints, and resources, what is the logical sequence?
- c. What resources will be available to do anything differently? What are the resource levels of the AID, BID, BCIE, and World Bank programs for 1983? What is the optimal way to allocate any of these resources not already earmarked for specific activities?
- d. What criteria should be used to evaluate reactivation activities? Has there been any relationship between this plan and the 1983 Budget?

This report will recommend some answers to these questions. Obviously, the economic base must be maintained and reforms underway cannot be abandoned. The three most important sectors for reactivation have been analyzed carefully in separate sections. In the remainder of this section, economic and policy parameters and constraints which bear upon the ability of El Salvador to rehabilitate itself will be examined.

## B. Economic Parameters and Constraints

### Expectations

Given the sustained conflict with guerrilla elements, it is unquestionably difficult to design a program which will reverse the economic decline. One will note elsewhere in this report that even the massive dose of external assistance is only maintaining the Salvadoran economy in a "holding pattern", and realistically even that position is declining somewhat. The economy is declining largely because of the great risks which all investors face. Furthermore, one must seriously ask, given the reforms which have been undertaken, whether private investment, internal and foreign, will return to normal levels once the conflict is over. This section will discuss investment behavior and the manner in which some risks might be reduced in order to stimulate investment.

Employment and equipment utilization levels are a result of today's expectations regarding the future. The behavior of each individual firm in deciding its daily output is based on its short-term expectations of costs and sales. For Salvadoran investors, the levels of expectations must be fluctuating almost daily with news of guerrilla and/or army actions, external donor announcements the status of discussions in the Constituent Assembly, the state of the U.S. economy and OPEC prices. A major influence on investment behavior is the possibility of losing assets due to nationalization, either by external or internal political forces. Phase Two of the land reform may not be undertaken because of a lack of GOES financial and manpower resources, but farm investment on the affected lands will be limited until there is some clear indication of the status of this reform, and of the 'rules of the game'

regarding reserve rights, etc. Increasing guerrilla strength causes a dichotomy between investor types:

1. Those who will remain in the country of their own volition or because of limited resources and mobility.
2. Those who can leave if conditions become too risky or intolerable.

Those in the latter category are likely to be hedging their position, investing only enough to keep their Salvadoran productive assets operational and transferring as much cash as possible to foreign banks in case of a forced exit. Large sums of capital that might have gone into private investment has already been placed abroad by persons who have the ability to do so. These transfers take the form of dollars purchased in the black market or through false invoicing mechanisms which enable export sale or import purchase dollars to end up in banks abroad. A recent AID audit estimated that invoices were overstated by a considerable number of firms receiving foreign exchange which came from AID-supplied balance of payments support. If uncertainty builds further, colones will decrease in value as persons increase the flow of cash assets abroad.<sup>1/</sup>

The primary effect which uncertainty has had upon the Salvadoran economy has been that fixed private investment has fallen off sharply. The table below demonstrates the reduction in annual private investment of nearly \$300 million from bank or personal resources. The PREN estimates that private investment will reach \$225 million in 1983; we feel this is highly optimistic. Because of reduced investment levels, plant and equipment are aging and it must be difficult to simply keep production lines working. The large amount of external assistance has not and cannot cover this "private investment gap".

Private investment will not increase substantially until the hostilities cease. The important question is: If the hostilities continue at their present level interminably, what can be done to reduce investor reticence? We arrive at six answers. First, the GOES needs to set a clear policy and firm action

<sup>1/</sup> The black market has presently stabilized at approximately ₡4.15 per dollar, but has increased from approximately ₡3.00 during the past year.

Table 11-8

FIXED PRIVATE INVESTMENT  
(millions of U.S. Dollars)

	1978	1979	1980	1981	1982
Fixed Private Investment	501.1	391.7	230.4	209.1	217.4
Investment/GDP Multiplier	6.1	8.8	14.7	16.2	17.2

plan regarding economic reactivation and communicate these to all Salvadorans. Second, it should identify those steps remaining to be carried out in the economic reforms which involve low political and financial costs and take them. Third, adequate levels of foreign exchange should be provided to those economic entities capable of earning additional foreign exchange, thus relieving the shortage which currently exists. An adequate supply of food and medicine of course must be assured to maintain social calm. Fourth the GOES should continue public employment and low-cost housing programs which will have the effect of maintaining aggregate demand, thus benefitting private sector firms. Fifth, some sort of interim insurance programs need to be designed and put into effect to protect cotton crops, raw material imports for assembly operations, and business property. Insurance against terrorist activities is available, but at such high premiums that businesses cannot afford it. Sixth, the reactivation program should include a component for artisan and small industrial development to provide investment opportunities for those businessmen who do not have the option of leaving the country, and who may fill market gaps left by departing larger producers. These activities do not depart greatly from the activities prescribed in the PREN, however, our implementation recommendations answer the questions posed above regarding by whom, how and when these steps should be taken.

To set things moving forward, the CREN could present its recommendations to the President of the Republic as soon as possible. The President could designate a National Coordinator of the Economic Reactivation Program and provide him with a talented staff. This Coordinator should be given considerable latitude to remedy particular economic blockages in consultation with the CREN, the Junta Monetaria, the Central Bank, the Ministries, Agencies and the private sector.

There are so many economic problems to be resolved that we do not believe that the CREN can address them all simultaneously, in fact, it would be foolhardy to do so. We suggest that the CREN attempt therefore to review and make recommendations on one serious problem blocking reactivation per month. The CREN could set up a timetable of six to eight such problems to be considered during the remainder of 1983. This schedule would be publicized and adhered to for maximum impact. If the program were to be initiated in May, investigation would be carried out by CREN staff and AID-supplied short-term specialists who would provide the CREN with a brief background and discussion of the issues by the end of April. During May, the CREN would set up at least four hearings where all interested parties could make their views known in presentations of limited duration (10 to 15 minutes). At the end of May, the CREN would vote a recommendation on the issue and send that on to the President and the Constituent Assembly. In case of a tie, the Coordinator would function as the tie-breaker. That recommendation should be widely publicized. The recommendation would be best passed on in the form of a draft decree which could be amended by the Constituent Assembly. This would imply the need to have a competent attorney on the CREN's staff to prepare draft decree language.

The general ideas regarding reactivation and action program decided upon should be communicated to the Salvadoran public by means of a public relations program to announce proposed steps and to report on their effects. If the GOES were to undertake one solid activity monthly, with appropriate and credible announcements to the public, we believe that the effect upon investor

climate would be highly beneficial. The public relations program formulated to promote the 1982 elections was highly effective and could be used as a model. If such a program did not create unrealistic expectations or over-sell, the Salvadoran public would respond by increased investment, purchases and prolonged social tranquility.

### Foreign Exchange Availability, Rationing, and Strategy

The most critical constraint to expansion of production is foreign exchange. As noted above, El Salvador's open economy depends greatly upon imported inputs for industry (raw materials, capital goods and parts), agriculture (fertilizers and insecticides) and construction (plywood, glass, bathroom fixtures, asphalt). The current declines in volume and value of exports, capital flight, and reduced international lending exposure has led to a severe shortage of foreign exchange.

The BCR (Central Reserve Bank) has the official role of rationing among users the foreign exchange which ends up in the banking system. Uses of foreign exchange are sales to banks for private and public sector activities, petroleum consumption, international loan amortization, coverage of foreign trade deficits, and international reserves. The rationing process involves several layers of approval. One approval step determines whether the foreign exchange request meets one of six use priorities or whether it falls in a non-priority category. The six priority categories are as follows:

1. Foodstuffs
2. Medicine and certain health related equipment and supplies
3. Petroleum
4. Industrial inputs and capital goods
5. Agricultural inputs
6. Replacement parts for transportation vehicles.

Another layer of approval is required to release the funds when available.

Allocation of foreign exchange among priority uses is not made according to the above ordering. For example, when a petroleum tanker arrives to off-load at Acajutla, the BCR must see that the dollars are available; or when planting season arrives in May-June, fertilizers and insecticides must be ready for the farmers. The balancing of foreign exchange needs with availability is a process requiring considerable flexibility and deftness. There is tremendous pressure upon the BCR's International Department (many requests for foreign exchange are based on urgently needed medicine or equipment, or the closure of a factory may result if approval is delayed).

At the present time, the backlog of foreign exchange requests at the International Department, and Exchange Control, and commercial banks, is estimated at \$75 to 90 million. The backlog of requests in the International Department alone has averaged \$27.2 million throughout 1982, and there appears to be no downward trend in these requests (see Table 11-9).

The composition of these requests bears some examination. Among the priority requests, industry and medicine account for the greatest portion of the backlog in the International Department. Commercial loan repayment requests are rarely granted foreign exchange nowadays. However, loan repayments to foreign donors actually are given top priority in order to maintain credit standing with them. (The U.S. Government requires that recipient countries make loan repayments on a timely basis, or face a cut-off in funding) (see Table 11-10).

The IMF has pressured the BCR to reduce its arrearages, payments to suppliers for goods already in the country, which amounted to some \$65 million at the end of 1982 (\$71 million in mid-February 1983). IMF assistance in 1983 presumably will provide foreign exchange only if these arrearages are reduced further, to at least \$45 million, thus enabling Salvadoran businesses to maintain to some degree their creditworthiness.

Given the level of the backlog, firms and public entities have a great deal of trouble obtaining needed materials and equipment. Moreover they have difficulty maintaining their credit standing with suppliers who generally

Table 11-9

FOREIGN EXCHANGE REQUEST BACKLOG  
INTERNATIONAL DEPARTMENT  
January 1982 - January 1983  
(thousands of dollars)

January 1983	\$ 31,826
December 1982	24,892
November	n/a
October	24,221
September	24,953
August	21,656
July	18,832
May	32,715
April	33,230
March	30,287
February	30,428
January	26,332

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Source: BCR

Table 11-10

## COMPOSITION OF FOREIGN EXCHANGE BACKLOG

January 31, 1983  
(thousands of dollars)

<u>Category</u> <sup>1/</sup>	<u>Amount</u>	<u>%</u>
Energy	\$ 983.6	3.1
Food	626.0	2.0
Medicine	6,352.3	20.0
Industry	9,088.5	28.6
Agriculture	602.4	1.9
Transportation/Parts	807.3	2.5
Loan Repayments	4,244.9	13.4
Commissions	1.9	0.0
Royalties	1.0	0.0
Commerce (productive)	3,481.2	10.9
Commerce (non-productive)	638.3	2.0
Other Goods and Services	3,329.1	10.5
Various	<u>1,664.8</u>	<u>5.1</u>
Total	\$31,826.3	100.0

Source: BCR

<sup>1/</sup> Does not distinguish between type A and B requests, however.

'A' requests equal \$29.6 million and 'B' requests equal \$2.2 million.

demand that all previous liabilities be paid off in cash before shipping more products. The foreign exchange scarcity has resulted in temporarily shut down industrial plants, and closures in other cases.

AID provided \$100 million in balance of payments support during fiscal 1982, and will provide an additional \$90 million during fiscal 1983. The Mission policy has been not to tie these dollars to any specific allocation, but to allow the BCR to use the dollars for the priorities listed above. The colones generated have been earmarked for different uses. AID set levels for credit expansion for 1982 as follows: ₡350 million for the Central Government; ₡50 million for autonomous agencies; and ₡125 million for private sector use. Due primarily to the lack of foreign exchange availability, private sector borrowing actually shrank by ₡98 million during 1982. Unless additional foreign exchange is made available to the private sector, credit demand will not increase much in 1983.

The comparison of foreign exchange flows is shown in Exhibit 11-11. A major change is noted in the level of foreign exchange from coffee sales, a \$139 million reduction. The AID infusion of \$100 million held the overall flow decrease to \$46 million; the situation would have been considerably tighter without it. Some positive signs are also noted: a decrease in petroleum imports of \$14 million; a reduction in public sector foreign exchange usage of \$17 million; and an advance in sugar inflows by about \$13 million. It should be noted that outflows maintained their 1981 proportions in 1982, which is to say that despite decreasing availability of foreign exchange in 1982, the amount available appears to have been distributed in a relatively equitable manner.

The Central Bank has acted to relieve some of the foreign exchange pressure: refinancing for \$14 million in short-term obligations was obtained with a three year term; additional relief will come from the \$40 million IDB industrial loan, the first tranche of which will be disbursed in mid-February 1983. Industrialists are especially interested in this loan's availability as the

Exhibit 11-11

INFLOWS OF FOREIGN EXCHANGE

1982 and 1983  
(millions of dollars)

	1981	%	1982	%
Beginning Balance	9.4		2.3	
Inflows:				
Coffee	452.7	50.1	313.3	36.7
Cotton	41.1	4.6	42.1	4.9
Sugar	.9	0.0	14.1	1.6
Shrimp	16.0	1.8	10.4	1.2
Others	<u>--</u>	<u>--</u>	<u>.5</u>	<u>0.0</u>
	510.7	56.7	380.4	44.5
Loans:				
Central Bank	237.5	26.4	227.0	26.6
Public Sector	<u>68.9</u>	<u>7.6</u>	<u>80.6</u>	<u>9.4</u>
	306.4	34.0	307.6	36.0
Other Inflows:				
BCR Deposits (Liquidation)	54.6	6.1	52.8	6.2
Others	29.0	3.2	13.8	1.6
Donations	<u>---</u>	<u>---</u>	<u>100.0</u>	<u>11.7</u>
	83.6	9.3	166.6	19.5
Total Inflow	900.7	100.0	854.6	100.0

Exhibit 11-11, cont'd.

OUTFLOWS OF FOREIGN EXCHANGE

1982 and 1983  
(millions of dollars)

	1981	%	1982	%
<b>Outflows:</b>				
Sale to Banks (private sector and other priorities)	311.3	34.3	288.0	34.1
Petroleum	149.1	16.4	134.8	15.9
Public Sector	<u>70.1</u>	<u>7.7</u>	<u>52.7</u>	<u>6.2</u>
	530.5	58.4	475.5	56.2
<b>Loan Amortization:</b>				
Central Bank	223.4	24.6	205.2	24.3
Public Sector	<u>42.2</u>	<u>4.6</u>	<u>43.7</u>	<u>5.2</u>
	265.6	29.2	248.9	29.4
<b>Deficit in Regional Agreements:</b>				
Central America	26.8	2.9	16.2	1.9
Mexico	7.9	0.8	16.2	1.9
Others	<u>1.0</u>	<u>0.0</u>	<u>1.3</u>	<u>0.2</u>
	35.7	3.9	33.7	4.0
<b>Other:</b>				
Deposits (BCR)	63.3	6.9	83.0	9.8
Others	<u>12.7</u>	<u>1.4</u>	<u>4.3</u>	<u>0.5</u>
	76.0	8.3	87.3	10.3
Total Outflow	907.8	100.0	845.4	100.0
Ending Balance Available	2.3		11.5	

Source: Banco Central de Reserva

funds are to be used for industrial inputs and capital goods.<sup>1/</sup>

The BCR projects that these funds should enable it to meet industrial foreign exchange demands for the next six to eight months. AID will also provide an additional \$90 million in balance of payments assistance during its fiscal 1983; \$20 million has been trached; and an additional \$20 million will be disbursed in early March 1983.

The World Bank has also expressed an interest in providing an additional \$40 million for industrial purposes, with a presently projected disbursement late in 1983 or early in 1984. The amount of the IMF's international reserve support for 1983 is not known at this time.

What appears to be missing from the financial scenario is a strong inflow from the sale of manufactured exports. This amount is remarkably absent from the figures presented in Exhibit II-11. The industrialists themselves have suggested that a rotating fund be set up to streamline the process through which their foreign exchange solicitudes pass. Likewise, they believe that the fund can be replenished because the banks will receive the dollars directly and remit them to the BCR. The fund can even be increased over time as the firms are willing to add 10 percent to the amount requested upon payment of dollars by the purchaser. There has been some BCR resistance to the idea of a rotating fund up to this point, and AID has supported their position which allows total flexibility in the management of the foreign exchange rationing. Nevertheless, we believe that it is time to provide a psychological boost to the industrial sector, especially in light of the section above on expectations. In order for the private sector industrialists to proceed with needed investments, it is necessary to give them the feeling that the BCR (a GOES institution) is working to accomodate their needs. We recommend a rotating fund of approximately \$60-120 million be set up to provide increased rapidity in delivery of foreign exchange to industrial firms. This will be

<sup>1/</sup> Also of interest is the disbursement system devised by the IDB. A sight letter of credit system has been set up with the Irving Trust Bank of New York City. When local commercial banks receive 'qualified' invoices, they send confirming telexes to the supplier and Irving Trust which releases the payment to the supplier. IDB immediately thereafter remits to Irving Trust. The BCR clearly stated that they do not want abuses or leakages in this arrangement and will insist that industrial firms remit foreign exchange earned from the sale of goods to maintain access to the program.

discussed in greater detail in the industrial section below. This fund should be monitored carefully to assure that industrialists are using the funds to import, not as a vehicle for capital flight. At the present time, the International Department at BCR has insufficient staff to monitor such disbursements on a plant-by-plant basis. At best, it might be able to set aside a small group of personnel to randomly check prices and replenishment of the fund. This monitoring may require additional external donor assistance.

Which firms should be given priority to such a foreign exchange fund? The BCR estimated that \$268 million in foreign exchange will be needed for industrial firms in 1983. If the fund is large enough, no allocation would be necessary; however, if it is funded at the \$60 million level, even assuming two turnovers per year, some allocation may still be necessary. One criterion might be that the fund be used only for exporting companies.

If there is still a shortage, the Economic Investigation Department of the BCR has carried out an evaluation of 1,127 firms, based on value added, net foreign exchange generated by the firm's operations, imports, national input usage, and the number of personnel employed in 1978. The ranking of the firms which results appears to be a rational means to distribute funds from the recommended rotating fund. This process would give emphasis to those industrial firms which are net earners of foreign exchange. The acceleration of this distribution process and the expansion of the fund, could, over time, ease the shortage of foreign exchange in the country.

In order to generate additional foreign exchange, we recommend that the GOES launch an austerity program which is well publicized and explained through the public relations program discussed above. Specific targets for this program should be to reduce consumption of gasoline, we believe at least a \$10-15 million reduction, and a decrease in imported processed foods, where an additional \$5-10 million can be generated. Customs should tighten up their border and airport operations to reduce leakages.

## Unemployment

Unemployment is the most pressing economic constraint. The problem is recognizably widespread and severe although no recent estimates have been made. Table 11-12 merely takes into consideration the entry of 50,000 new workers which are estimated to enter the labor force each year, the lack of new job slots because of the decline of the economy and dislocations caused by violence, and the already existing level of unemployment in 1981. Based only on these figures, there are an estimated 344,000 persons without work, for an unemployment rate of 21.5 percent. The conclusion is that there is severe stress building up at lower income levels, as per capita income has been diminishing due to frozen wages, inflation, and this high unemployment level. Any policies which would further deteriorate the economic position of persons at low income levels could have explosive social implications. Steps which would create employment, could assist those families who presently have no work possibilities, and relieve these social responsibilities.

### C. Policy Parameters and Constraints

#### 1. 1983 Budget and Lack of GOES Resources

A review of the budget of the ministries which will carry the major load of reactivation-- Foreign Commerce, Economy, Agriculture, and Public Works-- shows their planned expenditures to be \$193 million or 24 percent of the total GOES budget. The entire budget has \$62.4 million in construction activities planned, out of the \$823 million total.

A careful examination of line items shows few activities which seem directly related to reactivation, and some which may not be appropriate at all for this period of economic crises. Some planned activities require additional evaluation to determine whether some financial and human resources could be shifted from one activity to another in order to achieve a greater reactivation impact. For example, we know from our interviews that the Ministry of Foreign Commerce is functioning as a unit in reactivation efforts, especially in the promotion of non-traditional exports.

Exhibit II-12

CONJECTURAL EMPLOYMENT AND UNEMPLOYMENT DATA, 1971 - 1981

(thousands of persons)

	(1) Labor Force	(2) Employment	(3) Adjusted Employment	(4) Employment Growth Rate	(5) Unemployment	(6) Unemployment Rate	(7) GDP Growth Rate
1971	1,117	1,028.9	1,029	-	87	7.8	4.6
1972	1,153	1,076.8	1,077	4.7	76	6.6	5.7
1973	1,191	1,124.6	1,125	4.6	66	5.5	5.1
1974	1,230	1,172.4	1,172	4.2	58	4.7	6.4
1975	1,270	1,220.3	1,220	4.1	50	3.9	5.6
1976	1,313	1,263.2	1,263	3.5	50	3.8	3.9
1977	1,357	1,307.7	1,308	3.6	49	3.6	5.2
1978	1,403	1,234.5	1,352	3.4	51	3.6	4.4
1979	1,451	1,222.2	1,340	0.9	111	7.6	1.2
1980	1,500		1,256	6.3	244	16.3	8.7
1981	1,550		1,256	0.0	294	10.0	9.6
1982	1,600		1,256		344	21.5	5.0

- Sources:
- (1) IDB, Economic and Social Progress in Latin America. 1977 Report. Chapter 5.
  - (2) El Salvador, Ministerio de Planificación y Coordinación de Desarrollo Económico y Social, El Salvador: Informe Económico y Social 1971 (San Salvador, August 1980).
  - (3) 1971-77 Column (2) figures, rounded; 1978-81: Based on the elasticity of employment with respect to GDP from 1971 to 1977.
  - (4) Column (3).
  - (5) Column (1) minus Column (3).
  - (6) Column (4) divided by Column (1).
  - (7) 1971-79: Same as (2); 1980: Central Bank estimate; 1981: Best-case assumption.

Table 11-13

## MINISTRIES WHICH WILL PLAY KEY ROLES IN REACTIVATION

	Millions of Colones	%
Ministry of Foreign Commerce	2.8	.1
Ministry of Economy	95.5	4.6
Ministry of Agriculture and Livestock	158.2	7.8
Ministry of Public Works	<u>226.9</u>	<u>11.0</u>
Total	483.4	23.5
Total Budget	2,058.6	

Source: GOES Budget, 1983.

The Ministry of Economy has a sectoral support services Department which might be reinforced, as its basic unit for reactivation. On the other hand, it appears that certain activities, such as Economic Integration and Statistics and Census activities might be given less emphasis during the reactivation period.

Under the Ministry of Agriculture, increased budgets would seem important for plant health to intensify the roya program; fishery development because of the strong growth potential for shrimp, lobster and tuna; livestock development to increase milk production; and grain, agroindustrial and vegetable development for their export and import substitution potential.

The Ministry of Public Works activities are covered thoroughly in the construction section of this report. Reductions which might be considered in its budget are in the areas of geotechnic research, construction of national buildings and sports facilities, and work on the national land map.

Exhibit 11-14

GOES RESOURCES FOR REACTIVATION  
(millions of colones)

	<u>Amount</u>	<u>Recommended Action</u>
<u>Ministry of Foreign Commerce</u>		
Management and Coordination	1.2	maintain
Planning and Development	1.0	increase
International Operations and Transfers	.3	maintain
Free Zone Construction	<u>.3</u>	maintain
Total	2.8	
<u>Ministry of Economy</u>		
Administration	.9	maintain
General Administrative Service	1.3	maintain
Economic Integration (CACM)	.2	decrease
Sectoral Support Services (industry, foreign commerce, energy, and mining)	3.2	maintain
Statistics and Census	2.6	decrease
Regulation of Land Transportation	.7	maintain
Civil Aeronautics	1.3	maintain
Operating Expenses-Autonomous Insts.	8.2	maintain
Construction, Expansion, Improvements of Airports	.5	maintain
Investment Financing-Autonomous Insts.	15.3	maintain
Financing Exec. Comm. Rio Lempa Hydroelectrics	<u>61.3</u>	maintain
Total	95.5	

Exhibit 11-14 (continued)

<u>Ministry of Public Works</u>	<u>Amount</u>	<u>Recommended Action</u>
Management	.4	maintain
General Administrative Services	1.0	maintain
Planning, Coordination and Evaluation	1.1	maintain
Geotechnic Research	1.4	decrease
Study and Maintenance of Road Works	44.7	maintain
Urban Development	9.4	maintain
Projects and Supervision	.7	maintain
Cartographic Studies	.8	maintain
Supplies	.5	maintain
Mineral Resources Evaluation and Industrial Investment Assistance	.7	maintain
Construction and Improvement of Roads	17.0	maintain
Longitudinal and Northern Zone Highways	15.1	maintain
Regional Highways	23.5	maintain
Rural Roads	34.8	maintain
Urbanization Works	34.1	maintain
Construction of National Buildings and Sports Facilities	3.0	decrease
National Land Map	8.7	decrease
Metropolitan Highways	2.2	maintain
Tourist Highways	6.7	maintain
Paving Secondary Roads	.4	maintain
Housing	.3	maintain
Integrated Community Development	3.9	maintain
Investment Financing-Autonomous Entities	12.1	maintain
Operational Financing Autonomous Entities	<u>4.3</u>	maintain
Total	226.9	

Exhibit 11-14 (continued)

<u>Ministry of Agriculture</u>	<u>Amount</u>	<u>Recommended Action</u>
Management	1.4	maintain
General Administration	2.2	maintain
Planning	1.1	maintain
Plant Health	2.1	increase
Agricultural Economics	1.4	maintain
Fishery Resources	1.1	increase
Center of Agricultural Tech.	11.4	maintain
Natural Resources	9.1	maintain
Agricultural Training	1.0	maintain
Animal Health	6.3	increase
Operating Expenses-Autonomous Insts.	19.8	maintain
Statistics	.3	maintain
Livestock Development and Health	19.2	increase
Meteorologic Services	.9	decrease
Hydraulic Resources	1.0	maintain
National Parks	.3	decrease
Soil Use	.6	decrease
Forestry and Watershed Developments	3.4	decrease
Agricultural Technology	.4	decrease
Grain, Agroindustrial and Vegetable Development	3.4	increase
Irrigation and Drawage	2.1	maintain
Commercial Infrastructure	.9	maintain
Small Farmer Irrigation	1.1	maintain
Industrial and Ag Training	.8	maintain
Small Fishery Development	3.5	increase
Land Reform	54.7	maintain
IRA	<u>8.0</u>	maintain
Total	158.2	

Our recommendation is that these Ministries make an in-depth budget review, applying the six project selection criteria suggested above. There may be some flexibility in these budgets and activities and a greater emphasis on activities which economic reactivation potential would be beneficial. We recognize the problems involved in shifting technicians from one type of activity to another, but given the fact that the country is not functioning under normal conditions, people need to be stimulated to support the reactivation efforts.

## 2. Wage and Price Policy

As an emergency measure, the Law of Economic Stabilization (Decree 544) promulgated in December, 1980, effectively froze all salaries until March 31, 1983. In February, 1982, one-time salary increases up to 10 percent were allowed depending upon the financial condition of individual private businesses. This increase did not extend to public employees. Minimum wages for non-agricultural workers have also remained frozen since April 1980. The minimum daily wage levels are 11.00 colones in San Salvador and 10.00 colones in the rest of the country.

Considerable pressure is building up to grant salary increases of at least 10 percent in March, 1983, given consumer price index rises of 10.1% in 1981 and 13.4% in 1982. No salary increases have been incorporated into the GOES budget and the consensus is that the wage freeze will continue.

There are also price controls working in tandem with the wage freezes. Controls are in effect on basic food grains, medicines, medical services, education and rent. No increases are expected for these, or for petroleum products, which are also regulated. There are some systemic pressures in cases where manufacturers in the production chain must purchase foreign exchange in the parallel market, and some final product price is fixed. Prices on consumer durables will continue to rise because of the parallel market effects. The contemplated 10 percent increase in Public employee salaries would add \$64 million to the deficit already projected. Therefore,

we recommend that no raise be given to public sector employees as part of the overall austerity program cited above.

### 3. Taxes

As can be seen in the table below, with the exception of the possible increase in certain stamp taxes (included in 'other' category) which are estimated will bring in an additional ¢217 million colones, tax revenue levels have remained quite consistent in all categories during the past several years. It seems doubtful, however, given the problems of roya, lack of replacement of coffee trees and the world market price, that coffee tax revenues can continue to climb. Income tax, given the numerous businesses operating at below break-even and the number of closures, also may be overestimated. Import taxes, of course, will continue to decline given limited foreign exchange availability.

Table 11-15

TAX REVENUES  
(millions of colones)

	<u>1981</u>	<u>1982</u>	<u>1983</u>
Income Tax	226.3	229.0	232.6
Net Worth Tax	56.0	54.0	55.3
Coffee Export	232.0	264.0	295.3
Import Tax	87.0	85.0	84.0
Other Taxes	389.3	409.0	632.3
	<u>990.6</u>	<u>1,041.0</u>	<u>1,299.5</u>

It is difficult to believe that tax revenues will achieve the predicted levels, and therefore some caution is appropriate regarding closing the budget deficit. An expansionary monetary policy to compensate for the deficit will be inflationary ("inflation is a tax which is not voted on"), and this tack

will not be acceptable to the IMF. Moreover, if the stamp tax is not passed, the IMF standby agreement will likely not be renewed which would be disastrous for this economy.

Some consideration should be given to an increased tax rate on net worth tax. Such a tax increase probably would be best applied to investments other than business ventures in order not to impede recovery. The Ministry of Hacienda is considering a value-added tax which would be aimed directly at industries, and probably would not help to stimulate their reactivation. Further tax reform is needed and this would be a helpful measure during the medium-term of the economic reactivation program.

The Ministry is also strengthening its ability to collect taxes (requiring a single set of books for taxpayers) and by setting up a training center for their tax collection agents desires to reform and clarify certain tax codes. Financial and technical assistance is being provided by the IDB. These efforts are commendable and foreign donors would do well to support them.

#### Exchange Rate Policy

At present, there is a dual exchange rate system recommended by the IMF. In the official market the colon is valued at 2.5 per dollar, and the parallel market fluctuates freely (it was ₡3.75 per \$1 in February, 1983). 'Freely' is a relative term, for the BCR has been able to set guidelines to slow the further deterioration of the colon's value.

Proceeds from all traditional exports (including shrimp and lobster) and from exports to the CACM (Central American Common Market) must be surrendered at the official rate. As of November, 1982, firms exporting more than 25 percent of their sales outside of the CACM can sell foreign exchange generated from those sales in the parallel market. As can be seen, in Exhibit 11-16, an exporter must sell at least 50% outside of the CACM to take advantage of this policy. More export stimulation would be promoted if exporters could sell all exports proceeds beyond foreign exchange replenishment at the parallel rate.

Payments for priority imports are the only ones which can be effected at the official rate. Non-essential imports have been shifted to the parallel market; this is a correct policy. All official capital transfers of transactions are conducted at the official rate.

Obviously the strategy of the BCR is to hold down the prices of essential products and discourage the import of non-essential items. The creation of the parallel market, had the purpose of increasing the amount of foreign exchange which is available, and taking the pressure off in the area of non-essential imports. The policy basically says if people can afford such an import at a price 50 percent higher than the old price, let them import. But apparently little new foreign exchange is available in the banking system as a result of the parallel rate. Commercial businessmen who carry non-essential items are forced to go into the black market to keep their doors open; the black market rate is  $\text{¢}4.15$  and it is alleged that ample dollars are available at that price.

In general, we find that the overall policy of the BCR is very prudent. We agree that efforts to control the black market will likely be fruitless. Yet adherence to the  $\text{¢}2.5: \$1$  rate is further evidence of not facing the hard facts: El Salvador is in a difficult position because of foreign exchange shortages and depends heavily upon foreign commerce. Even though the six priorities are important, the demands for some of those products are not inelastic. The exchange rate can be devaluated slightly without causing major social impacts. All persons would share in the cost of resolving the economic dilemma facing the country. We recommend simultaneous pegged devaluations of both the official and parallel rates of a magnitude of perhaps 10 to 15 cents (colones) on a quarterly basis until the foreign exchange shortage begins to resolve itself. This devaluation should take place after several important economic questions have been resolved, and a recovery momentum exists. The devaluation program can be publicized as a part of the overall austerity program. Too severe a devaluation could result in retaliation by CACM trading partners, an undesirable outcome; therefore this moderate scheme seems the best path to follow. Foreign financial assistance at the

Exhibit 11-16

EFFECT ON NON-TRADITIONAL EXPORTS OUTSIDE THE CACM  
BY EXCHANGE RATE POLICY

	<u>Exports</u>	<u>Imports</u> <sup>1/</sup>
Case 1: Outside CACM (25%)	\$100.00	\$ 200.00
	X <u>3.75</u>	X <u>3.75</u>
	Ø375	Ø 750
CACM	\$300.00	
	X <u>2.50</u>	
	<u>Ø750</u>	
Total Exports	Ø 1,125	
Less Imports	<u>- 750</u>	
	Ø 375	
Case 2: Outside CACM	\$ 40.00	\$ 200.00
	X <u>2.50</u>	X <u>2.50</u>
	Ø100	Ø 500.00
CACM	\$360.00	
	X <u>2.50</u>	
	<u>.900</u>	
Total Exports	Ø1,000	
Less Imports	<u>- 500</u>	
	Ø 500	

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<sup>1/</sup> Imports not related to exports outside the CACM may be settled in the official market, but it is not clear in the guidelines how this distinction can be clearly determined.

currently high levels cannot be anticipated for interminable periods of time. Devaluation will be advantageous as Salvadoran products will enter export markets at decreasing prices, and production will be stimulated. Import substitution effects are already noted especially in the industrial area.

### Reform Consolidation

One of the clearest political parameters is the unlikelihood of a reversal of the three major reforms instituted in 1979: agrarian reform, nationalization of the banking system, and nationalization of coffee and sugar export operations.

Land reform has done well to distribute land and maintain productivity. Considerable technical assistance has been provided, and will be required many more years until the process is seen as self-sustaining. The financial requirements are large, and will draw financial resources away from other important economic activities for some time to come.

In March 1983, The Constituent Assembly will decide whether to continue the freeze on cotton lands which could be claimed under Decree 207. A closing date on Decree 207 applications has not been finally set. Most importantly, the status of Phase Two land reform looms over potentially affected landowners inhibiting further investment.

Regarding Phase Two, even if there is political will, the GOES currently and foreseeably lacks the financial resources to implement it. Previously Checchi studies have recommended that Phase Two not be implemented as was Phase One. Rather, they recommended that Phase Two owners be allowed to sell their land down to the appropriate reserve right (100 to 150 hectares), with preference for these sales given to groups of campesinos who would form cooperatives (like the Phase One scheme). Additional technical assistance would be required to help with the formation of such cooperatives, if such an avenue were pursued. An alternative recommendation was the enactment of a law authorizing the sale of lands up to 200 hectares, which would affect 1,200 of the 1,700 farms in this size category.

The resolution of the status of Phase Two could stimulate agricultural production considerably as 15% of total cultivable land would be affected.

The banking reform complemented the land reform, as all banks extend some credit to reform cooperatives. Yet, given the economic situation of the country the banks will be under increasing pressure to refinance borrowers who cannot repay at the present time. At the end of 1982, approximately 34% of outstanding bank credit was listed as directed to refinancing, compared to 14% in 1978. Some have suggested the formation of new banks as a means of creating competition for these banks, thus creating greater efficiency in the banking industry. Bank boards are to date only comprised of government appointees, and there is no representation of the private sector. Also a plan to sell 40% of the bank shares to the public has not been implemented.

Similar to banking reform, the nationalization of the coffee and sugar export operations also complemented agrarian reform. The major constraint which lies in that area is the large unsold coffee inventory (discussed in greater detail below). These operations will continue as a central government function into the foreseeable future. They also do not have private sector Board members as contemplated at the time of the reform. The continuation of these reforms presents some predictable uses of resources, some possibilities for enhancing the investment climate, and some problems which need to be resolved.

The reforms have adjusted the political economy from almost purely capitalistic to one which is more socialist in nature. Attempts to return to a structure resembling the capitalist version is likely impossible.

### External Financial Resources - 1983

#### AID

AID has provided the GOES with financial support to meet the following objectives:

- Support of the economic stabilization (including reduction of high employment levels);
- Assistance to the GOES in implementation of the agrarian reform;
- Provision of humanitarian assistance for persons displaced by the conflict and
- Expansion of population and family planning services.

Some AID loan, grant or guaranty programs have been channeled through the GOES during the past several years in activities which could be included under economic reactivation;

1. Small Producer Development Program: development and expansion of small scale employment.
2. Public Sector Employment: employment generation through the Ministry of Public Works.
3. Private Sector Support: balance of payments support to the Central Bank with colon credit for private and public sector purposes.
4. Public service restoration: replacement of infrastructure destroyed in the conflict.
5. Trade and Investment Development: assistance for expansion of non-traditional exports (funds will be disbursed for the first time in 1983).
6. Housing investment Guaranty Program: construction of low-income houses.
7. Employment for displaced persons.

More than \$160 million has been committed to support these activities and by December 31, 1982, more than \$140 million had been disbursed. During fiscal 1983 an additional \$130 million is scheduled for disbursement for these activities. Programs which might be expansible are the Housing Investment Guaranty program and perhaps some health funding (the former might be expanded by as much as \$20 million and the latter by \$10 million). The conclusion is that AID resources are more or less committed through September 1983, and it is difficult to know whether there will be any increases in fiscal 1984.

#### Inter-American Development Bank

The IDB will lend \$40 million to reactivate the industrial sector through import financing. It also signed a \$15.6 million loan for marketing agri-

cultural inputs and products and a \$66 million loan for complementary financing of the San Lorenzo Hydroelectric Project. These loans as disbursed will continue to provide additional foreign exchange.

#### International Monetary Fund

The IMF provided \$85 million in 1982 (not all of which is disbursed yet) to help El Salvador's net international reserve position. It is anticipated, especially given the additional financing provided to the IMF in February 1983 by its donors, that it will provide additional reserve support to El Salvador during 1983 as long as the stand-by agreement conditions are met.

#### Mexico and Venezuela

Mexico and Venezuela have committed to provide concessionary financing for 30 percent of El Salvador's oil purchases through 1983. Given the financial position of these countries and the deterioration of OPEC, it cannot be predicted with certainty whether these oil facilities will be continued.

#### Other

Numerous other donors including the UNDP, FAO, the European Economic Community provide limited but important, assistance.

The conclusion is that there are some bright events occurring which will assist reactivation efforts: the IDB industrial loan; the IMF support; and the oil facility which will lower the country's oil bill somewhat. AID's large amount of assistance continues to be crucial to holding the economy together. Also, the World Bank is considering a loan for industrial recovery which would supplement the IDB loan, but this may not be available until the end of 1983. Pressure should be placed on the World Bank to accelerate the disbursement of that loan. All in all, given the overall financial needs, resources to meet them appear limited.

## IMF Stand-By Agreement

Discussion of the IMF agreements with its member countries are generally considered to be taboo. Unquestionably, the IMF's cash infusion of \$58 million in 1982, relieved to some extent El Salvador's severe negative international reserve position. In return, the IMF asked the GOES to comply with certain economic guidelines. In general the IMF program provided for austerity and restraint, and specifically set the following guidelines:

Real growth rate	0 percent
Rate of inflation (CPI)	15 percent
Growth in nominal GDP	16 percent
Growth in bank liabilities to the private sector	12 percent
Growth in money and quasi-money	13½ percent
Increase in velocity	2½ percent
Growth in currency issue	7½ percent
Growth in currency in circulation	7½ percent
Ratio of end-of-year currency in circulation to annual GDP	7½ percent
Increase of net domestic credit	¢815 million
Public sector share	¢400 million
Export value growth	minus 1 percent
Import value growth	6½ percent

The thrust of the agreement was to reduce the fiscal deficit. As noted above the GOES has curtailed to some degree the level of current and capital expenditures. The number of GOES employees has been limited and wages have been frozen. The tax bill before the Constituent Assembly in mid-February 1983, if passed, could further reduce the fiscal deficit.

Inflation has been held, according to the most recent year-end estimates to 13.4 percent.<sup>1/</sup> This low inflation level is important in maintaining

<sup>1/</sup> Direccion General de Estadisticas y Censos  
Ministerio de Economia, January 1983

social calm. It is sufficient, however, to warrant the wage increase of 10 percent in March 1983 as discussed earlier. The overriding constraint is the level of unemployment. As discussed elsewhere, unemployment and the deterioration of social programs (especially in health areas) present constraints which could reverse by force the reactivation program.

## SECTION III

### INDUSTRY

#### A. Summary and Critique of the Reactivation Plan

Industry appears to be one of the most affected sectors of the Salvadoran economy, suffering a 36 percent decline since 1979.

TABLE III-1  
Industrial Production Index  
(Base 1978 = 100.0)

<u>Year</u>	<u>Production</u>
1979	97.0
1980	84.0
1981	69.0
1982	64.0 <u>1/</u>

1/ Estimated

Source: Central Reserve Bank

This decline is due to well known causes: political uncertainty, social restlessness, labor unrest, lack of foreign exchange for raw materials and capital goods, lack of credit, and reduced export and domestic markets.

The result of the production decrease is low output and some plant closures. According to a recent survey of 23 firms made by ASI (Salvadoran Association of Industries), factories are operating at 44.5 percent of capacity. In addition to low utilization of capacity, 70 factories have stopped production; 59 of those employed more than 20 workers while 42 employed more than 99 workers. Industrial unemployment is high: 1982 industrial unemployment reached 32 percent of those employed in manufacturing during 1978. Meanwhile, the numbers of those involved in cottage industries have increased substantially to absorb unemployed industrial workers.

Capital goods imports by industry in 1982 were reduced to less than one-third of corresponding imports for 1978.<sup>1/</sup> Industrial raw material imports in 1982 were less than two-thirds of 1978 levels.<sup>2/</sup> Manufactured exports dropped faster than industrial output.

In an attempt to provide a framework for reversing this decline, MINPLAN drafted an industrial reactivation program, which was included in the PREN.

The plan for industry focusses on five subsectors: medium and large enterprises, small industry, artisans, rural micro-enterprises and agroindustry, with the support of an international program for technical cooperation.

Some major constraints such as lack of permanent working capital, affect all sizes of industries. Such constraints become more acute due to the inadequate availability of industrial credit, political uncertainty, declining demand in internal and external markets, and shortages of some local raw materials.

Other constraints affect only smaller industries. For example, there is little acknowledgment of the importance that small industries, rural micro-enterprises and artisanry can have in the country's economy. There is also a lack of appropriate technical assistance in production and marketing, and a lack of coordination among the entities which are supposed to assist these small industries.

Lastly, there are some limitations which apply to only the larger firms, such as the lack of foreign exchange for importing capital goods and raw materials, the low availability of credit, difficulties in getting paid for Central American Common Market transactions, and delays with bank loan disbursements.

The main objective of the PREN is to increase industrial output, and to

1/ \$87 million

2/ \$267 million

achieve an efficient use of the country's human and natural resources. To achieve this goal, the supply of local and imported raw materials, must be increased so that idle industrial capacity can be used, shut down plants can be restarted, and the unemployed can be put back to work. Credit needs to be made more readily available. Technical assistance programs, as well as coordination among the offices engaged with industrial promotion, need to be improved.

The PREN seems to confuse means with goals. On one hand, the PREN aims to avoid further closures of medium and large factories. On the other, it considers it necessary to reactivate a minimum of 40 companies presently operating at very low levels of output; to improve the performance of four exporting companies; to study the reactivation of at least 10 shut down factories and to start up the BANAFI (National Bank of Industrial Finance) and CORSAIN (Salvadoran Corporation of Industrial Investment). In the case of small industries, the goal is to provide a minimum of \$12.5 million in working capital and refinancing during 1983. For agroindustries, it proposes to set up a national committee to promote that subsector, to rehabilitate plants (cashews, chili, curcuma, oregano, and sugar), to promote new projects (ethyl alcohol, seafood industries, natural poultry colorants, and "vetiver"), to promote the efficient use of the agroindustrial line of credit provided by the Interamerican Development Bank to the BFA (Agricultural Development Bank. With regard to rural micro-enterprise, the PREN proposes to prepare 360 persons who will act as "change agents" for the Ministry of Agriculture and DIDECO to assist 1,800 micro-enterprises with their production and administrative problems; and to provide 18 technicians to supervise the sub-program. Finally, the PREN proposes to set up an artisans association and a National Institute of Artisans.

The goals of the PREN in this area are not clear. Furthermore, the means and proposed actions to reach these goals are weak, because they focus only on financial questions: purchasing capital goods and raw materials, providing working capital and refinancing due loans. These things are important, but they are not sufficient in themselves to promote reactivation in this

sector. Nevertheless, the PREN does suggest some measures which appear usable, such as the concept to provide incentives to new investors in assembly operations in the Free Zone. Other useful concepts are the guaranty for investors and exporters; preference to be given to small industries in public sector purchases; enactment of a law to promote small industries; granting facilities to some agricultural producers for industrialization; agroindustrial studies; and improvement of technical assistance staff. However, many of these activities are medium-term in nature, and will not have an immediate reactivation effect.

The PREN estimates that the five industrial subsectors, including international technical assistance, will require \$494.3 million for 1983. Table III-2 shows the allocation and sources of financial support to carry out this plan.

#### B. Critique of the PREN-Industrial Sector

Prior to setting forth a critique of the PREN, a general observation seems in order. It is our observation that the PREN does not give due weight to the effect that El Salvador's continuing difficult political and social situation has on the investment and production climate. The actual economic crises, a consequence of other well-known factors, will not be overcome by mere additional infusions of cash. Similarly, actions, unless well considered, will not be able to overcome the deep and abiding problems. A reactivation program which does not take into account both investor and producer confidence will be inadequate.

The PREN seems vague, superficial and incomplete. It is vague because it does not show how actions can be implemented. It ignores implementation of financial remedies. It is superficial, and does not reach the core of the problem. It is incomplete because in some cases goals are not clearly stated, and in other cases the goals seem clearly unobtainable.

More concise goal setting would help. For example, a useful goal might be that industrial production be stimulated to reach some quantifiable level

TABLE III-2

Estimated Financial Needs for the Economic Reactivation  
Program in the Industrial Sector - 1983

(millions of colones)

Sub-Sector/Source	Fixed Capital	Working Capital	Refinancing	Total
Medium and large enterprise	12.4	339.7	73.8	425.9
Small industry	1.7	10.0	0.8	12.5
Agroindustry	35.3	4.5		39.8
Rural micro-enterprises		14.0		14.0
Artisans				
International Technical Assistance				2.1
	49.4	368.2	74.6	494.3
Own resources				11.2
General fund				5.5
B.C.R.				267.4
National banks				168.3
External resources				41.9

Source: PREN 1982-1983.

in relation to 1978 levels. Instead, PREN proposes that 40 factories be rehabilitated. Why 40? What will be the outcome of rehabilitating these? Four exporting companies will be helped. Why four? What contribution to reactivation will they make? Ten shut-down factories will be considered for appropriate studies. Again, why ten? And what short-range good will these studies produce? Lack of justification for these figures give a feeling of superficiality.

Finally, while the PREN's focus is on financial constraints, not enough information is provided to evaluate the other actions which the PREN proposes. Of course, financing is a big problem. But is sufficient financing by itself enough to overcome the great limitations which Salvadoran industry faces? Assuming that financing is the core of all the problems, are correct figures provided in the PREN for remedying the situation? Lastly, even if the estimates are correct, can the financial institutions indicated provide the funds? We doubt the completeness of the figures, and question the analysis of the problem.

#### C. Public and Private Sector Reactions

We are concerned that only a few people interviewed by the study team in San Salvador were acquainted with the PREN. Apparently there was little circulation of the PREN among public and private interests. In any case, if the PREN was known to an interviewee, it was the first part, dealing with Global Aspects, with which he was familiar. That section, from a planning point of view, was considered to be a relatively good effort.

Public officials familiar with the PREN noted that the plan includes some interesting items, while others were disappointed that their suggestions were not included. In the private sector, the plan seems virtually unknown. People who read it at the consultant's request, commented that goals were good, but the proposed actions will not achieve the goals.

#### D. Policy Parameters and Constraints

The Salvadoran Government has not yet defined a clear and consistent policy

to reactivate the economy, including the industrial sector. Even if there was no need for reactivation, there is no clear and permanent policy to encourage industrial exports. For example, the overvalued colon, due to current exchange rate policy, acts to hinder both production and sales of exportable items. Similarly, the uncertain availability of foreign exchange with which to import raw materials and other production inputs acts to dampen possible reactivation efforts.

The current policy for foreign exchange distribution is cumbersome. Industrial raw materials and other inputs compete with oil, medicines, foods, and agricultural and transportation inputs for foreign exchange. Under the circumstances, the industrialist feels he will not get fair and timely action on his foreign exchange request.

At the same time, the performance of the parallel market has not resulted in an increase in foreign currency. Instead, it has contributed to an increase in the black market price which has further discouraged efforts to export non-traditional products outside the CACM.

Credit policy primarily accommodates public sector credit demand, and follows IMF recommendations for limiting credit expansion. Resources provided to the private sector are based on the amount available without taking into account whether the individual activities are foreign currency and/or labor generators.

The GOES should set a clear and definite industrial policy which would encourage industrial sector confidence, thus laying the ground work for the economic reactivation program.

#### E. Economic Constraints

Today, the Salvadoran economy shows a significant reduction in production, employment, and exports. Besides internal factors, there are external factors, including falling prices for basic Salvadoran export products, lack of dynamism in the Central American Common Market, heretofore high oil prices, and world inflation which affect production levels. In addition, the

increase in military expenditures must be recognized as an economic constraint, as these expenses consume a significant part of resources which would otherwise be used in productive activities.

Salvadoran industry identifies the more serious constraints to be:

1. Shortage of foreign currency. Industry imports two-thirds of its raw material, thus requiring \$185 million this year to maintain present levels of production. Due to the negative position of international reserves at the Central Bank<sup>1/</sup>, continuing problems with balance of payments, and the reduction of supplies and bank credits, most industries have a serious problem obtaining the necessary foreign currency to import capital goods, spare parts, raw materials and other products, including those which come from the Central American Common Market. Besides actual foreign currency scarcity, the policy assigning foreign currency through the Central Bank itself becomes a source of uncertainty and harmful delays. To prevent stoppages or delays in production, manufacturers turn to markets other than the official one for foreign exchange. The consequent increase in production costs diminishes competitiveness, especially in the case of exporters.

2. Financial Constraints. Some companies have closed down or nearly so because they are no longer subject to credit or creditworthy. Production, sales, and financing costs together are more than some companies can hope to cover given current conditions. The overdue and refinanced portion of the industrial portfolio of the commercial banks is high, representing 42.5 percent of ₡414.4 million loaned out as of December 31, 1982.<sup>2/</sup> This overdue portfolio not only jeopardizes their creditworthiness and therefore the output of the factories, but it also seriously reduces the liquidity of the banking system.

3. Weakness of the Central American Common Market. Exports to CACM have dropped by about 38 percent during the last three years, due in part to

<sup>1/</sup> Negative ₡300 million as of year end 1982.

<sup>2/</sup> El Salvador: Credit Supply and Demand. Checchi and Company, February, 1983.

restrictive measures applied by the country members, economic problems in and reduced purchases by other members, and to the increase in production costs and reduced price competitiveness for Salvadoran producers.

As the Central American countries are a natural market for Salvadoran industry, this reduction is an important shift. El Salvador has in the past sold more than 90 percent of its total exports to this market or about 22 to 25 percent of the total gross value of industrial production.

4. Lack of Incentives to Export. Salvadoran industry has no real incentives to export, despite the fact that there is an existing Export Law. The levels reached several years ago are due to the aggressiveness of an entrepreneurial group which has been one of the best assets to the Salvadoran economy. During certain periods incentives have existed, but these were reversed by rule changes or economic shifts. Presently those companies exporting outside the Central American area are allowed to sell foreign currency from such exports in the parallel market, if those sales exceed 25 percent of a company's exports. However, in this case, the enterprise must also buy foreign currency for its import needs in the parallel market. If those extra-CACM sales are low in relation to the company's import requirements, the company may not be able to take advantage of the parallel market.

#### F. Planning Factors

While the PREN states that the industrial sector is crucial to reactivation, we doubt whether the recommended actions and their prospects for success would be agreed upon by both the public and private sectors. Even if the plan should be implemented, the outcome is doubtful as the plan does not take into account major problems affecting local industry, and because the main agents for implementation are public sector offices, which tend to have little direct effect upon private sector enterprises.

Notwithstanding, there are some aspects of the plan which seem interesting, especially those regarding agroindustries and the promotion of rural microenterprises.

For these reasons, our recommendations are in effect an alternative plan of action, including recommendations for lines of authority and evaluation which we feel will create a more favorable climate for industrial reactivation. The main participants in this alternative plan presented below are: the GOES, the entrepreneurs, and the international financing institutions.

Within the GOES the key Ministries will be MINPLAN, as the entity to evaluate the progress of the program and to assure coordination among the public entities; the BCR, which would act as fiduciary for industrial re-equipment and industrial reactivation funds; and CORSAIN (Salvadoran Investment Corporation).

The Salvadoran commercial banks would be the financial intermediaries between the BCR and the industrialists. The BFA (Agricultural Development Bank), FIGAPE (Fund for Finance and Guaranties for Small Enterprises), and the Federacion de Cajas de Credito will also play important roles as government financial institutions.

The Chamber of Commerce and Industry, ASI, The Society of Salvadoran Merchants and Industrialists, FENAPES (National Federation of Small Enterprises), ANCP (National Association of Private Enterprise) and the National Institute of Artisans, will each have an important role.

The task of these entities, in the next two years, will be to stop the deterioration of the Salvadoran economy, and then to work to achieve 1978 production levels. After that, it would be possible to make some real gains, but that is foreseen only in the third year of this plan. Although the next two years will be a period of economic recovery, we can anticipate taking steps now to pave the way for the future through investment project identification and feasibility studies, especially in the agroindustrial sector. For example, production of ethyl alcohol as an energy source would seem to be a very interesting idea for a country like El Salvador, which imports its oil and has a large sugar cane crop which could be used as an alcohol source. This seems to be an avenue worth exploration, given world sugar and petroleum prices. Another area for investigation would be the

industrialization of some marine products such as shark, lobster, and crawfish. In general, all those industrial processes which add economic value to agricultural and livestock products are natural areas for investigation, and, if feasible, investment.

#### G. Alternatives and Recommendations

The fundamental premise for the economic reactivation program is trust. Without it any program is destined to fail. The participants in reactivation will be the investors, entrepreneurs, laborers and consumers, all of whom need to have certain level of confidence to enable them to invest, produce and consume.

Economic reactivation in El Salvador will be carried out by the Salvadorans, with international agencies and foreign investors in complementary roles. El Salvador has been an example of a hard working people with efficient and able entrepreneurship, better prepared now through the lessons of the last few years to develop an environment of progress and social justice.

If the necessary measures are taken to elevate that level of confidence, the first and most important step toward reactivation will have been taken. To conceive of and apply those measures is clearly the responsibility of the Government. If the proper groundwork is laid in terms of confidence-creating measures, investors, entrepreneurs, and the financial and development agencies will respond positively. It can be said that the economic reactivation of El Salvador will be the result of an agreement made by the Government, the entrepreneurs, and the developmental and financial institutions.

The reactivation phases are three: halting the deterioration and fall of industrial production; recuperating 1978 output levels; and subsequent expansion through more production and new products to be sold in presently existing and new markets. These three phases will unfold automatically, based on the steps taken by the principal agents of reactivation. During the first two phases, significant increases in the production capacity

should not be expected, but at the beginning of the third phase, that is, about two years hence, some plant expansion can be anticipated.

#### The Government's Role.

Besides the considerable effort to achieve internal peace, the Government needs to set forth a series of policies to convince entrepreneurs that a new level of trust can be achieved, that reactivation has started in the country, and that the years of insecurity and instability are a thing of the past. Some of these policies, while they are not directly related to industry, do however have a deep effect upon its development.

- 1) First, some final legal disposition should be made regarding Land Reform. This step will awaken trust in the private sector and will stimulate agricultural and livestock investments which are basic to the Salvadoran economy. Without a clarification of this issue, no economic program will be feasible. (Recommendations concerning this matter are found in Section IV below.)
- 2) Second, Phase I Land Reform bonds should be allowed to be used for investment and settlement of debts at their nominal value. These bonds could be used to repay commercial bank loans and invest in industries owned by CORSAIN. Thus the bondholders, who may be good managers within the entrepreneurial sector, will be given an opportunity to play an important social role, the rehabilitation of industries that are shut down or working at a very low level of production.
- 3) Ultimately, the commercial banks should be converted to mixed capital enterprises with management functions in the hands of the private interests.
- 4) CORSAIN should assume control of the assets and liabilities of INSAFI. BANAFI is seen as neither necessary nor productive; and this is one area in which a quick government policy reversal would seem helpful. CORSAIN would have the task of divesting companies in its portfolio (see

Table III-3

CORSAIN'S INVESTMENT PORTFOLIO

Enterprise	Activity	Paid up Capital ( $\text{¢}000$ )	CORSAIN'S Share	
			Share	%
Industrias Sinteticas de Centro- america (INSINCA)	Synthetic	30,000	15,000	50
Conductores Electricos de C.A. (CONELCA)	Electric wires	12,500	2,840	23
Quality Foods de Centroamerica S.A.	Frozen Fruits and Vegetables	5,800	1,088	19
Cemento Maya S.A. de C.V.	Portland Cement	20,700	2,250	11
Implementos Agricolas de Centroamerica S.A.	Agricul- tural tools	3,700	100	3
Ingenio Central Azucarero Jiboa	Sugar	90,700 <u>1/</u>	-. -	100
Hotel Presidente	Hotel	40,700 <u>1/</u>	-. -	100
Textilera Izalco	Cotton	14,879 <u>1/</u>	-. -	100
Lud Dreikorn	Fabric Printing	3,060 <u>1/</u>	-. -	100

Source: CORSAIN

1/ Total Investment

Table III-3) following these fundamental steps:

- a) All CORSAIN-controlled enterprises should be transferred to the private sector at their appraised value, in exchange for cash or Land Reform bonds. CORSAIN would retain such bonds as assets.
- b) If private interests cannot purchase a company outright, they will form a joint venture with CORSAIN and will assume the management of the enterprise, even if they do not hold a majority of the capital in the joint venture.
- c) Enterprises which are not viable or saleable should be liquidated. Under no circumstances should CORSAIN sustain a company that does not demonstrate profitability.
- d) CORSAIN will also try to clean up INSAFI's credit portfolio, granting special payment arrangements if necessary. If the loans are uncollectible, CORSAIN can foreclose on the enterprises in default and resolve the problem through steps a), b) and c). Table III-4 shows INSAFI's credit portfolio.
- e) The overdue and refinanced industrial loan portfolio of the national banking system could be transferred to CORSAIN, with prior agreement with each bank and the industry over conditions to be met. In the case of ultimate uncollectibility CORSAIN will act according to paragraph d). This step will have the advantage of increasing the liquidity of the banks, while at the same time, encouraging industrial reactivation.

5. Instead of initiating BANAFI, two revolving funds should be set up at the Central Bank: an industrial equipment fund, with an initial capitalization of \$40 million, and an industrial reactivation fund of \$120 million. The first fund will provide money to purchase machinery and spare parts, and the second to purchase raw materials and for medium term working capital. The funds will be channeled through the banks to the industrial enterprises. Capital from these funds would be used to finance up to 70% of each operation and the banks and industries would provide up to 30%. The contribution of each of the latter should not be less than 10% of the loan amount. The funds would rotate, and could be expanded with additional capital as the industrial recuperation takes ahold.

Table III-4

Credit Portfolio of INSAFI  
(Colones)

	1981	1982	No.
Sound credits	6'182,428.16	3'151,267.62	35
Doubtful credits	169'936,317.05	176'152,314.41	239
Unrecoverable credits	1'392,302.61	687,306.90	99
	<hr/>	<hr/>	<hr/>
	177'510,947.82	179'990,889.02	373
	<hr/>	<hr/>	

Source: CORSAIN

Setting up such funds in the BCR would be much more efficient than initiating an entirely new institution such as BANAFI in that it would avoid a new government bureaucracy. Capital could begin to flow as soon as the funds are established.

A "rotating foreign exchange fund" proposed by the Industrial Reactivation Committee of the Private sector, is included in the total amount of the industrial reactivation fund. It could be set up with the just-released IDB loan for US \$40 million. The primary uses of this fund will be for raw material imports, semi-elaborated goods and packing materials for industries exporting their production.

This could operate through the same channels as the reactivation fund, but it may be wise to keep the two funds separate because one will serve only exporting firms. The Industrial Equipment Fund should be increased up to US \$120 million, and the Industrial Reactivation Fund up to US \$207 million, by the third year of the proposed reactivation program.

6. The foreign exchange generated through exports to other countries should be negotiable in the parallel market no matter what percentage of total volume is exported by a company. This does not mean however that the companies must acquire the foreign currency in the parallel market. The idea is to encourage Salvadoran industry to expand its exports in more stable and attractive areas than the CACM, and this shift should be encouraged.

#### The Role of Entrepreneurs

If Government, through its actions and incentives can create confidence, the private sector will respond to the challenge with an aggressive reactivation effort. The private sector can offer not only its proven managerial capability, but also risk capital to aid the recovery of factories.

It would be rather premature to attempt any new undertakings at this time. The private sector must currently focus their capital, time and leadership upon the rehabilitation of existing industrial capacity and reopening

currently paralyzed factories, while maintaining both quality and quantity of production. If their own financial resources are not enough for this first line effort, the entrepreneurs might associate themselves with CORSAIN, on the basis that they could maintain their majority position in the enterprises, and in all cases the management of the companies. CORSAIN for its part could act as a private investor receiving dividends when profits were achieved. The GOES would do well not to consider such CORSAIN investments as public investments, as such rigidity would dampen the likelihood of future investment in mixed companies.

At the same time, entrepreneurs must consider carefully the social impact of their actions upon the workers. After a period such as El Salvador has experienced since 1979, this consideration is extremely important.

Another recommendation is to make an appropriate use of the San Bartolo Free Zone. Free Zones are not a permanent solution for developing countries but rather a transitional solution to the problems caused by the differences in wage levels between rich and poor countries. Looked at from their positive side, Free Zones can generate considerable payrolls and exports. Salvadoran entrepreneurs could set up new companies, associating with foreign companies interested in activities, such as assembly or commercial operations.<sup>1/</sup>

Private companies in El Salvador should organize an insurance program to protect buildings, equipment, raw materials, finished products and crops against terrorism. This could be another step to improve the climate of confidence. Specialized experts should be brought in to study this proposal.

Small industrialists and artisans also have an important role in reactivating the country's economy. For visibility, small producers might consider formation of guilds in accordance with different types of activities. Each guild would establish its own center for cooperatively buying raw materials

<sup>1/</sup> The Zona France Industrial y Comercial de Exportacion had 12 enterprises and 4200 workers in 1979; now those are only 4 enterprises and 1010 workers. In its 90 hectares, a considerable amount of employment generation is possible.

and selling their products. Such guilds could give small producers some bargaining power, which should result in higher personal incomes for their members.

It might be useful to strengthen FIGAPE's capabilities to finance small industrial activities. For its part, FIGAPE must try to collect at least ¢12 million of its past-due portfolio of ¢17 million in due and outstanding debts. This represents 40 percent of a ¢41.3 million portfolio lent to 3,800 small producers as of December 31, 1982.

With respect to handicraft activities, there are 253 artisan centers in the whole country. If the proposed National Institute of Artisans were well organized with adequate financial resources, it could become an organization from which craftsmen could buy raw materials and well finished products. Financing for craftsmen could be furnished through the Federacion de Cajas de Credito, which has offices throughout the country.

Rural micro-enterprises also present interesting possibilities for assisting small rural producers. With appropriate technical assistance--\$1.4 million would be required--even more than the 4,500 microprojects developed in the last two years could be started. A total of ¢11.5 million has been lent so far; and adding to these loan funds shows great promise for achieving good results.

#### The Role of Financial Institutions

If the Salvadoran commercial banks could improve its industrial portfolio through a "soft window" developed at CORSAIN, and if plant managers had prospective new markets, new levels of short term credits for working capital would be required. The demand for short-term credits is not high now because of foreign currency shortages. The required foreign exchange exceeds the resources of a single donor, even if some aid is offered in the form of guarantees for capital goods and raw material imports.

Table III-5 is an estimate of the foreign currency resources needed by industry during the rehabilitation phase. Figures are based on past performance of the industry. Suppose that in first year, 1983, 1981 levels of output would be achieved and in 1984 the 1979 level. Then in 1985 we could estimate the output levels would surpass the 1978 levels by 10%. The table shows net contributions as the fund rotates and thereby expands.

Industrial equipment could be bought through the Industrial Equipment Fund which needs \$40 million to begin with in 1983, increasing to \$120 million by 1985. This fund will rotate once in five years. Resources for industrial reactivation are mainly used for raw materials import with two turnovers per year. Needs for 1983 are: \$120 million increasing to \$205 million in 1985. (See Table III-6).

As the availability of foreign currency is so tight, the initiation of the Industrial Equipment Fund could be postponed until 1984, but it is recommended that the Industrial Reactivation Fund be established because it is essential to reverse economic conditions. The amount established for this purpose is quite close to the figure given in the PREN.

If the direction of this plan seems viable, it is suggested that AID invite other agencies (The World Bank, IDA, IDB, EXIMBANK, CIDA and perhaps the Spanish aid agency) to discuss each agency's potential to support the plan. This would coordinate different countries' efforts and convince the GOES that a concerted approach is needed to improve the investment climate. External assistance should support the agreement reached by the Government, entrepreneurs and the financial agencies as to the proper approach to reactivation.

Table III-5

Foreign Currency Requirements to Reactivate  
the Industrial Sector  
(\$ millions)

ITEM	1983	1984	1985	Total
Industrial equipment	40.0	50.0	70.0	160.0
Industrial reactivation	240.0	130.0	40.0	410.0
Agroindustrial development			10.0	10.0
Technical assistance	1.0	1.5	2.0	4.5
TOTAL	281.0	181.5	122.0	584.5

Source: An estimate based on figures up to 1981 in the study: Maintaining El Salvador's Private Sector: Industrial Recovery, Checchi and Company, December 1981.

Table III-6

Net Foreign Currency Needs for Industrial Reactivation  
(\$ millions)

ITEM	1983	1984	1985	Total
Industrial Equipment Fund	40.0	40.0	40.0	120.0
Industrial Reactivation Fund <u>1/</u>	120.0	65.0	20.0	205.0
Agroindustrial Development			10.0	10.0
Technical Assistance	1.0	1.5	2.0	4.5
TOTAL	161.0	106.5	72	339.5

1/ Includes the US \$40 million rotating fund from IBD.

Source: Maintaining El Salvador's Private Sector: Industrial Recovery, Checchi and Company, December 1981.

SECTION IV  
AGRICULTURE

Basic Grains

The PREN asserts that food supplies would be endangered if many farmers abstained from sowing basic grains, and adds that this potential hazard is made worse by the loss of production derived from the drought and flash floods affecting parts of the country in 1982. The draft plan states that the PREN includes a subprogram to reverse this situation, benefiting both grain producers and consumers.

The PREN plan probably overstates the objectives somewhat. They are a true list of a planner's long-run objectives for the agricultural sector in any country, but they do not seem very realistic in the short-term (1983-84) for El Salvador. These stated objectives are:

- a) Ensure the production, availability and supply of basic grains through the cultivation of enough land to meet internal demand for basic grains;
- b) Encourage the production of basic grains through integrated actions by the public and private sectors;
- c) Implement mechanisms to guarantee efficient marketing so both producers and consumers obtain just benefits;
- d) Increase employment to levels that maximize the utilization of the rural labor force;
- e) Raise the level of campesino family incomes so they have effective purchasing power with which to acquire their needs for goods and services.

As concrete goals, the PREN Subprogram calls for producing 18.2 million hundredweight (quintals) of basic grains, as follows:

<u>Crop</u>	<u>Area Planted</u> (manzanas)	<u>Yield</u> (cwt/manzana)	<u>Production</u> (cwt)
Corn	400 400	29.0	11,600,000
Beans	76,200	14.0	1,100,000
Rice	30,000	59.0	1,800,000
Sorghum	<u>200,200</u>	<u>18.5</u>	<u>3,700,000</u>
TOTALS	706,800		18,200,000

The Preliminary PREN document does not indicate historical levels of production of basic grains. These goals appear to be unrealistic, however, when one consults statistics of past output, unless one supposes that the PREN will include policy or input changes sufficient to increase production above historical levels.

El Salvador Basic Grains Output, 1975-82  
(000's "quintales" or hundredweight)

<u>Crop</u>	<u>Avg., 1975-79</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
Corn	9,414	11,231	11,314	9,000
Beans	872	1,000	854	830
Rice	1,024	1,362	1,284	770
Sorghum	3,455	3,444	3,004	2,700
TOTALS	14,765	17,037	16,456	13,300

Notes: Crop years begin May 1 of the year named, and end April 30 of the following calendar year.

Source: MAG/DGEA

Examination of the detailed data for area sown and yields shows that the draft PREN projects an increase in the area sown to levels as high as have ever been achieved, and in the case of rice, 50% more than that. Moreover, the only time corn acreage reached the level planned in the draft PREN in recent years was 1980, and the only time sorghum acreage reached the planned level was 1979. However, the area sown to sorghum dropped in 1980 and that was one reason corn acreage reached its record level in 1980. Even without a war, it would seem unlikely that the planned area of both corn and sorghum could be reached in the same year. The area to be sown to beans is plausible, at about the area planted in 1980, and just under the average area planted for the period 1975-79. However, the area to be planted to rice is projected to increase 50% over historic levels.

Corn yields are planned to be higher than ever before, though only a few percent higher than in the record yield year of 1980. Bean yields would be

considerably higher than ever before, and 40% over the level actually achieved in 1982. While projected rice yields would be almost 50% higher than in 1982, per manzana, at least the levels projected have been attained in the past, in 1979. Sorghum also is at least plausible: yields would be some 15% over 1982 levels, but at a yield close to the actual average for 1975-79. Tables of historical area planted and yields obtained are appended to this report. They are also available from the DGEA/MAG, and in another recent report by this firm.<sup>1/</sup>

There is no problem with projecting increased output, of course, so long as planners include appropriate means to cause this to happen. The PREN document lists the resources to be used in this production:

Land	700,700 manzanas
Labor	34,700,000 man-days
Machinery	800,000 passes (presumably over a manzana)
Fertilizer	61,800 metric tons

The PREN discussion document then indicates the estimated cost of each of these except land, plus pesticides, seed, and trucking the harvest to market, etc., reaching a total need for resources estimated at ¢424,600,000. It envisions the financing of about 40% of this by the BCR (Central Reserve Bank) through the banking system. Although nothing is said explicitly, presumably the rest is financed by the producers themselves or by non-governmental moneylenders, suppliers, etc.

Comparison of the area to be financed with the area sown shows that the plan assumes that most of the rice and relatively little of the sorghum will be financed by the banking system. Although there is no explanation of this in the draft PREN discussion paper, this is logical, since it is the rice area, yield and output which are supposed to rise the most

<sup>1/</sup> Strasma, Gore, Nash and Rochin, Agrarian Reform in El Salvador, San Salvador Checchi and Company, 1983, pp. 43 and 46.

dramatically. As for the sorghum, the planners may have been aware that the banks do not especially like to finance a crop which IRA (Food Supply Institute) is not willing to buy at a reasonably firm price. So they apparently have not projected much bank lending for this crop.

<u>Crop</u>	<u>Area Financed</u>	<u>Area Sown</u>	<u>% Financed</u>
Corn	181,800mz	400,400mz	45.4%
Beans	51,000mz	76,200mz	66.9
Rice	24,700mz	30,000mz	82.3
Sorghum	87,000mz	200,200mz	43.5
TOTALS	344,500mz	706,800mz	48.7%

Much of the necessary financing is already contemplated in the BFA's plans, however, the provision of inputs is not as secure. For instance, the PREN document calls for ₡33.5 million in fertilizers, ₡17.4 million in pesticides,<sup>1/</sup> and ₡28.0 million in machinery. As of the first week in February, 1983, the BFA stated that it was two months behind schedule for buying fertilizer, and had not been given any foreign exchange with which to make purchases. The draft PREN correctly states that the participation of the BFA will be decisive in implementing the Basic Grains subprogram, through its development credit line.

MAG is supposed to provide technical assistance, trying to get every beneficiary to practice rational, intensive land use in order to increase productivity and achieve these goals. Also, the total capacity of seed production will be utilized to produce and certify the production of improved seed.

How is this subprogram to be implemented? Essentially, the preliminary, discussion version of the PREN simply calls for everyone to do their regular work, and in addition, a "Comision Tecnica Mixta" is to be formed with persons of the private and public sectors, recognized as competent, to study and

<sup>1/</sup> BCR estimates for fertilizers and pesticides for all crops.

recommend solutions to problems of the basic grains. MAG was responsible for carrying this out in January, 1983, but it does not yet appear to have happened. It is also unclear what the agenda would be, nor why competent people in either sector would commit themselves to a committee to study unspecified problems.

In our own opinion, it appears that there are two keys to the supply and the production of basic grains. First, there is the continuing violence in the countryside, which causes land in production to be reduced, rather than increased, and discourages investment by farm owners, large and small.\* Second, marketing arrangements for basic grains leave much to be desired. GOES attention to the revamping of IRA might do much to achieve an effective reactivation, particularly if it were done early on, and in a way that inspired confidence by campesinos that they would receive a fair price, with little delay involved in delivering their product or collecting for it.

The preliminary PREN document calls for IRA to facilitate the institutional process for receiving products, and to fix goals for its purchases, seeking to regulate supply and demand for basic grains. It is not clear what exactly is meant by this. It is clear, however, from a recent evaluation conducted by technicians from the BCR and IRA itself that there is vast room for improvement in IRA operations.\*\*

Recent field research in El Salvador revealed that IRA only buys a small fraction of all basic grains marketed\*\*\* by smallholders and land reform beneficiaries. The reasons appear to be general mismanagement and disorganization in IRA, and it would appear that a massive overhaul is in order.

\* Strasma, Gore, Nash and Rochin, Agrarian Reform in El Salvador, Chapter 6, San Salvador, Checchi and Company, 1983.

\*\* Comision Tecnica, BCR/IRA, Evaluacion del Instituto Regulador de Abastecimientos (IRA), San Salvador, Julio de 1982.

\*\*\* Op. cit., Checchi report.

There is a myth popular in some circles to the effect that many of the problems of developing countries, including El Salvador, are due to a shortage of production in basic grains. Various writers have urged a naïve response, via policies calculated to increase the output of basic grains by forcing reduction in the area planted to export crops. This negative policy stance is a "cop out," attacking the export crops and their producers without asking Why campesinos do not produce more basic grains. When one investigates this in the field, with the campesinos, it invariably turns out that they consider grains to be relatively unprofitable and export commodities to be relatively profitable. That is, the problem is effective demand rather than supply as such. Given effective demand, the supply will be there.

If there is malnutrition in El Salvador, it is usually because the malnourished lack jobs to earn money to buy food. There is seldom a shortage of food at prevailing prices. Thus the key to increasing basic grains output lies in policies that make basic grain production more profitable than it is now. That would mean making IRA, which buys grains, a reliable buyer paying attractive prices to producers, and receiving their crops promptly, without delay, discounts or demands for bribes to the employees. These conditions do not now exist, according to the campesinos interviewed for the Checchi II Evaluation of El Salvador's Agrarian Reform.

Since no other means are proposed to achieve the projected increases in output of basic grains, and since there is no reason to assume that IRA will in fact reform itself in time for campesinos to have confidence before planting time, it appears most unlikely that the PREN will be implemented so far as basic grains are concerned. This should be a priority area for GOES attention.

## Coffee

The Coffee Subprogram begins by stressing the importance of this crop to the economy--it is the biggest foreign exchange earner, and one of the biggest sources of employment and income. The sector is plagued by violence, internal inflation in costs, an outbreak of roya, and the relatively low prices in world coffee markets (outside the International Coffee Agreement countries, to which El Salvador can only export a certain quota).

In this Subprogram, the PREN proposes to recover output and productivity, ensure adequate levels of employment and income to the rural population, fight the roya, and utilize to the maximum the installed capacity of the subsector.

The draft PREN indicates just one goal: harvest 3.5 million hundredweight (quintals) of beans from 265,700 manzanas.

To achieve this goal, it proposes to use 265,700 manzanas of land, 32.7 million man/days of labor, and 92,200 metric tons of fertilizer. (The fertilizer will cost ₡50 million, the labor ₡445 million, pesticides ₡4.0 million, freight ₡17.5 million, and other inputs ₡8.5 million.) Financing will be needed for 200 million manzanas, or about 78% of the area to be harvested.

## Implementation

- 1) A Joint Technical Committee is to be set up to study and make recommendations about coffee problems; MAG is to achieve this by January 1983. It is to propose alternative solutions for the problems of the sector, to decision-makers.
- 2) A report on the profitability of coffee-growing is to be prepared by MAG, with participation by the private sector, also by January 1983.
- 3) The BCR is to maintain or increase credit lines, for updated production costs.
- 4) The BCR, INCAFE and the banking system are to make the banking formalities

more flexible and speedier, both in granting credit and in providing the funds after the credit is approved.

- 5) The BCR is to review interest rates and determine if coffee growing can be encouraged by lower rates, considering the profitability of this activity.
- 6) The BCR is to review the line of refinancing for unpaid balances of coffee growers, to adjust its term and interest rate.
- 7) The BCR is to adjust credit lines for fighting the roya, in amount, term and interest rate, to encourage their use by growers.
- 8) Suppliers and INCAFE are to ensure supply of fertilizers and pesticides, as close as possible to the growers.
- 9) INCAFE is to improve marketing so growers get remunerative prices, liquidating balances as quickly as possible so as to minimize interest charges on credit in use.
- 10) INCAFE is also supposed to find new markets abroad for disposing of surplus coffee (over quota).
- 11) MAG is to check the quality of inputs, provide technical assistance, and especially back research on roya.

### Evaluation

There are traditional organizations speaking on behalf of coffee growers and the coffee processors (beneficios). Neither felt a need to await the appointment of the Joint Commission mentioned in the draft PREN, before making its viewpoint clear. Essentially, these groups demand a return to the previous state of things, except that they want taxes cut and authorization to sell the dollars earned with coffee exports on the (higher) "parallel" market.

Ever since the two-rate foreign exchange system appeared, every organization has been struggling to get permission for its members to sell their foreign exchange earnings at the higher price. It is not obvious what the source of foreign exchange at the "official" price would be, if coffee exports were liquidated at the higher rate.

Likewise, the pleas to cut the coffee export tax are not accompanied by indications as to a source of revenues with which to replace this major source of budget resources.

### INCAFE

Like its predecessor private sector organization for coffee marketing, INCAFE appears to have gambled that prices would rise, and it is currently stuck with far more coffee inventory than it wants. Making matters worse, INCAFE has few resources with which to pay the carrying costs of this inventory. Therefore, it orders growers to hold the stocks themselves and to deliver certain quantities at a specified rate, to INCAFE. Most importantly, INCAFE only pays growers when it sells the product, which sometimes delays payment to the farmer for over one year. Thus it was that in December 1982, coffee grower cooperatives finally learned how they had fared financially, from the harvest they delivered to INCAFE in 1980/81.

We recommend that INCAFE be forced to assume the financial responsibility for decisions it makes as to the time and place at which it sells coffee. Specifically, we recommend that growers be allowed to deliver coffee to INCAFE whenever they like, and that from that day forward, INCAFE be responsible to the financial institutions for the payment of interest of whatever production debt was behind that coffee. (Perhaps some limit should be imposed, such as 75% of the current market price of the coffee delivered.)

INCAFE and its private sector predecessor organization have an atrocious record of speculating on world coffee markets--and losing famously. It is tempting for any organization to hang onto inventories, hoping desperately for a better price, when it does not have to pay interest on the value of the inventory. In practice, however, someone does have to give up something when INCAFE decides to wait a month longer to sell, and insofar as possible that should be INCAFE. That way, its decisions to wait or to sell would reflect the real world.

There are complex questions concerning the way in which quotas are set in

the International Coffee Organization, which have been raised by those opposed to selling coffee in other markets at lower prices. We do not regard these objections as very powerful, in view of the likelihood that the ICO itself will not last much longer. Rather, it would seem timely for INCAFE to find out (as we understand it has begun to do) at what price it can actually sell its excess stock of coffee. It should sell that excess, and based on the results, announce a price for coffee in the future that will blend the quota price and the price it has to take in order to sell the rest of the coffee.

It is likely that some small areas would go out of coffee production in response to a lower expected price, but they should. Many hectares now in coffee could go into other tree crops, and a lower coffee price will lead to more thought about that.

However, for purposes of the PREN and the short-term, we believe that the simple announcement that INCAFE had actually sold off all of the accumulated stocks, and that henceforth it would either sell at once or would pay the interest and assume the production loans of coffee producers as of the day of delivery of the product, would be extraordinarily stimulating. We would expect an immediate increase in fertilization, pruning, and other discretionary steps that can increase output from existing coffee trees. At the same time, we would expect decisions on new plantings to be taken rationally, with an eye to the lower prices projected, and that would also be a good thing.

The coffee sector has organized a very successful public forum in 1982, and the papers presented there were a strong statement of the views of the larger growers and processors. At the same time, the presentations were well-larded with heavy statements about past and present government attitudes and laws.

There are a surprising number of small producers of coffee in El Salvador,

and it is not clear whether their needs and views are adequately represented in the public statements from the traditional private sector organizations. Members of the Study Team and of the Ministry of Economy and Planning were very well received by these venerable organizations, and we had a frank and lively exchange of views. It appears that the growers for whom they speak will not enter into a Reactivation Plan, nor much less invest their own money, unless the GOES first capitulates on a series of major policy issues. This was made abundantly clear to us, in both verbal and written presentations.

We do not know whether there is a need for separate organizations, but there does appear to be a need to identify spokesmen who can accept what is, even if they would never have sought it, and study objectively what can be done from the present as a point of departure.

### Cotton

Cotton is the export crop most dramatically affected by the crises which El Salvador has suffered for the last several years. The area planted has fallen, yields are down, world prices are unkind, and even nature has been fickle. Guerillas have burned cotton fields, destroyed gins and warehouses, and shot down crop dusting airplanes. The draft PREN also stresses the importance of cotton as an input for industrial plants, which have also been working well below capacity. Hence the PREN includes a Subprogram to encourage farmers to produce cotton.

The stated objectives are similar to those of other crops: regain former levels of production and productivity, utilize to the maximum the existing processing capacity, produce maximum generation of foreign exchange, supply the needs of industry for raw materials, and in the process, ensure adequate levels of employment and income for rural families.

According to the draft PREN, all these objectives can be achieved by reaching the stated goal of planting 80,000 manzanas and obtaining yields of 13.0 quintals (cwt) of cotton per manzana.

Achieving this production goal will require, in addition to the 80,000 manzanas of land, 2,900 metric tons of seed, 3.6 million passes by machinery (presumably over 1 manzana), 6.7 million man-days of labor, and 32,400 metric tons of fertilizer.

All this will cost ₡190.3 million, of which almost half is labor (₡88.5 million), and pesticides account for ₡54.7 million. Fertilizer and machinery require about ₡17 million each, hauling will take ₡5.4 million, and the seed and other costs barely reach ₡3 million. In addition, the cost figures include the payment of land rent at ₡5.0 million. (For all other crops, it is assumed that the producers own the land, or that the return on the crop is divided between owners, tenants and banks according to their private arrangements, but it is not shown as a cost

in the PREN document.)

In another departure from the practice planned for coffee and sugar, the PREN document calls for the BCR to finance 100% of the land, 80,000 manzanas, planted to cotton, through the banking system.

Action to Implement the Subprogram

1. MAG is to form a Joint Technical Commission to be formed with experts from the public and the private sectors, to study problems of cotton production and recommend solutions to policymakers.
2. MAG is also to study the profitability of cotton production, with the aid of the private sector, producing a report in January 1983.
3. The BCR is supposed to increase the amount of credit to meet the requirements of the updated cost study, by March or April of 1983.
4. The Banking System is supposed to make its procedures more flexible and quicker, in order to grant credits and then actually supply the funds, promptly and when needed.
5. The BFA, COPAL, and private suppliers are supposed to see to it that adequate supplies of fertilizer and pesticides are on hand where and when needed by cotton growers.
6. COPAL and the Ministry of Foreign Trade (MICE) are to find and gain new markets abroad for additional cotton grown.
7. COPAL is also charged with finding mechanisms that will bring profitable prices to the producers, yet sell the cotton quickly, and get the proceeds to growers rapidly so as to reduce the time during which they have to pay interest to the banks.
8. MAG is to control the quality of fertilizer and pesticides, provide technical assistance to growers, and carry out integral control of plagues affecting cotton in defined areas.

### Cotton Grower Cooperative (COPAL)

COPAL, the cotton producers' cooperative, prepared two studies directly relevant to the PREN. The first analyzes the situation of cotton production and marketing; the second is a request for a \$50 million line of credit from a major foreign bank, which COPAL would use to finance inputs and marketing of the cotton to be produced in 1983/84.

The COPAL analysis highlights the damage done to both cotton production and the industries based on it, by the socio-political crises El Salvador lives, "...even after the elections of March 1982." The Cooperative itself, as an entity which channels funding to both producers and firms buying cotton for manufacturing activities in El Salvador, has also been affected to the point that it is unable to meet its own short-term debts. COPAL therefore asks urgently that the GOES refinance it.

COPAL's analysis begins by comparing the area sown, output and prices of cotton and cottonseed, and the incomes and foreign exchange generated in this activity. The area sown to cotton has fallen slowly ever since 1977/78, except that it dropped 43.1% from 1980/81 to 1981/82. In addition, world prices have fallen despite a modest improvement in the quality and yield of fiber from El Salvador. Between prices and lower output, foreign exchange earnings from cotton have fallen alarmingly:

1978/79 compared to 1977/78	- 2.6%
1979/80 compared to 1978/79	- 6.0%
1980/81 compared to 1979/80	-35.2%
1981/82 compared to 1980/81	-51.6%

COPAL expects the negative trend to continue for the 1982/83 crop year as well.

The world price lately has been around \$64.00 per cwt, or quintal, and in COPAL's opinion it takes \$75.00 to allow the cotton farmer to reach a level of "subsistence." (Analysis, p. 5.)

COPAL sums up the problems facing the industry as follows:

- 1) Violence spreading throughout the countryside;
- 2) Increased costs of ginning as a result of smaller production;
- 3) Lack of working capital;
- 4) Lack of adequate credit, both for production and for refinancing unpaid past debts;
- 5) Increased rates of interest on credit;
- 6) The cost of guards to prevent arson at the gins; etc.

COPAL then demonstrates the many links between cotton output and the rest of the economy. For instance, cottonseed "cake" is used as cattle and chicken feed. Cottonseed oil is used for cooking. Fibers are used in the textile and apparel industry and in making mattresses. And of course, these activities require many kinds of services and inputs.

COPAL then presents a study of costs over time, showing a marked increase in the cost of fertilizer, of which more is used than before, and in insecticides and the cost of applying them by air. Costs per manzana of cotton purportedly have risen from ₡2,630 per manzana in 1978/79 to ₡3,494 in 1981/82. About the only significant cost that did not rise during this period was rent for land, which remained steady at ₡300. Yields, alas, were falling--from 35 quintals (cwt) per manzana in 1976/77 to 30 in 1978/79 and 29 in 1981/82. Making things worse, average prices received fell from US \$67.25 in 1976/77 to US \$55.00 in 1981/82, though they were better in 1979/80 and 1980/81, at US \$69.19 and US \$77.97 respectively.

By COPAL's estimate, producer net profits per manzana fell from ₡369.40 in 1976/77 to a net loss of ₡504.78 in 1979/80 and ₡562.09 in 1980/81, and then plummeted to a loss of ₡1,900.31 in 1981/82.

The cost of cotton ginning (separating seed and fiber) rose, largely as a result of the lower volume of cotton handled, from ₡5.78 per cwt in 1977/78 to ₡13.92 in 1981/82.

COPAL continues its analysis with an estimate that cotton is one of the crops that generates the most jobs, with wages paid per manzana of about ₡1,000. Thus the 112,189 manzanas not sown to cotton in the last two years have cut employment measurably.

Even tax receipts were hurt, COPAL concludes, by loss of the 2% stamp tax on receipts for inputs purchased, of more than ₡1.5 million per year.

COPAL admits that cotton uses a lot of imported inputs, but states that the inputs only require 39% of the foreign exchange generated, leaving a net foreign exchange gain of 61%. Worse, COPAL says, El Salvador now buys cotton products abroad that it used to produce, for some ₡53 million a year (p. 16).

COPAL also states that producers cannot afford recent higher rates of interest, though they recognize that this should promote savings and fight inflation. COPAL normally borrows from the BCR each year in a "Pre-export" line of credit, which enables it to give producers an advance on account of ₡75 per cwt, with which they repay production loans and plan for planting next year's crop. However, it says it needs more than it has been getting-- and specifically, that it needs ₡187.5 million. Admitting that it (and its members) will still have financial problems, COPAL then asks that it be allowed to liquidate foreign exchange earnings in the parallel market.

COPAL notes that the BCR lends money more cheaply to manufacturing industries than to it, and argues that ginning is an industrial process, so it too should be allowed to borrow at 6% interest from the BCR.

Finally, COPAL has a list of "incentives" it would like:

- 1) Unfreeze properties of owners with less than 500 ha. and revise the agrarian reform laws (in unspecified ways);
- 2) Allow reform sector coops to rent cotton lands to other persons if the coop cannot raise cotton.

- 3) Speed up payment for expropriated land, and at just prices.
- 4) Refinance, for 10 years, at 6%, the debts from 1979 to date.
- 5) Automatic advances of some money on presentation of credit applications, since the actual production loans are not approved quickly, and the banks are demanding too much collateral.
- 6) Wage freeze during the season.
- 7) Duty-free imports of tires, lubricants, parts, etc.
- 8) Support price for cotton of ¢80 per quintal.
- 9) Creation of a Mixed Commission with representatives from BCR, MAG and COPAL.
- 10) Technical assistance for the control of pests and disease.
- 11) Launch a campaign to raise the area sown to cotton to 125,000 manzanas.
- 12) Exempt cotton producers from income taxes on profits they promise to use to repay off debts from past years.

#### Comment

An old Spanish saying, "En el pedir no hay engaño," comes readily to mind when reading these presentations. There is no reason producer groups should refrain from asking for the moon--and the last suggestion, that they be allowed to use pre-tax income to pay off past debts, is at least different from the otherwise similar lists of other groups. However, none of these groups has proposed a tax that should be increased, or a form of government expenditure that should be reduced (except for costs of running government marketing agencies, which they want given back to the coffee and sugar producers).

The cotton growers distinguish themselves, however, in the way they have not been content to prepare studies and write out petitions for tax breaks, foreign exchange privileges, etc. They have also sought external credit themselves, with a businesslike presentation to a major foreign bank. And in meetings with them, the cotton group was much more interested in talking about "What can we do, starting from here?" than in refighting past battles about agrarian and other social reforms.

### Evaluation

Whereas at least some coffee and sugar growers do not like to work with banks, cotton growing in El Salvador is almost entirely a straight financial short-term investment by businessmen who prefer to operate entirely with other people's land and money. This makes their operations highly leveraged, and they normally either make a lot of money or lose a lot of money, depending largely on world prices, rainfall, guerilla action or inaction, and events similarly beyond their control.

For the PREN, this is advantageous, because it means that if the conditions, natural, political and psychological, are suitable, there is a group of businessmen who will respond quite quickly and cotton acreage can rise rapidly. On the other hand, during the civil war and political uncertainty of the last few years, it has meant that some of these entrepreneurs have moved operations to Guatemala or have gone into other activities.

How realistic is the goal of 80,000 manzanas of cotton for the crop year starting May 1, 1983? In mid-1982, MAG predicted that 70,000 manzanas would be planted, but the actual figure came to only 68,000. During the 1982/83 growing season, the guerilla radio ordered crop-dusting pilots not to fly any more, and at least five planes were shot up and one pilot killed when they ignored the warnings. As a result, much of the cotton sown did not receive the full dose of pesticides required to grow cotton in tropical lands, and yields fell short of predictions. It is hardly possible to predict the success of a cotton program dependent on aerial spraying, without knowing whether political events will permit such spraying to be carried out.

On occasional and isolated farms, cotton has also been grown by campesinos (land reform beneficiaries) using backpack sprayers to control pests and disease. There is also a fair amount of use of natural biological controls, some of which do not need to be distributed by airplane. Given El Salvador's abundant labor resource, it might well be appropriate to do a quick study to determine whether that technology might be cost-effective, if aerial

spraying is not possible.

The availability of rental land is another question mark. In spite of Decree 6, which prevented persons renting land for cotton from subsequently claiming it under Phase III of the land reform, and in spite of the fact that acreage limits in the land reform law sought specifically to exclude land rented in large amounts by commercial growers such as the cotton producers, the study team was told that many landowners were reluctant to rent land, or as much land, as they previously had. To some extent, this may be replaced by land reform cooperatives (Phase I) choosing to grow cotton on some of their land--which may well be land that the former owner rented out for cotton growing. There is talk that some cooperatives may contract with growers for a sort of joint venture, using their land and workers and letting the entrepreneur manage the operation and worry about finances and inputs. We are not aware of any such arrangements actually coming to fruition yet, however, and we are unsure whether ISTA functionaries would accept or would attempt to prevent them.

At a minimum, then, the projection of 80,000 manzanas to be sown to cotton appears unrealistic unless the guerillas announce that they will no longer attack crop dusting planes, and unless ISTA decides that along with other experimental efforts at improving the ability of cooperatives to manage their farms, it will encourage the signing of one-year joint production contracts between experienced cotton growers and the agrarian reform coops.

### Financing

While the PREN draft calls for the BCR and the banking system to finance all of the cotton production, COPAL--a private sector cooperative which rather successfully manages cotton input imports, cotton ginning, and cotton exports--is also looking for financing from a major foreign commercial bank. COPAL has asked for a line of credit which would enable it to finance inputs imported for its members, as well as re-lending to them to cover other production costs, and finally to finance inventories until they can be

exported and sold, or sold to local industries.

Clearly, such a line of external finance would be helpful to El Salvador, whose resources are stretched quite thin by the effects of the guerilla war and the capital flight of the last few years (although this latter factor appears to have abated somewhat). It would be outside the restrictions imposed by the International Monetary Fund, and if cotton output is effectively increased, there should be no particular problem in repaying it.

While the world market prices for cotton are not encouraging, presumably any external lender would insist that the borrower (COPAL) hedge by forward sales of enough cotton on futures commodity exchanges, to guarantee at least a price that would permit repaying of the loan. Thus the financial viability of the cotton subprogram would be guaranteed in advance--as long as the assumptions about the war risk are valid, or are covered by some type of insurance.

In a previous study, we have recommended establishment of a sort of insurance program to cover both natural hazards and war risks. As matters stand, if guerillas burn the cotton gin that serves one agrarian reform cooperative, and do not burn the gin that serves another, the first loses money and the second does not, but there is no mechanism that lets them share the risk. The same applies to natural risks, such as drought or flood. We again recommend that the PREN include some such risk-sharing arrangement, and we would regard it as appropriate that it be reinsured or backstopped with external assistance from parties interested in encouraging the economic reactivation. Commodity programs might be an appropriate form of such backing, since to the extent that the reactivation succeeds and actual losses to nature or to acts of war are minimal, fewer commodities are needed, and vice versa.

It is interesting to note that the cotton export marketing was not nationalized, and that the private sector spokesmen who work in it are far less bitter in their expressions toward the present government, than are the persons who

formerly controlled the export marketing of sugar and coffee. On the other hand, there are not nearly as many small farmers and campesinos growing cotton as there are growing coffee and sugarcane. Thus the level of political involvement is lower in the case of cotton; just like the growing arrangements (landowners dealing with capitalist investors on an annual rental basis), cotton is just a business proposition largely devoid of the traditions and the emotions found in coffee and to a lesser extent, in sugar growing. In the present "climate" of El Salvador, it is also likely to respond quickly and favorably should the political process end the threat of attack on cotton gins, warehouses and airplanes.

In the longer run, however, the huge volume of pesticides that are dumped onto El Salvador's cotton lands are worrisome. We heard concerns for the shrimp and other fishing resources, and we note that cotton growers seem to need heavier and heavier doses of chemicals over time as pests become resistant. While cotton may be important in the short-run economic recovery, we would recommend that MINPLAN also undertake an objective study to determine whether such concerns are just rumors, or are in fact valid, and that the GOES make a decision in the next year as to whether the long-term interests of the country require an expansion or a contraction of cotton production. We do not have an opinion on the issue, but we do think it needs to be addressed.

### Sugar

Since 1978, the area planted to sugar has been declining. According to the draft PREN, the causes include the burning of cane fields as part of the violence in recent years, and the fall in world market prices as other suppliers have expanded their production. The PREN document concludes that this has cut sugar output, reducing employment and incomes of rural people and cutting foreign exchange earnings. Therefore, the document concludes, "The State considers implementation of this Subprogram to be urgent."

The objectives stated are familiar: recover output and productivity levels, contribute to the gross national product, guarantee supplies for the internal

market, increase export earnings, generate employment and income for rural families, and keep the sector alive by fighting the "carbon" that has been attacking sugar cane.

The specific goals of the Subprogram entail the cultivation of 54,000 manzanas of sugar cane, of which 8,000 would be replantings and 6,000 would be newly planted areas. The goal is to obtain 60,000 short tons of cane per manzana. From this, the goal is to produce 5.9 million quintals (cwt) of sugar, assuming a yield of 190 lbs. per short ton of cane. The internal market would receive 3.4 million quintals, and 2.5 million would be exported in order to fill the quota established under the International Sugar Agreement. As a byproduct, 229,400 barrels of molasses would be produced, for internal and external markets.

To achieve this, apart from the land, it would take an estimated 4.46 million man-days of labor, 192,000 machine passes (or about 3 apiece for the 60,000 manzanas of land), 140,000 short tons of seed, and 22,100 metric tons of fertilizer.

The cost of the Subprogram is estimated at ₡120.6 million, of which transportation is the largest portion at ₡45.5 million, followed closely by labor, at ₡40.8 million. Fertilizers cost some ₡12.0 million, pesticides ₡4.7 million, and seed and other items account for the balance.

The financial plan calls for financing 14,000 manzanas of new and replanted sugarcane, for ₡18.6 million, plus 54,000 manzanas of existing sugarcane for 35.5 million. Another ₡66.5 million are needed to finance cane hauling and combating plant disease. That said, the preliminary PREN document continues stating that the cane producers are accustomed to paying for the harvest and transportation of the cane themselves, with funds which INAZUCAR advances to them on account shortly before the harvest. The BCR is therefore expected to lend INAZUCAR ₡155.0 million for this purpose.

There is no explanation in the preliminary PREN document of the inconsistency; the total cost of labor and transportation is shown as ¢86.3 million, and the entire cost of the subprogram is shown as ¢120.6 million. There may be a typographical error, or there may be the refinancing of past debts, or some other item left out of the Subprogram costs, but intended for financing.

#### Action to Implement the Subprogram in Sugar

1. MAG is to organize a Joint Technical Commission with experts from the public and private sectors, to study problems of sugar production and recommend alternative solutions to policy-makers.
2. MAG is also to carry out a technical study of the costs and profitability of the sector, with help from the private sector.
3. The BCR is to adjust credit lines to the updated costs. The BCR and the banks and INAZUCAR are also to make it easier and quicker to get credit, and to actually get the cash when credit has been approved.
4. The BCR is to review interest rates, to see whether it could not encourage sugar production by cutting them. It is also to review refinancing of past debts, to provide more favorable terms of time and interest rate.
5. Private sector suppliers are to provide inputs on time and where they are needed.
6. INAZUCAR is to buy the sugar cane and the sugar more quickly, and pay more promptly for it.
7. MAG is to check the quality of inputs, provide technical assistance, and fight the "carbon" disease in sugar cane.

#### Evaluation

Except for the discrepancy in financial provisions, which is apparently a typographical error, the plan appears plausible. It is also a clear case of "planning" to go on doing what one has been doing all along, but to assert that it ought to be done better. The only actual new step in the sugar subprogram is the proposal to create a joint committee with private sector technical experts, to study the problems of sugar production.

Early in its work, the study team was told that guerilla burning of sugar

cane fields was a serious problem. Later, however, we learned that the workers themselves burn the cane because they can cut 50% more in a day if it has been burned so they don't have to handle the leaves. It appears that they get the same pay for cutting a ton of cane either way, so their behavior is completely rational.

We were then told that the problem is that the guerrillas burn the cane in larger areas, and not according to the "plan" of the producers, so sugar content is lost because it cannot all be milled quickly after being burned. Yet we learned that the mills do not pay any differently for cane with a high sugar content and cane with a low sugar content. There is very little incentive for the growers or the cutters to work so as to maximize sugar output, as opposed to sugarcane output.

There is awareness among the INAZUCAR staff and among the PRO-CANA spokesmen that perhaps something ought to be done to create a premium for high-yielding cane, but no one seems to intend to actually study the problem, let alone recommend action. It appears that the campesinos and other farmers are quite rational people, who have responded quickly to other kinds of economic signals, and it therefore seems likely that a clear signal that higher sugar content would lead to better prices, could probably achieve as much as a simple-minded increase in the number of manzanas planted. It may be too late for a national program in 1983, but we would recommend experimentation in at least the area of one major mill, and that the PREN contemplate introduction of a yield premium at all mills by 1984.

It is also curious that there is no mention of the U.S. sugar quota, which El Salvador fulfills at the expense of not meeting its less profitable quota under the International Sugar Agreement. Perhaps the author of this section simply confused the two.

As for other export crops and basic grains, a real program to reactivate the agricultural sector also needs some decisions on matters of agrarian

reform policy and implementation. These will be discussed below, together with the draft PREN subprogram on agrarian reform.

And as for other crops, obviously real reactivation needs a peace which has eluded sugar producers as well as those of other crops.

### Livestock

The draft PREN notes that livestock activity has declined "...as a result of the economic crises that has affected the country since 1979." Milk and meat production are down, and the reduction in cattle herds has reduced incomes and employment. "Therefore it is necessary to execute a Program to overcome these difficulties."

The objectives stated are to slow the reduction in herds, increase the supply of milk and meat to consumers, and create the bases for the recovery and development of the cattle industry.

Unlike the other subprograms, this one actually has a section entitled "Policy" at this point. The cattleman is to be encouraged to increase utilization of his existing, idle capacity, while measures are to be taken to prevent further decline in herds. Support infrastructure is to be built up, and external resources are to be sought for the preparation of a basis for rebuilding and developing the livestock industry.

Specific goals are proclaimed: 25, 812 metric tons of beef; 7,554.9 metric tons of pork; 15, 136 metric tons of chicken; 240,000,000 liters of milk, and similar targets for eggs, honey, beeswax, etc. Some 3,000 cows are to be "rescued" from slaughter and turned over to cattlemen, and 2,000 more are to be imported. The cost of this subprogram is laid out in terms of feed rations, veterinarian products, day-old chicks, fertilizer, etc. Since many of these appeared earlier as goal of basic grain production, there could be some double-counting.

Financial requirements call for maintenance of lines of credit, including

the purchase of calves for fattening, machinery, and the purchase of cows for breeding to increase milk production. The total financing envisioned is \$54.9 million.

In contrast to other subprograms, this one is divided into discrete projects (5), on livestock development and animal health; milk production increase; "rescue of wombs," a national network for the control and processing of meat production; internationally-supported programs for building rural silos; and development of rabbit, poultry and beekeeping enterprises.

All of these are to be carried out by the Centro de Desarrollo Ganadero, ISTA, the banking system, and MAG, with MAG being charged also with the creation of a Joint Technical Commission with experts of the private and public sectors to study problems of the sector and recommend solutions. The PREN then enumerates several pages of specific steps to be taken, such as the creation of field stations, research on disease and on better rations for animal feed, extension and services in animal production (both large and small), artificial insemination, and all the rest of the activities of a sound livestock service infrastructure in any country.

Centers of livestock development are to be constructed in Izalco, Morazan and Chalatenango.

### Evaluation

This is a good livestock development program for any nation, but it appears somewhat unrealistic for a nation at war, in which cattle grazing on the hills are likely to disappear. Two of the three Centers of Livestock Development are to be built in areas that are located in combat zones.

In our meetings with private sector cattlemen and with members of land reform cooperatives, we consistently heard the complaint that cattle theft goes on and that there is no way to prevent it. Until such time as authorities have no one to pursue across the hills except cattle thieves, this will likely continue as a problem. Therefore, we suggest that little can

be expected of the beef subsector in the PREN.

However, there is clearly scope for development of rabbit, chicken, and bee production, and that part of the PREN deserves more attention. These activities are carried out by persons for whom a move to Miami is not an option; they will invest and will produce even if they do not like what happens in the political arena.

The representatives of the cattlemen stressed their insistence on repeal of parts of the agrarian reform, as needed before their members would have "confidence" and invest in the rebuilding of the livestock herds. We believe that the small farmer beneficiaries of the land reform are committed to staying on the land, but that they also need some actions--which we discuss below, in the subprogram on land reform. At a minimum, the beneficiaries of agrarian reform need titles to their land and in many cases, they need a reduction or reprogramming of their debts, just as the large farm operators ask.

The cattlemen seem to have a reasonable proposition in urging that the municipal slaughterhouse not accept beef whose legitimate origin is not proven. They say this facilitates cattle theft, and this would appear correct. We would suggest that this be looked into by the MINPLAN and the MAG, and resolved as part of the PREN. However, it may be about the only part of the program affecting beef that can be executed because of the current lawlessness in most of the country.

The program to "rescue" healthy cows sent to slaughter by cattlemen who fear theft is operating now, and in effect is just creating a market for live cattle that was lacking. The cows are resold to other cattle producers--perhaps land reform coops--that are more committed to staying put, or that are operating in safer areas such as Sonsonate. (Unfortunately, Sonsonate alone probably cannot meet all the crop and livestock production needs of El Salvador. However, the contrast in attitudes and farmer expectations--large and small alike--between that region and others where there is more frequent lawlessness or even open battle between army units and guerrillas, is dramatic and does much to explain El Salvador's production

problems. Absent a war, and present a government which the population unanimously accepts as legitimate, this country would easily have the highest per capita income in Central America, and in a few decades, it could rival the smaller countries in Europe.

#### Renewable Natural Resources

The draft PREN speaks eloquently of the excessive cutting of the few remaining forests, the waste of water resources, and the risk of extinction of various species, animal and vegetable. The objectives of the Subprogram are, of course, to protect areas apt for forestry, conserve soils, and construction and maintenance of systems that will use irrigation water optimally.

Specific goals include the reforestation of 1,100 hectares, the adding of 1,105 hectares of irrigated lands to production, the building of various storage dams, maintenance of irrigation on 3,000 hectares, care of 9,600 hectares of national parks and 2,024 hectares of tree and plant nurseries. The Subprogram also calls for research on solar energy for drying grain, and for production of firewood at about present levels.

The cost of these programs is to be covered almost entirely by external resources, mostly from USAID, which is to provide about 92% of the \$10 million cost.

The programs have been studied carefully, and are no doubt sound. We have heard complaints that the reforestation program paid such good wages that it drew campesinos away from their jobs in land reform cooperative production; presumably this sort of thing will be adjusted quickly as problems arise. It is especially important to try to ensure that programs aimed at creating employment attract the unemployed, not those who already have jobs (unless you want the unemployed to move into the latter, which is not the intention of the land reform beneficiaries who took jobs planting trees nearby).

One of the key assumptions behind Phase III of the agrarian reform is that when campesinos who have been renting tiny plots of land on hillsides and growing corn on them, become owners of those plots, they will suddenly become interested in conserving their soil. It would be appropriate for these natural resource programs to work closely with FINATA to locate and assist such reform beneficiaries, with terracing, small-scale ponds and irrigation, tree planting, and the like. The PREN document does not indicate whether such coordination has taken place, but it seems unlikely since FINATA is not mentioned as a collaborating agency in the programming document.

We recommend that those responsible for renewable natural resources in the PREN meet with FINATA staff as soon as possible, to coordinate these efforts and ensure that investment and jobs go to people who are committed to staying on the land.

#### Agrarian Reform

The draft PREN states that the agrarian reform has suffered from inadequate support for this complex process of socio-economic change, both by state agencies and by the banking system. Matters are made worse by the destructive effect of the conflict, the lack of experience among the campesinos as business managers, and the lack of funds with which to compensate the former owners. This last has in turn prevented the adjudication of lands to the beneficiaries.

The preliminary document concludes that the consolidation of the reform process requires reorganization to encourage the optimal use of the economic resources at the disposition of the reform farms. The objectives of the PREN, in the agrarian reform subprogram, are:

- a) Facilitate access to land and other means of production, to the highest number of campesinos possible;
- b) Contribute to increasing national income through an optimal use of the available productive resources of the farm units;

- c) Increase rural employment and incomes through maximum employment of the available labor supply;
- d) Improve living conditions of a large part of the rural population through access to basic services needed for a minimal level of well-being;
- e) Help diversify farm production, using the productive resources of the farms to their maximum capacity;
- f) Increase the generation of foreign exchange from agricultural and livestock export products;
- g) Achieve the consolidation of the process through the conversion of producer units into self-managed firms, profitable and well-managed.

To achieve the goals just set forth, the PREN proposes goals as follows:

Decree 154 (Phase I)

- Turn over reserve right lands to 40 ex-owners;
- Pay ex-owners for 282 properties;
- Adjudicate 291 production units to their beneficiaries;
- Utilize 163,700 manzanas in agricultural and livestock production.

Decree 207 (Phase III)

- Deliver 20,000 provisional titles, with which 25,000 farmers will benefit directly, and indirectly 150,000 rural dwellers more;\*
- Appraise 1,300 properties for compensation, involving 26,000 parcels covering an area of 59,800 manzanas;
- Payment to ex-owners for 1,000 parcels including 46,000 manzanas;
- Delivery of 9,700 definitive titles, involving 7,857 direct beneficiaries, or 47,142 altogether, with 22,300 manzanas; and
- Utilization of 138,000 manzanas in agricultural production.

These numbers appear to contain typographical errors.

Cost of this Subprogram

The estimated cost of this subprogram is as follows:

Phase I (Decree 154):

¢27.2 million in cash and 446.8 million in bonds issues in payment to former owners, plus 7 million in interest due on the bonds to be issued;

¢296.1 million in production credit;

The subprogram expects to collect ¢7 million in payments from beneficiaries for the land they have received.

Phase III (Decree 207)

¢ 27.6 million in cash and ¢27.6 million in bonds in payment to former owners, plus ¢4.2 million in interest due on those bonds;

¢124.4 million in production credit;

The subprogram expects the GOES to collect ¢700,000 from the beneficiaries in payments for the land received.

In total for the two phases of land reform, the PREN calls for the payment of ¢54.8 million in cash and ¢474.4 million in bonds to former landowners, plus ¢11.2 million in interest due on those bonds, and it calls for production finance of ¢420.5 million.

Phase I (Decree 154) is to be carried out by ISTA, Phase III (Decree 207) by FINATA, technical assistance is to come from MAG and the National Financial System is to provide the production credit. And all of this presumes the active participation of the beneficiaries, associated in cooperatives.

The execution of this Subprogram requires the following steps:

1) ISTA is to develop a farm management program training the beneficiaries in management, production, marketing and law, in order to turn the production

- units into profitable firms able to direct their own development;
- 2) The GOES is to provide ISTA and FINATA the cash needed to pay off the former landowners, including interest on bonds issued previously;
  - 3) ISTA and FINATA are to move faster on the legal steps in that compensation to former landowners;
  - 4) FINATA is to deliver provisional titles to all who ask for them;
  - 5) ISTA and FINATA are to speed up the process of transferring title to the beneficiaries;
  - 6) ISTA is to accelerate assignment and definition of reserve right lands to those former owners who request them;
  - 7) FINATA is to do the basic studies needed to supply production and social services in the near future to beneficiaries of Phase III (Decree 207);
  - 8) MAG is to supply technical assistance to permit optimal use of the productive resources of the sector.

#### Evaluation

All of the action steps of the draft PREN merely call for the GOES to go on doing its regular tasks, some of them overdue. That would be helpful, but it does not address some of the most pressing policy issues as seen by both the campesinos (beneficiaries) and the former landowners:

- 1) Review and reduction of outstanding debts of many Phase I cooperatives where there is real doubt as to their legitimacy or as to the ability of the cooperatives to pay them for reasons quite beyond their control, such as destruction or theft of resources, or the arbitrary and capricious results of land valuation that by law is largely based on what the former owner happened to declare on his 1976 and 1977 tax returns;
- 2) Define and implement a policy regarding the future of land holdings between 100 and 500 hectares per landowner;
- 3) Facilitate the financing of longer-term productive investment in addition to short-term crop loans;
- 4) Create the agrarian tribunals already contemplated by law, to resolve conflicts arising over land and related problems;

- 5) Create an insurance system that will compensate in part those cooperatives that suffer grave losses from weather, accident, or military actions by guerrillas and the armed forces;
- 6) Issue needed regulations to enable the use of agrarian reform bonds for the purchase of state-owned factories and other assets which the GOES wishes to privatize; and to enable reform beneficiaries to pay their agrarian debts with bonds acquired in the market (thus allowing beneficiaries as well as former landowners to profit from the fact that the bonds trade at a discount from face value).
- 7) Change marketing and financial arrangements so that reform cooperatives (and other producers as well) know promptly how they have performed and where they stand, financially. The most pressing problem has been the long delay between harvesting of coffee and payment for it, but there is room for improvement in the marketing and liquidation of almost all crops and products.
- 8) Create mechanisms whereby the reform beneficiaries can meet, discuss common problems, help train each other, and deal on a more businesslike basis with the GOES agencies of the sector.
- 9) Conduct experiments, analyze the results of present policies and organization, and evaluate with an eye toward future organization of productive units in the reform sector. It appears that the experience and desires of beneficiaries varies greatly, often in part depending on the specific crops produced, and that a set of possible models will be more productive as well as more acceptable politically, than any effort to impose one model on all.

These issues have been analyzed and more detailed policy recommendations have been presented in a recent report by this firm entitled "Agrarian Reform in El Salvador, 1983".\* One of those recommendations was that the debts of land reform cooperatives be analyzed carefully, and that some of these debts be written off or reduced, where it appears that the original loans never actually reached the cooperative (there were some cases of "mysterious disappearance" of funds in the confusion of the first days of the reform).

\* Strasma, Gore, Nash and Rochin, report cited, Checchi and Company, 1983.

### Problems Resulting from Land Debt Calculations

There is also a problem with the land debts: by law, ISTA must pay former landowners the average of the values for land and improvements that appear in their tax returns for 1976 and 1977. It appears that some landowners evaded taxes by declaring values far below what the land was really worth. However, it appears that at least some owners did the very opposite--declared it at more than it was worth. One theory is that they hoped thereby to increase the amount of credit they could obtain from banks. Another theory is that they were perfectly aware that land reform was likely to come to El Salvador, and that in many reforms owners are paid for their land at the values they themselves have declared for tax purposes. Whatever the reason, the fact is that cooperatives with land of the same size and quality may be required to pay very different prices for it, solely because the former owner declared falsely, low or high, but not at the true market value. In the above-cited report, this firm has recommended that these cases be restudied and the land debt modified to a level that can be repaid out of production, taking into account the actual size and quality of the lands involved rather than the amount that ISTA had to pay the former owner. FINATA already determines the price for the land that the beneficiary of Phase III must repay, on the basis of soil quality and potential, rather than on the amount paid the former owners, and we recommend that ISTA do the same. This may require legislation. We believe that the Program of National Economic Reactivation requires the effective participation of the entire private sector, including the campesinos of the agrarian reform. We also believe that if the cooperatives struggle under a debt load they know they can never pay, they may never believe that the land is definitively theirs. They may hesitate to make investments, and may even neglect coop fields and animals in favor of their own, since the very future of the coop is cast in doubt by these overhanging debts.

DIECRA has now analyzed the consequences that could follow a program of partial reduction or forgiveness of these early loans, for a sample of 28 cooperatives for which it has enough data to project their ability to repay their present debts with some accuracy. According to DIECRA, only 6 out of the

28 will ever be able to repay their present debts. However, if those initial loans from 1980 were forgiven, 11 of the 28 would be able eventually to pay off their other debts, including the land mortgage. If the land debt were reduced just 10%, even if the initial loans were kept intact, 13 of the 28 could pay off their debts over time. And if the land debt were reduced 10% and the initial loans forgiven, the number that could eventually get out of debt rises to 15.

A more drastic reduction of the land debts, by 40%, would only increase the number of cooperatives eventually able to pay off their remaining debts slightly: to 16 if the original loans stayed in effect, and 17 if those loans were forgiven. There are 11 of the 28 coops that could not work their way out of debt even if the land debt were cut by 40% and the initial 1980 loans forgiven, and those clearly need more help than simple debt reduction could provide.

#### Communication with the Private Non-reform Sector

In conspicuous contrast with other sub-sectors of the draft PREN, there is no mention in the draft PREN of a Mixed Commission of GOES functionaries and the private sector, to evaluate the development of the agrarian reform and recommend appropriate policy changes. Yet in this subprogram such meetings might be especially helpful in attaining the goals of the PREN as well as of the agrarian reform. For agrarian reform, of course, at least two separate parts of the private sector need to be represented: the campesinos who are the beneficiaries and the principals of the reform, as well as those who speak for the former landowners.

Some of the businessmen with whom this Study Team met seemed only to want to reverse most of the major actions of the last three years. Nevertheless, there are businessmen in El Salvador who accept the agrarian reform as a historical fact and do not seek to reverse it, but do want to make it work better, and they have a lot to offer.

### How to Accelerate Compensation Payments

For example, it is not enough for the PREN to exhort ISTA and FINATA to move faster on the appraisal of expropriated land and the delivery of reserves, cash and bonds to the former owners. There are cases in which the delays are caused by the former owners, whether by flat refusal to negotiate with ISTA, or inability or unwillingness to produce legal documents to justify their claims. Owners who want to frustrate the process may threaten to go into court, or may actually do so, to delay the compensation process. It is hardly fair to blame the staff of ISTA and FINATA alone, for the resulting delays in the settling of compensation claims.

We would recommend the modification of existing laws where needed to enable ISTA and FINATA to complete the process of appraisal and deposit the resulting bonds and cash with a bank, in the name of the former landowner, who could claim them as soon as he was willing to sign a settlement. Meanwhile, the GOES would be legally empowered to go ahead and transfer title to the reform beneficiaries. Former owners would still be allowed to go into court and attempt to change the terms of compensation, but they would no longer be able to exert pressure on the beneficiaries by preventing the transfer of title and adjudication in favor of the future owners of the land. In other words, we recommend separating the dispute over the amount of compensation, from the process by which campesinos come to get titles to their new lands. Legal disputes can easily last for many years, but the PREN wisely requires that the land be assigned now, to those who are to make it produce.

Clearly, enactment of such laws as well as their implementation will be easier if a responsible group of businessmen helps draft them, and then endorses them as the way to get the economy moving while not depriving former landowners of access to the courts if they feel the proposed compensation is inadequate under the laws.

(The amounts indicated in the draft PREN are consistent with amounts given by ISTA in January 1983, for Phase I compensation still awaiting the provision of funds and, in some cases, final determination by ISTA of the exact amount

of compensation due. In other words, there was no progress since October 1982, because ISTA simply did not have the funds to cover the cash payments, a small part of the total compensation due, even for those cases in which the amount due was not disputed.)

#### Uses of Agrarian Reform Bonds

Another area in which a joint study and support by representative beneficiary leaders and businessmen could help bring about the Reactivation, is the proposal that agrarian reform bonds be given some additional uses. The GOES is planning to sell some deficit-ridden industries back to the private sector, and the persons in charge of this liquidation are definitely interested in selling them to persons holding land reform bonds. In this way, they would not only exchange one liquid asset for another, but they would also tell the bond-holders in effect, that although they no longer have a social role running estates of more than 500 hectares, the Salvadoran society has an important role for them: buy these failing industries and turn them around; and make them once again productive, create jobs, export or replace imports, etc. At least some former landowners would probably succeed at this. Others might opt to sell the bonds (which are freely transferable and trade on a small market that has sprung up in the last six months, at 42 to 75% of face value, depending on denomination (the biggest bring the lowest percentage, because relatively few people can use them in payment of death and gift taxes). The buyers of the bonds, having paid much less than their nominal value, could then bid higher for the failing industries, than would other buyers. But since the GOES assumes that it will pay off the land bonds when they fall due, it improves its debt situation considerably if it can take in and retire a large number of bonds in exchange for the industries whose operating losses have to be subsidized.

#### Campesino Uses of the Agrarian Reform Bonds

At the same time, it is politically unrealistic to expect the needed enabling legislation to be passed solely to assist the former landowners. We would suggest that the campesinos also be allowed to use the bonds--which they would buy in the market too--in payment of the land debt and the original

1980 loans. (Obviously, this is another way of reducing the effective amount of these debts.) When they turned the bonds over to ISTA, to which they owe both debts, their accounts would be credited for the nominal value of the bonds, and ISTA would be relieved of a future obligation to pay off those bonds. (Our previous report analyzes the proposal more fully, and goes into an alternative that would solve the cash flow problem that otherwise might affect ISTA.)

#### Resolution of the Phase II Question

In meetings of various private sector organizations, and in their publications (such as those listed as References here), it is clear that one of their greatest concerns--after ending the fighting and restoring law and order to the countryside--is the somewhat uncertain future of landholdings between 100 and 500 ha. While most of our interviewees recognized that the present government is not about to affect these holdings, the Basic Law of Agrarian Reform does call for their eventual inclusion in the reform. Meanwhile, these lands cannot be sold or transferred, even to one's family. They can be sold to the GOES, and FINATA is buying a fair number of them, paying 50% in cash and the rest in bonds.

In Checchi's last report on Agrarian Reform, we analyze this problem and present two possible solutions:

- a) Enact a law authorizing private sale to campesinos, with the seller providing land contract financing (outside the banking system and without a government guarantee of payment), or
- b) Enact a law authorizing such sale of lands up to 200 ha., with FINATA and ISTA continuing to be the only option for lands over 200 ha.

The second option has one main advantage: the Christian Democratic Party was ready to endorse it in early 1982, and probably still would. It would leave some 1,200 landowners free to look for enterprising, reliable campesinos who want to buy land, and thus reduce their holdings to the 100 ha. that in no case would be affected by land reform. Only some 600 owners have more

than 200 ha., so the number of people claiming that the threat of Phase II keeps them from investing, would be reduced.

The first alternative has the advantage that it invites the present owners to find and carry out a constructive alternative to the government-directed land reform without losing sight of the objectives of the reform. Landowners would choose genuine farmers known to them, or among applicants applicants for parcels that would be advertised for sale. They would negotiate a price, without government participation or responsibility. (Under the present conditions, owners who tried to hold out for high prices would probably not succeed in selling, and the campesinos would know the pressure on landowners to sell.)

It is important that everyone understand that bank credit, already extremely scarce, would not be made available for land purchase. Selling landowners would themselves accept a down payment and give payment terms of 10 years or so, to buyers. If the buyers failed to make payments, the seller would foreclose and again have the land--and the threat of Phase II. It is important that the GOES not guarantee payment of this debt, as that guarantee would require GOES participation in the process, and would remove the incentive of the owner to choose carefully the farmer-buyers who would be successful and hence able to pay for the land. Those are precisely the farmers who ought to take on 20 hectares more, as part of an Economic Reactivation Plan.

We have been assured by members of the Council of Agroeconomic Organizations that landowners with 100-500 ha. can indeed identify genuine campesinos who would successfully farm more land than they now have, and who they would trust to make payments on time. This plan would also reduce uncertainty, and move to get that land out of the hands of people who will not invest, and into the hands of others who are willing and eager to make it produce.

We also believe that periodic meetings of these responsible businessmen and campesino leaders emerging in the reform sector organizations would be highly productive, and that much of use in the Economic Reactivation campaign could emerge from such contacts without requiring the GOES to serve as an

intermediary beyond the initial help in getting organized.

There is much that could be done to make the agrarian reform a significant part of the program of national economic reactivation, but it will take policy decisions and implementation of this sort, and not merely the "business as usual, though done more briskly" approach to ISTA, FINATA and the banks that appears in the draft discussion paper on the PREN.

Exhibit IV-1

Comparison of Area Projected for 1983/84 and  
Area Actually Planted in 1982/83

<u>CROP</u>	<u>AREA PLANNED</u> 1983/84 (mz)	<u>ACTUAL AREA</u> 1982/83 (mz)	<u>DIFFERENCE</u> %
BEANS	76,200	79,400	(4.0)
COFFEE	265,700	265,700*	---
CORN	400,400	341,000	17.4
COTTON	80,000	68,000*	17.6
RICE	30,000	16,000	87.5
SORGHUM	200,200#	170,000#	17.8
SUGARCANE	54,000	45,480*	18.7
	<hr/>	<hr/>	<hr/>
TOTALS	906,300 mz	815,580 mz	11.1%

Notes

\* = Provisional estimates.

# = Intercropped with corn, so the area is not added and does not appear in the totals.

Source:

Planned area, October 1982 draft Program of Actions to be Taken to Reactivate the National Economy, Agricultural and Livestock Sector, MINPLAN.

Actual 1982/83 area: MAG, Direccion General de Economia Agropecuaria, latest data available as of 18 January 1983.

Exhibit IV-2

Comparison of Yields Planned for 1983/84  
With Yields Actually Attained in 1982/83

<u>CROP</u>	<u>YIELDS PLANNED</u>	<u>ACTUAL YIELDS</u>	<u>DIFFERENCE</u>
	1983/84 (QQ/mz)	1982/83 (QQ/mz)	%
BEANS	14.0	10.4	+ 34.6
COFFEE	13.2	13.9*	- 5.0
CORN	29.0	26.4	+ 9.8
COTTON	13.0	N.A.**	
RICE	59.0	43.1	+ 13.7
SORGHUM	18.5#	15.9#	+ 16.4
SUGARCANE	60.0	54.5*	+ 10.1

Notes

\* = Provisional estimates.

\*\* = 30.9 Quintals (hundredweight), "en rama" (unginned).

# = Intercropped with corn.

Source:

Planned Yields, October 1982 draft Program of Actions to be Taken to Reactivate the National Economy, Agricultural and Livestock Sector, Ministry of Planning and Development.

Actual 1982/83 Yields: MAG, Direccion General de Economia Agropecuaria, latest data available as of 18 January 1983.

Exhibit IV-3

Comparison of Output Planned for 1983/84  
With Actual Output 1982/83

<u>CROP</u>	<u>OUTPUT PLANNED</u> 1983/84 (CWT)	<u>ACTUAL OUTPUT</u> 1982/83 (CWT)	<u>DIFFERENCE</u> %
BEANS	1,100,000	830,000	+ 32.5
COFFEE	3,500,000	3,690,000*	- 5.1
CORN	11,600,000	9,000,000	+ 28.9
COTTON	1,040,000	n.a. **	
RICE	1,800,000	770,000	+133.8
SORGHUM#	3,700,000	2,700,000	+ 37.0
SUGARCANE	3,100,000***	2,478,660***	+ 25.1

Notes

- \* = Provisional estimates.
- \*\* = Not Available.
- \*\*\* = Short tons of sugarcane. 1 short ton yields about 190 pounds of sugar, according to MINPLAN.
- # = Intercropped with corn.

Source:

Planned area, October 1982 draft Program of Actions to be Taken to Reactivate the National Economy, Agricultural and Livestock Sector, MINPLAN.

Actual 1982/83 area: MAG, Direccion General de Economia Agropecuaria, latest data available as of 18 January 1983.

SECTION V  
CONSTRUCTION SECTOR

This sector analysis is divided into four distinct parts, consisting of six sections. The first section - A - is a summary and critique of the Construction Sector of the PREN. The second section - B - contains the reactions of the public and private sector to the PREN. This information was gathered from interviews with representatives of both sectors, as well as from published documents and papers. Sections C through E cover the various policy, economic and planning factors affecting successful implementation of the PREN. Finally, the last section provides recommendations.

A. Summary and Critique of the Construction Plan

According to the PREN, its overall purpose is to structure a framework through which an action oriented program can contribute to the immediate reactivation of El Salvador's economy. Further, the key element in reactivating the construction sector is to identify bottlenecks currently inhibiting reactivation, whose resolution will ensure the success of the program.

Construction Sub-Sectors

The construction sector is classified in seven sub-sectors:

- Housing (the formal part)
- Urban Development
- Water and Sewage
- Highways
- Special Projects (port; hydroelectric complex)
- International Technical Assistance
- Infrastructure Works carried out by other Ministries and GOES Agencies

The construction sector, when broken down into these sub-sectors, excludes several major components. One is informal housing activity which during normal times accounts for as much as 60 percent of total investment in housing. This includes almost all rural housing, all illegal and self-help housing built in and around the cities and especially San Salvador, and in some cases, minimum standard housing built without the benefit of

assistance from formal financial and development institutions. The impact of this informal sector on the economy is significant; for some areas, say building materials suppliers, it would appear to play a major supporting role as even poor people purchase some building supplies.

A further limitation of the PREN is that the sub-sectors are classified somewhat capriciously. While housing is the responsibility of several institutions, and urban development the stepchild of numerous agencies, the water and sewage sub-sector belongs exclusively to ANDA (Water and Sewage Authority), and roads and highways to MOP (Ministry of Public Works). Yet both the latter are basic infrastructure activities. Development of the hydroelectric complex and the port are classified as special projects, but in fact are infrastructure projects also. International technical assistance supports many of the sub-sectors, but is not a construction program or project. Finally, the infrastructure support sub-sector appears to be a catch-all for construction activities carried out by other government agencies not included in any of the other sub-sectors. Dividing the sector along these lines confuses outcomes with funding sources.

In addition, the almost complete exclusion from the PREN of any mention of commercial development and construction activities ignores one of the most depressed, if not the most depressed construction area. The construction of office buildings, commercial establishments and industrial plants is at a virtual standstill. While this demonstrates the almost complete lack of demand today, the fact that El Salvador has established a strong commercial and industrial base over the years would indicate that once idle capacity is put to use again, renewed commercial construction activities would reinforce other construction sub-sectors in reactivation.

A more logical classification of sub-sectors would be as follows:

- Housing (formal and informal).
- Basic Infrastructure (water & sewage, energy, communication, roads, ports, airports).

- Social Service Public Works (clinics, schools, community centers and buildings, government administrative building, police posts, etc.).
- Commercial construction.

Such a classification would permit the program's developers to set construction priorities better, and to identify productive individual projects with more surety.

#### Project Selection Criteria

The most glaring weakness in the PREN construction plan is that there is no formal list of criteria for selecting the most appropriate sub-sectors to carry out PREN objectives, nor are there any criteria for choosing particular projects. Is housing, for example, a better sub-sector to invest in to help reactivate the sector than, say, investments in Social Service Public Works? And is construction of low income housing a better housing reactivation activity than middle income housing?

Conversations with MINPLAN (Ministry of Planning) indicate that projects were selected, not by a standard set of criteria or economic analysis principles, but rather in a more informal manner. Each Ministry and GOES Agency was asked to supply MINPLAN with a list of projects planned or considered for development during the reactivation period. MINPLAN then subjected each project to financial scrutiny to determine if funds had been allocated or obtained. Those without ready financing were discarded. Further adjustments were, and are still being, made to the PREN to ensure the reactivation projects coincide with the national budget, and to incorporate changes and increases resulting from foreign assistance programs.

This is not to say that the projects selected will not satisfy economic reactivation needs, but rather that there is no way of determining if they in fact may do so. It appears that the PREN is at best a refinement of the national development plan with certain projects culled out to fit the expected exigencies of the Economic Reactivation Program.

How should construction activities be selected so as to make the greatest impact on the national economy? The consultants, after complete analysis of the construction sector, the country's current economic situation, the constraints on the particular sector, social and political realities suggest that such criteria are available. While availability of funds is clearly a sine qua non, there certainly must be other considerations. Given that this plan must be initiated and most of the funds spent within 10 months, proposed projects must be essentially planned and ready for execution virtually tomorrow. Jobs help create demand, so employment generation aspects should be taken into consideration. Foreign exchange is a crucial element in the supply of materials and equipment: so projects using minimal amounts of hard currency should be given a higher priority. Further, local building material manufacturers are producing well under capacity. Thus, projects that use local materials instead of imported materials should be rated higher. Projects that generate income, especially foreign exchange, and are self-supporting through fees or loan repayments must be classified differently than non-income generating projects.

These are only the most important considerations in selecting projects. It is recommendable that such a list be compiled by MINPLAN, a rating system developed, and each proposed project subjected to evaluation prior to final inclusion in the PREN. In Section F, on recommendations, we suggest a quantitative method to qualify potential projects for inclusion. Certainly such considerations can be included in next year's planning process.

It should be noted that the PREN does discuss the employment generating aspects of the Program. However, it treats employment as a result or program output, not as one of the criteria for selecting programs or projects. In a country with more than 350,000 unemployed, employment generation is important to reactivation. Based on information given in the PREN for 1983, the investment required to generate one person/month of employment is shown below.

TABLE Y-1  
INVESTMENT PER PERSON/MONTH OF EMPLOYMENT-1983

Sector	Investment <sup>1/</sup>	Person/Months	Investment Per P/M
Housing	¢ 243.0	119,040	¢2,042
Urban Development	82.4	56,148	1,469
Water & Sewage	54.0	58,644	9,210
Highways	151.2	58,560	2,584
Infrastructure Support	173.4	313,836	552

<sup>1/</sup> Millions of colones

Source: PREN - Construction Sector and Checchi calculations.

Employment generated in the housing sub-sector appears to be in line with estimates from other housing projects. It appears that the estimate for urban development and highway projects are also relatively accurate. Proposed water and sewage projects will not generate much employment vis-a-vis other sub-projects because of the need for large amounts of heavy, costly, construction equipment and expensive materials. The latter includes steel pipes, valves, pumps, etc., most of which are imported.

However, the estimate of 552 per person/month of labor for the Infrastructure Support sub-sector appears far too low. Roughly 60 percent of the jobs generated here are attributed to the ORE (Oficina de Recursos Especiales) Program; which is designed specifically to generate employment. Employment figures from ORE show that each new job requires an expenditure of 598 per month, based on a 22 day month. Given that the other 40 percent of investment in the urban development sub-sector is in more conventional construction

projects - requiring at least the same level of inputs as housing construction - it is hard to understand why all jobs generated in this sub-sector are estimated at a cost inferior to the ORE program.

#### Factors that Constrain the Construction Sector

As mentioned earlier, the PREN places strong emphasis on the bottlenecks which prevent the construction sector from operating at maximum capacity. Maximum capacity can generally be defined for the purposes of this report as that period when construction activities are operating under normal economic circumstances. According to sector data, construction investment by the private sector reached an all time high of 224.9 million in 1978. Commercial construction that same year reached 75.7 million. By 1981, private sector commercial investment had fallen to 7.2 million, the latest year for which complete figures are available). It is highly unlikely that the commercial construction activities in 1982 exceeded the 1981 figure. (See table V-2 in following page).

What are the bottlenecks?

The PREN divides them into two categories: exogenous and structural factors. The exogenous or primary factors appear to be factors over which the construction industry has no control, for example, political and military problems. But the paper also includes as an exogenous factor changes in the housing sector which today emphasize the development of lower cost housing to meet the demand of low-income families rather than other more affluent sectors. Whether this is an exogenous factor is questionable.

Structural or secondary factors are those factors over which the construction industry has some control. They are:

- internal capacity of the construction industry to meet demand (lack of coordination, non-availability of financing, bureaucratic inertia, etc.)
- shortage of construction materials
- inability to meet water and energy needs for new projects.
- unsold inventory of upper income housing.
- no housing market data.

TABLE V-2  
PRIVATE SECTOR CONSTRUCTION INVESTMENT<sup>1/</sup>  
(millions of colones)

Investment by Sector				
Year	RESIDENTIAL	INDUSTRIAL	COMMERCIAL	TOTAL
1975	47.0	3.2	36.7	86.9
1976	72.5	7.1	22.0	101.6
1977	132.8	2.6	42.4	177.8
1978	147.3	1.9	75.7	224.9
1979	132.8	8.3	74.8	215.9
1980	116.3	9.4	31.8	157.5
1981	161.9	1.0	7.3	170.2

<sup>1/</sup> Based on building permits, and therefore does not include most informal sector construction, nor public works construction.

Source: Ministerio de Planificación

The PREN implies that the five factors will equally affect the success of the Plan, however, it does not state that these factors cannot be and are not being controlled to the degree necessary to implement the Plan. The construction industry, while certainly needing improvements, is building more housing than ever before, particularly low-income housing. Shortage of construction materials has caused delays and increased costs, but the sector has not been shut down. Builders and developers are settling the problem of water and energy supply by drilling wells on-site, running sewage lines to collectors, and hanging electric wires to the closest transformer. Unsold houses are tying up housing capital and endangering some institutions, however, these are not critical constraints for the PREN. And while additional statistical information and analysis on the housing market would be useful, this is a long-term need, not a short-term need. Thus the PREN raises as critical constraints those which are currently being handled, while ignoring far larger issues.

#### Private vs. Public Sector Involvement

In the PREN, private sector construction is not covered in the same amount of detail as the public sector. The PREN seems to regard the private sector as an individual investor or consumer who has withdrawn from the sector because of his fear of political instability.

In some minor cases this is true. However the majority of the industry is hard at work, shifting emphasis away from the commercial and upper income housing to lower and middle income housing, and, at the same time, working with government to construct public works projects.

#### Sector Objectives

The PREN states that there are six program objectives:

- Contribute to the reactivation of the economy
- Improve living conditions through better services
- Generate employment
- Provide more housing

- Improve water and sewage systems, and
- Improve major infrastructure.

Essentially this reduces to one major objective: to reactivate and, thereby rebuild that sector. While in the short run -- 1983 -- it is highly unlikely that the construction sector will return to the halcyon years of the late seventies (see table V-2), some measurable growth rate should be achievable.

Four of the remaining six objectives enumerated in the PREN are actually methods by which the goal will be attained. The final objective -- generating employment -- while a type of objective, is both a contributing factor and an end product, depending on the types of projects.

The key word, as described in the PREN, is reactivation or redevelopment. New projects will be built and old projects rebuilt and maintained, but the idea is to simply get the economy back to where it was, not develop the economy.

To attain the objective, the PREN states that:

- Institutions must coordinate
- Plans must be prepared
- Financing must be obtained
- The problem of unsold upper-income housing must be studied and then resolved, and
- Materials must be supplied.

Certainly, these short-term actions must occur for the PREN to be successful. Plans for projects have already been prepared; if not, it may be too late for implementation this year. Financing is supposedly available for all projects. Foreign exchange must be channelled to building material manufacturers and suppliers, and the institutions must coordinate with one another. It should be stated once again that while the problem of unsold

housing may be of utmost importance to some, its disposition should not affect the implementation of the PREN.

MINPLAN considers the above activities to be "global" while the following activities are more specific undertakings.

- Revise land use legislation and modify building codes and standards
- Coordinate the supply of water and energy to projects built
- Undertake housing demand studies
- Study the use of agricultural tax receipts for housing
- Obtain technical assistance
- Promote the use of housing cooperatives, and
- Prepare urban development plans.

#### Source of Financing

The PREN recognizes the importance of the availability of financing. Financing has, in fact, been the principal, if not only, criterion used in project selection. For 1983, MINPLAN has budgeted 818.7 million for achieving this plan.

Roughly 50 percent of the investment in the PREN Program will derive from foreign sources in the form of loans and some grants. Major lenders are AID, IDB BCIE, IBRD and FIV (The Venezuelan Investment Fund). While all these monies have been allocated or committed, it is still possible some loans will not materialize. For example, the 40 million that BCIE has authorized for urban development projects may not be forthcoming due to lending constraints.

Contributions to the construction sector by the international finance agencies are crucial. For every colon generated internally, one colon is made available from outside the country. It is therefore most important for MINPLAN to be assured of financial commitments from external lenders in order not to jeopardize the execution of the Plan.

TABLE V-3  
FINANCIAL SOURCES AND INVESTMENT - 1983

Sub-Sectors	Investment by Source			Total Investment
	Internally Generated	Domestic Loans	Foreign Sources	
Housing	117.3	57.0	68.7	243.0
Urban Development	--	42.4	40.0	82.4
Water & Sewage	4.0	2.7	47.3	54.0
Highways	--	73.6	77.6	151.2
Special Projects	6.7	0.1	104.8	111.6
Technical Assistance	--	--	3.2	3.2
Infrastructure Support	65.9	48.2	59.2	173.3
	<u>193.9</u>	<u>224.0</u>	<u>400.8</u>	<u>818.7</u>

Source: PREN - Construction Sector

The remaining 50 percent will be generated from tax revenues, half through domestic loans and half from several participating institutions (like housing finance agencies) which are capable of generating funds internally. Several sub-sectors depend heavily on external funding for the bulk of their funds - the water and sewage projects receive 88 percent of total funds from such sources, and special projects (the port and hydroelectric complex) receive 94 percent. On the other hand, the housing subsector will raise only 28 percent of its required investment from external sources, while the infrastructure support sub-sector will receive only 34 percent.

### The Sub-sectors

The Construction Sector contains a chapter on each sub-sector which provides detailed objectives for each sector, investment and financial inputs, and other relevant information. The data base and areas covered are not equal in all sub-sectors, but rather dependent on what information MINPLAN was able to obtain from the participating institutions, or to develop independently.

The sub-sector chapters are riddled with the same problems that affect the overall PREN. First only basic details of each of the projects are available. Many of the questions as to how, what, where are not elaborated on. Secondly, none of the projects are new, but were lifted from existing GOES programs and retitled economic reactivation projects. There is no new project which adds to the overall stock of construction projects. Thirdly, no new financing is involved, and in fact, the 1983 GOES budget does not always agree with the PREN, particularly with respect to external financing. These divergences are covered in greater detail below. Finally it should be emphasized that the objective and goals in some of the sub-sectors do not conform to the overall reactivation objectives.

#### a) Housing

The objective of the housing sub-sector is to provide greater housing opportunities, especially to low income and rural families, and to improve

coordination between institutions providing infrastructure services. Market conditions will determine the allocation of scarce housing finance resources. The goal will be to produce 23,557 units of housing in 1983, an average of 2,000 units per month. This construction will involve approximately ₡243 million (see Tabel V-4).

The PREN encompasses housing financed by five Government, Parastatal and private sector institutions. They are:

- IVU (Instituto de Vivienda Urbana)
- FNV (Financiera Nacional de la Vivienda) which includes the eight savings and loan associations.
- FSV (Fondo Social de la Vivienda)
- FUNDASAL (Fundacion Salvadorena de Desarrollo y Vivienda Minima)
- SSVDU (Subsecretario de Vivienda y Desarrollo Urbano).

The first three are quasi-governmental agencies (parastatals); the fourth is a private, non profit foundation, and the last is a part of the MOP.

TABLE V-4  
PLANNED HOUSING PRODUCTION AND INVESTMENT - 1983

<u>Institution</u>	<u>Units Planned</u>	<u>Investment<sup>1/</sup></u>	<u>Average Investment Per Unit</u>
IVU	1,178	27,054	22,966
FNV	13,830	138,059	9,983
FSV	4,002	68,873	17,210
FUNDASAL	4,147	6,000	1,447
SSVDU	400	3,000	7,500
Total	23,557	242,970	10,314

<sup>1/</sup> Thousand of colones

Sources: PREN Construction Sector, and Checchi

Before discussing the likelihood of meeting the targets, there are several other issues to discuss. Based on the breakdown of planned units and investment by each institution, production of units per colon investment varies widely.

Conversations with representatives of each institution indicate that the average unit cost for IVU and FSV housing is quite close to what they expect to invest in 1983. However, the figure for FNV, about ₡10,000, reflects S & L's (Savings and Loan Association) construction loans only, and is clearly on the low side. Over the years, and including last year, the average S & L construction loan was for ₡15,900 (₡14,950 in 1982), while the average cost per unit was ₡22,800 (₡20,331 in 1982). The probable explanation is that many of the homes whose construction is financed by the S & L's are purchased for cash or financed by the informal sector. That being the case, it is likely that the total investment in housing of the other four institutions is much higher than indicated in Table V-4.

It is also unlikely that FUNDASAL's average unit will cost ₡1,450, or thereabouts. The lowest priced unit FUNDASAL has built to date was in a rural project, where there were no land purchase costs, infrastructure was minimal, walls were constructed of mud and wattle, and actual construction was carried out by the occupants. This unit was built at a material only cost of ₡1,350. Also, FUNDASAL's site and service only projects usual cost in excess of ₡1,450.

In the case of the fifth institution, SSVDU, no units are being planned this year and the 400 unit production figure is therefore incorrect. Thus, we can expect that for all units projected under PREN the cost will actually be considerably more than stated, or fewer units will be built for the same amount of investment.

TABLE V-5

ANNUAL HOUSING PRODUCTION BY INSTITUTION  
(Number of Units)

<u>Year</u>	<u>IVU</u>	<u>FNV<sup>1/</sup></u>	<u>FSV</u>	<u>FUNDASAL</u>	<u>SSVDU<sup>2/</sup></u>	<u>Total</u>
1976	968	3,246	1,918	986	---	7,118
1977	1,022	5,286	2,239	1,190	---	9,737
1978	902	3,885	1,876	1,216	---	7,379
1979	960	3,407	3,583	798	---	8,748
1980	148	7,782	2,870	1,200	---	12,000
1981	924	9,566	2,919	966	---	14,375
1982(e)	1,052	12,238	6,827	n.a.	---	20,117

<sup>1/</sup> Production by all Savings and Loans is grouped under FNV. Included in FNV figures are units whose construction is financed by the Savings and Loans, but mortgage financing is provided by FSV. Of total units in 1982, 5,917 were provided long-term financing by FSV.

<sup>2/</sup> SSVDU was created in 1979 and to date has not financed any projects.

Sources: IVU, FNV, FUNDASAL, SSVDU

The plan states that 23,557 units will be built by these five institutions. This seems reasonable in that the largest number built to date was 20,117.

TABLE V-6  
COST BREAKDOWN FOR PREN HOUSING - 1983

<u>Category</u>	<u>Investment<sup>1/</sup></u>	<u>Percent</u>
Salaries	91.61	37.7
Imported Materials	24.05	9.9
Local Materials	78.82	32.4
Equipment (depreciation)	2.67	1.1
Legal and Financial	45.92	18.9
	<u>242.97</u>	<u>100.0%</u>

1/ Millions of colones

Sources: PREN, and Checchi calculations

The plan estimates that imported finished goods for use in the construction of a 36m<sup>2</sup> unit will equal 9.9 percent of total construction cost. Added to the percentage figure is the total amount of imported ingredients or raw materials required by local manufacturers to produce other materials. The total percentage of imported produce for type of unit is estimated at 15%. For more expensive housing incorporating a higher degree of luxury, the percentage would increase.

b) Urban Development

The objectives of the Urban Development Sub-sector are to make better use of urban land, equalize population distribution in the cities, and preserve the urban environment. To accomplish this, some 50 urban development projects are proposed under the PREN.

A review of the project list indicates that they will most likely not meet the stated objectives. In the first place all are road projects, which, for the most part, will be directed to opening new streets or widening and improving existing streets. While this might lead to better use of urban land, there is nothing in the PREN to demonstrate that. Moreover all the projects are located in the San Salvador Metropolitan area. It is possible that some of the 12 or so projects not specifically identified may be for other urban purposes or in other cities, but the PREN does not offer any assurance of this.

Another problem is that the projects are in various stages of pre-construction development. The first eight projects still require technical and economic studies to determine their feasibility. It is highly unlikely that these eight projects will be ready for implementation this year. Nine additional projects, (a second list) have undergone feasibility and preliminary design, and appear ready for initiation this year. The same appears to be true for a third list of 21 street projects.

One project listed is the construction of the East-West auto-route in the San Salvador Metropolitan area. The total cost of this project is ¢121 million of which ¢12.2 is expected to be disbursed this year. Initiation of the project is planned for late 1983, with completion in 1986. A loan application has been submitted to BCIE to cover the bulk of the required financing.

Investment in 1983 for the urban development sub-sector is budgeted at ¢82.4 million. Approximately half, or ¢40 million, will be provided by

the BCIE. In the event BCIE does not provide all or part of its expected commitment, the programs would be in jeopardy.

c) Water and Sewage

The objectives and goals of this sub-sector are the clearest and most rational of any of the sub-sectors described in the PREN. The objectives are to provide water and sewage services throughout the country, coordinate with other related institutions, exploit and preserve in a rational manner hydraulic resources, and prevent environmental damage. To reach these objectives, programs described in the PREN will result in:

- Completion of the remaining 25% of the 1st stage Zona Norte water supply project.
- installation of 10,000 new water hook-ups providing service to an additional 70,000 persons.
- Construction of 58 water projects and 34 sewage projects, through ORE.
- Construction of 25 rural water systems.

Activities in this sub-sector will be carried out by ANDA. Total investment in 1983 is expected to reach \$54 million, of which \$47 million will come from external sources (BCIE, AID, and BID). Details of the projects in this sub-sector are less comprehensive than the description of the objectives goals; it is therefore difficult to make additional comments on activities under this subsector.

d) Highways

Again this sub-sector is very clear in its objectives and goals, but even less information is provided about the projects and their implementation. Objectives include provision of road infrastructure, incorporation of potentially productive areas of the economy and maintenance, improvement and expansion of the existing road network. Specific goals are to construct 403.4 kms. of additional roads and four bridges, rebuild 22 bridges, improve 1,960 meters of drainage lines, and place road signs along 1,575 kms. of highway.

This program will be carried out by the Direccion General de Caminos of the Ministry of Public Works. Total investment will reach  151.2 in 1983, almost equally divided between external (BID and BCIE) and internal loans. The PREN provides a list of the proposed projects, many of which are already being developed using internal financial sources. As for other projects, it is impossible to determine their stage of development or whether financing is confirmed.

### 3) Special Projects

Two major construction projects merit sufficient attention to be set apart in a special projects sub-sector. They are the San Lorenzo Hydroelectric Complex and the Fishing Port and Facilities in La Union Province. In the case of the hydroelectric complex, the objective is to increase the electricity supply, thereby reducing energy imports, while the goal is to complete an additional 14% of the project to attain 94 percent completion.

Investment in the Hydroelectric plant is budgeted at  108 million in 1983, with  101 million derived from a number of external lending institutions. The objectives of the port complex are to strengthen the capacity of the fishing industry, thereby improving living conditions and the nation's diet. Accordingly, the goal is to install an additional electric plant, with accompanying fuel storage facilities, construct a number of housing, administrative commercial, support and infrastructure facilities.

Investment in the fishing complex is much more modest,  3.5 million in 1983, most of which appears to derive from French sources.

### f) International Technical Assistance

The PREN proposes that \$1.27 million in grant money be used for technical assistance projects in housing, urban development, water and sewage, and sectoral planning. However, technical assistance supports development activity: in itself it is not a reactivation or reconstruction activity. Moreover, as described, the seven proposed projects will not necessarily help rejuvenate the construction sector and its sub-sectors, nor does the PREN say or even imply that they will. Technical assistance should directly

support a particular program or project identified in the PREN or lead to the resolution of a short-term bottleneck holding up the implementation of a project. If that were the case, technical assistance could be integrated into the PREN as a sector or sub-sector.

g) Infrastructure Support Projects

This sub-sector includes construction projects by GOES Ministries such as MAG, with 17% of the total, Ministry of Education (20%), Ministry of Health (10%) and Ministry of Interior (48%). The projects range from irrigation systems and schools to telecommunications networks, for a total investment of  173.4 million. As in other sub-projects, it appears that these projects derive from current programs. There is no indication that these projects will add to the reactivation of economy. The objective of this sub-sector covers usual development aspects (improvement of the quality of life, infrastructure, etc.).

## B. Private and Public Sector Reactions

### Major Concerns of the Private Sector

The Private Sector is as concerned about the deterioration of the Construction industry as GOES. The PREN states that all construction sector activity fell by 65.7 percent in 1980 as compared to 1979<sup>1/</sup>. Statistics released by MINPLAN show that the value of private sector construction decreased from ¢225.0 million (in current colones) in 1978 to ¢170.2 million in 1981 (see table V-2). CASALCO (Salvador Chamber of Construction) estimates that only 40,000 workers are employed today in construction activities compared to 70,000 at the peak a few years ago. Regardless of the statistic used, all agree that the situation is grave.

The private construction sector consists principally of architects, engineers, builders, developers, and building material suppliers. Previously, the influential savings and loan institutions were counted among this private sector, but with the nationalization of the banking system, they function more like public sector organizations. The construction industry speaks through CASALCO. While preoccupied with the overall problems of the industry, the builders, who often design and promote housing projects as well, and material suppliers, have principally focussed on their short-term problems.

These problems, which some might call minimal, are very real to a businessman who must meet a payroll, and who might find himself on the brink of bankruptcy if he cannot sell his product in the current market.

### Unsold Inventory of Housing

Foremost in the minds of private businessmen in the housing sector, is the huge inventory of unsold, expensive houses and apartments, some of which are only partially completed. The outstanding balance of this inventory as of the end of October, 1982, was ¢138.9 million, including ¢37.8 million in unpaid interest. Contractors own these properties, and their equity position

<sup>1/</sup> Revista - Banco Central de Reserva, 1982, page 75.

is estimated at only 20% of the total.<sup>1/</sup> Savings and loan associations have provided construction financing for approximately 75 percent of the initial investment, while suppliers and sub-contractors are owed the remaining 15 percent.

The current liability of the Savings and Loans alone has increased today to \$113 million, or 81.4 percent of the outstanding value of the properties, due to capitalization of the unpaid interest. Given that the consolidated capital and reserves of the Savings and Loan Associations is \$49.4 million (as of September 1982), foreclosure on this debt would jeopardize the financial health of some, if not all, of the institutions. The builders and suppliers, whose liability is less, appear to be more concerned about this problem than the Savings and Loans, whose potential loss would be greater.

The most obvious solution is to sell the properties; however, the almost complete collapse of demand for housing in the upper income range for properties valued at more than \$100,000 prevents this solution.

The absence of sales and foreclosures, and the non-payments of interest by builders, create a situation which is totally deadlocked. Currently no one is willing to suffer a loss, but this reluctance represents the greatest danger to the major investor, the Savings and Loans. Bankruptcy of the Savings and Loan system would damage the housing industry irreparably.

Resolution of this problem through sale of the properties would undoubtedly give a boost to the housing industry. Suppliers would receive an immediate injection of \$15 million, and contractors \$10 million, all of which could be reinvested in housing projects in the stronger middle and lower income markets. On the other hand, sale of the properties would not necessarily generate more funds for lending by the Savings and Loans. Mortgages offered

<sup>1/</sup> This is CASALCO's estimate; one Savings and Loan Association Manager estimated this figure at 5 percent.

by the Savings and Loans to buyers of these units would amount to approximately \$125 million (assuming 90 percent mortgages), an amount greater than the total of the construction loans and unpaid interest. Actually, the Savings and Loans might have to reduce the amount of mortgage loans to open markets or the amount of construction loans. Only if a significant amount of the money used to purchase this housing came from outside the formal housing finance sector, would the resolution of this problem result in additions to the supply of housing finance.

#### GOES Contracts

A second concern of the Private Sector has to do with the large amount of GOES contracts with, and outstanding bills owed to, builders and suppliers. These are for the most part public works projects contracted out to private builders by various GOES ministries and agencies (MOP, Ministry of Education, Ministry of Health, and others). They include those bids submitted but not yet adjudicated, contracts awarded but not contracted, suspended contracts and projects which have been completed, but with final payments not yet made. The total amount of these works was calculated in September, 1982, at \$80 million. Contractors rightly claim that merely moving this money would give a strong boost to the construction sector.

#### Foreign Exchange

A third problem involves the lack of foreign exchange, which affects all sectors of the economy. While in some construction projects, for example low-cost housing, the foreign exchange component may be low in comparison with other types of projects, the lack of a single imported material may stop or delay any project, resulting in losses and/or overruns.

In addition to availability, the builders are also concerned about material costs. Building materials do not receive priority rating from the BCR for the purchase of official foreign exchange. Therefore, material suppliers and manufacturers often have to turn to the parallel market for foreign exchange, thereby increasing housing costs. Further, since the normal processing period for official foreign exchange is 120 days (for non-priority items, longer) and for the parallel market 90 days, delays add to the costs.

### Supply of Water and Electricity

Water and electricity supply to new housing projects are very much a builders concern. Most new housing projects, particularly those in the San Salvador Metropolitan Area, are built beyond existing water and sewage mains and electrical distribution points. In some cases, tardy hook-ups delay initiation of housing projects. In other cases, projects are completed but occupancy delayed due to lack of utility hook-ups. Normally, service is supplied by the utility companies to the site at the latter's expense, while distribution within the project's boundaries is a project expense. Many builders, particularly those developing projects for the parastatals, have had to either dig wells for water, or run sewer lines off-site to collectors, or hang electrical lines to the nearest mainlines. If any of these actions is required, the cost of the project increases.

### Interest Rate Structure

Finally, the private sector is preoccupied with the disparity in interest rates and other loan conditions. Mortgage rates can range from as low as 5% (by FSV) to rates offered by the Savings and Loan Associations which start at 16.5%. This means that an FSV-financed unit may have monthly carrying costs (principal and interest payments) as much as one-third less than a similar unit mortgaged by a Savings and Loan. This gives a distinct advantage to a builder who is able to obtain FSV financial backing.

High interest rates to borrowers reflect the cost of money to the lender. FSV pays 1 1/2 percent on accounts with its 175,000 savers, from whom it obtains the bulk of its lending capital, while the Savings and Loans must pay anywhere from 9.5% to 16.5% to savers. Needless to say, the Savings and Loans are making fewer long term mortgage loans, and the Banco Hipotecario's participation in the mortgage market is virtually nil today. Varying interest rates are tending to force some financial institutions out of the mortgage market, thereby reducing further the amount of money available for housing.

TABLE V-7  
MORTGAGE INTEREST RATES

<u>Institution</u>	<u>Mortgage Loans<sup>1/</sup></u>	<u>Construction Loans<sup>1/</sup></u>
IVU	7-11%	7-11%
FNV	--	11.5 - 16.5
Savings and Loans	16.5 - 18.5	16.7 - 20.0
FUNDASAL	up to 6	---
FSV	5 - 8	---

<sup>1/</sup> If applicable

Source: Financiera Nacional de la Vivienda

The PREN does not offer solutions to any of these private sector problems or concerns. It does admit to the existence of the problems of unsold housing, difficulties with utility hook-ups and supply, and shortages of materials due to foreign exchange restrictions, and suggests that something should be done to resolve them. Since no specific solutions are suggested, private sector reaction to the PREN is neutral, or, worse, negative.

However, overriding all these concerns, is the need for additional financing to carry out all the planned, and necessary, construction projects in the public sector. A few examples should suffice. MOP currently employs about 24,000 low- or unskilled workers in a variety of construction projects. The Minister of Public Works states that his ministry not only has the

institutional capacity, but also has identified enough projects to increase this work force by at least 75 percent, to 42,000. The Ministry lacks the funds to do so. ANDA's budget for construction of water and sewage projects for 1983 is only ₡8.8 million. Given the magnitude of the needs in this critical area, particularly in small towns and villages, ANDA could clearly expand its scope of operations. The Sub-Secretary for Housing and Urban Development has prepared, or has in preparation, urban development plans for thirteen secondary cities and towns. In just one town, La Libertad, urban construction projects costing ₡4.5 million have been identified. But this organization has no funds to invest in these projects. As a final example, FSV owns two building sites, with infrastructure completed on one site. There are 2900 units planned, but the FSV lacks the estimated ₡41 million to finance those projects.

At nearly every institution or business, the plea was the same: provide more funds (in some cases, foreign exchange) and we will be able to increase our operations. Only at one institution did management indicate that expansion of operations was not planned. Due to overexpansion, and internal administrative difficulties, FUNDASAL plans to reduce its housing operations this year.

It is clear that both demand and institutional capacity are generally in place. The infusion of additional funds is the ingredient most needed to accomplish reactivation of the construction industry.

As the PREN does not identify new sources of financing for the public sector nor suggest policy or regulatory solutions to existing problems, it does not adequately provide for public sector activity in reactivation.

### C. Policy Parameters and Constraints

Reactivation of the economy and the construction sector will require additional funding. This is true of the public sector, through which nearly all financing is funneled, as well as the private sector, which is the principal instrument for implementation.

Traditionally, financing for construction has derived from the following sources:

- GOES budgetary funds
- Domestic borrowing
- External loans, and
- Service fees and loan repayments.

#### GOES Budgetary Funds

Conversations with Ministers, institutional Presidents and Managers indicate that there is some possibility of supplemental funding from the GOES. The GOES, through the BCR, will be able to make an additional \$500 to 600 million available to the Ministries and other Agencies for a variety of uses in 1983. The funds can be made available in the form of loans, with or without interest, or advances, depending on the use of the funds. Most likely, the BCR would purchase the notes or bonds issued by borrower institutions, particularly a parastatal borrower. The GOES will not be able to generate any additional tax revenue.

#### Domestic Sources

Domestic borrowing through the sale of notes, bonds, or mortgage participation are not being used today to raise funds for investment in housing. Savings generated by the Savings and Loan system continue to show steady growth, due to the GOES policy of permitting the Savings and Loans to charge a one point higher interest rate on pass-book savings than commercial banks. However, due to the high cost of those funds to the Savings and Loans vis-a-vis the cost of funds to FSV, additional savings in the Savings and Loans will be used principally to increase the number of construction loans, rather than provide long-term mortgage loans.

### External Loans

External loans from some institutions for the construction sector appear to be decreasing rather than increasing. In November, 1982, the World Bank postponed indefinitely a number of proposed projects in El Salvador, including loans for a \$30 million low-income housing project, another \$30 million for expansion of Acajutla Port, and \$7 million to prepare a number of water and sewer projects. All of these projects would have contained major construction components, and/or generated employment. Moreover, the BCIE appears to have postponed a \$40 million loan for construction of urban development projects.

AID has been increasing its construction-related assistance to El Salvador. The Employment Generation Project (#519 - 0256) has provided 6.1 million person/days of work in the past two to three years, and contributed to the construction and improvement of many public works. However, none of the funds have been channeled through the private sector, except indirectly to subcontractors for a few services or equipment rentals. The Public Services Restoration Project (#519 - 0279) has reconstructed destroyed or damaged vital structures (bridges, telephone poles, and telephone lines). No additional funds are planned for the Employment Generation Project in 1983 (although some funds budgeted previously remain to be spent), while \$14.3 million is budgeted for Public Services Restoration this year.

The HIG program \$5 million in authorized but uncontracted funds available for 1983, while an additional \$10 million from this same source is budgeted for this year. In theory, HIG funding could be increased.

### Service Fees and Loan Repayments

Fees for services provided, such as water supply, and repayments of mortgage loans, will continue to be a steady source of funds for many institutions.

No spectacular increase in these sources is anticipated however.

#### D. Economic and Institutional Factors

There are several possible economic constraints that might affect the successful design and implementation of the reactivation program. Many of the constraints enumerated in the PREN, such as supply of materials, institutional capacity, and supply of water and electricity are quite legitimate. What the PREN did not cover was the degree of gravity of each, or how the constraints might be overcome. This area has been generally covered in the critique of the PREN (section A); however, three areas deserve more in-depth discussion here.

We include an analysis of and suggestions for the use of various institutions which might be involved in the resolution of these constraints, and thus the success of the reactivation program.

#### Construction Materials

Over the past several years, the supply of construction materials has become a problem to the industry. There are several causes. The most prominent is lack of sufficient foreign exchange to import finished goods, or raw materials for the manufacture of building materials. This has in some cases led to shortages which in turn has caused construction delays and increased costs. Lack of demand due to a declining economy and a slow-down in construction activity has resulted in reduced production, which has forced a few construction material manufacturers to close, thus some materials previously manufactured locally must now be imported. A list of the manufacturers which have closed are included in Appendix A. Nevertheless, construction material imports in fact decreased from ₺144.6 million in 1978 to ₺99.3 million in 1980. The figures for 1981 and 1982 are possibly even lower. This 31 percent drop over a two year period is close to the decrease (30 percent) in private sector construction, and reflects the poor shape of the sector in general. Construction materials exports, while relatively small, dropped by 19 percent between 1979 and 1980.

A few years ago, the country was almost self-sufficient in steel products used in construction, such as reinforcing rods. Of the three steel products manufacturers which were operating, the largest is closed, one is producing at 60% capacity, while the third and smallest, is producing at full capacity. As a result, El Salvador is importing more steel than ever before.

#### Interest Rates Structure

The different interest rates offered by the financial institutions to consumers are both confusing and distort the market. The private sector lists this as one of its most pressing problems. A more uniform interest rate structure is desirable (see Recommendations) with differences according to the economic needs of the families being served, i.e., lower rates for poor families: somewhat higher rates for middle income families. The ideal system would mix the funds so that institutions offering very low interest rates, like the FNV, would not have such an advantage over other institutions. An equitable solution would have a salubrious effect on the housing sector, and also would give an impetus to housing finance operations in general.

#### Demand for Housing

El Salvador has undergone significant changes in its economic and social fabric over the past few years. The economy has shrunk, while population growth has continued unabated. Moreover, unexpected, large-scale population movements, unprecedented growth in urban centers, and agrarian reform have changed population mix and housing needs all over the country. The last housing demand analysis<sup>1/</sup>, with concomitant projections, took place in 1977/78, prior to land reform. That study covered only the San Salvador Metropolitan Area, and while out-of-date is still the best source of information for the Metropolitan area.

A few years ago, AID analyzed the housing demand in urban areas, as a prerequisite for the present HIG program. Given the shortage of statistical

1/ EDURES: Programa para el Mejoramiento Integrado de las Areas Metropolitanas.

information, AID characterized the estimates as very rough. Nevertheless, it projected that the need for housing in San Salvador, based on new family formation, would be 31,000 units over the period 1978 - 1982. It should be expected that over the following five year period, the demand, as a result of new family formation and higher population growth rates in San Salvador, would be even greater. The demand resulting from new family formation in other urban centers was estimated at 36,000 units over the 1978 - 1982 period. In addition, there are thousands of families whose housing problems are not recognized in any survey - those who now make their homes in the wretched hovels that mar the urban landscape. When comparing the obvious demand to the scanty projection of the formal housing delivery system, there is a clear shortfall of supply. Every housing developer and financier interviewed declared moreover that applications for new housing outstripped available units. This is particularly true for AID-financed HIG projects for low-income families.

#### Institutional Framework

The PREN identifies many different institutions as participants in the Reactivation Plan. Almost all major housing finance and development institutions are involved, as well as most of the Ministries and parastatal agencies. In most cases, a government agency acts as developer and financial agent, while private sector contractors actually do the work.

The PREN mentions how the emphasis in housing development has been shifted from more expensive housing to housing for low and lower-middle income families. This reflects in part the dead market for upper income housing, in addition to the more recent recognition by the construction industry of the huge, relatively untapped market for less expensive housing. Both IVU and the FNV are promoting new projects, financed by the HIG Program, that are reaching lower income groups that these institutions have served before. The FSV, while not building housing costing as little as HIG financed units, is nevertheless able to reach the same market by offering more competitive financing terms. FUNDASAL has served the lowest income

groups, but because of its retrenchment would hesitate to take on new commitments. Therefore, it would appear that any of the three major housing institutions could handle additional housing programs.

One note of caution with respect to employment generation, is that IVU uses its own construction crews to build up to 80 percent of their projects, while both the Savings and Loans and FSV mostly finance projects developed and built by private sector builders. FSV's intention is to terminate its development activities as soon as it can, develop its remaining sites, and then concentrate on housing finance only.

The ORE employment generation program has been very successful in carrying out its goal. In a little over two years, it has generated 6.1 million person/months of employment through investment of close to \$60 million. Criticism of the program relates to administrative problems, resulting from its emergency origin. AID will provide major technical assistance this year to help resolve this problem, and make ORE more efficient. The ORE program concentrates on public works projects to generate employment. Because of the nature of the program, most projects are generated by MOP and its dependencies, plus a few other parastatals like ANDA. Private sector participation is minimal. Little "make work" is carried out; most of the projects have a productive nature, leading to better roads, water supply systems, etc. It would be hard to identify a better organization to implement public works based on a national list of selection criteria. If ORE were able to involve the private sector to a greater degree, this would be even more beneficial.

## E. Planning Considerations

### Identifying Objectives and Goals

Any program must contain a well-articulated statement of its objectives, targets, and goals. If there are any sub-programs, or subsectors, as in the case of the construction component of the PREN, those sub-programs should also contain a statement of objectives and targets.

Although not clearly enunciated in the PREN, the objective of the construction sector is basically to reactivate this sector to the level of activity attained in the late 1970's. The objectives of the subsectors are essentially the same.

Goals and targets preferably should be quantifiable and cover a specific period of time. There may be several goals, as well as different goals for different segments of a program. For example, the goals of the construction sector in El Salvador might be divided into private sector and public sector goals, due to differences in statistical data. The target of the private sector, whose statistics appear quite reliable, is to attain once again an investment in construction activities equivalent to the high-water mark of \$225 million reached in 1978<sup>1/</sup>.

In 1981, the last year for which figures are available, investment had fallen to \$170 million. Assuming that the \$170 million level is valid for 1982 also, the decrease (as calculated in current colones over the past four years) is 24 percent. In constant colones, this represents a decrease of 58 percent. To attain the 1978 level, investment in private sector construction would have to increase by 137 percent in 1983.

In the public sector, readily available information is found only in highway and road construction by MOP.

<sup>1/</sup> Statistics on construction and housing investment provided by MINPLAN, BCR, and various institutions varied widely. We used the MINPLAN figures.

### Target Groups

Projects developed with these new sources of financing should focus on two groups: producers and consumers. Producers are those who build housing and public works, and whose projects generate significant employment, especially for unskilled workers. Consumers purchase houses and use public works. Benefits will accrue to both target groups. Housing built under this proposed program must be affordable to families earning less than the median income in the area in which the project is being built. While the PID will determine unit costs and eligibility, a quick calculation demonstrates that a \$18,000 unit produced under this program can be purchased by a family earning as little as \$640 monthly.<sup>1/</sup> On the other hand, basic units costing as little as \$13,000 can be afforded by families having an income of \$475 monthly.

Public works projects should emphasize rural road construction to ensure maximum utility for poorer families requiring better access to market areas and employment.

### Interest Rates

The GOES should take steps immediately to rationalize the interest rate structure. A first step in that direction would mix HIG money with BCR funds to obtain a more equitable rate, while maintaining affordability.

HIG funds will probably be secured at about a 13 percent fixed interest rate from a U.S. investor, although adjustable rates go much lower. As HIG funds will comprise 73.5 percent of total funds for their new housing program, an interest rate of 5.5 percent on the remaining 26.5 percent for BCR funds will lower the average interest rate to 11 percent, a fair market rate for El Salvador.

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<sup>1/</sup> \$18,000 less a 10 percent down payment, for 25 years, at 11 percent interest, requires a monthly payment of about \$160. With housing at 25 percent of total income, minimum salary must be \$640.

### Project Selection Criteria

In paragraph E, the list of project selection criteria was discussed in general terms. Numbers and percentages can now be assigned to most of these criteria to provide a benchmark against which projects are analyzed and qualified for inclusion in the Construction Sector Reactivation Projects. It is recommended that the following criteria be employed:

- a) Construction must be initiated within 90 days from the day the project is selected.
- b) The foreign exchange component must not exceed 15 percent of the total construction costs for a particular project.
- c) The implementing and financing institutions must be operating at less than 80 percent of capacity, or demonstrate that they can tool up for the increased workload within 60 days.
- d) The labor cost component of all projects must exceed 50 percent of the total construction cost, or, for each  $\text{Ø}2,000$  of investment, at least one person/month of employment must be generated.

In addition, such non-measurable criteria as project productivity and lack of critical constraints must be incorporated into the selection process. The low-income housing project and the public works project recommended in this section meet these criteria. For the future, such quantifiable criteria, adjusted annually to reflect changing priorities, would help planners both select activities and measure results.

### Unsold Upper-Income Housing

The success of the construction sector reactivation program is not wholly contingent on the resolution of the problem of the huge inventory of unsold houses. Recently, legislation was passed by the Constituent Assembly to allow graduated mortgage arrangements. However, as long as this blockage continues, it poses a problem for the construction industry, especially the Savings and Loan system. Resolving this problem may free up additional housing funds, giving added impetus to the sector. Therefore, it is recommended that USAID explore ways to help resolve this problem, probably in the form of an advisor who specializes in buy-outs and bail-outs.

TABLE V-8  
HIGHWAY AND ROAD CONSTRUCTION EXPENDITURES  
(millions of colones)

Year	Force Account	Contracted	Total
1977	14.0	32.5	46.5
1978	15.4	65.2	80.6
1979	19.3	74.4	93.7
1980	23.1	46.3	69.4
1981	18.2	48.5	66.7

Source: Indicadores Economicos y Sociales, June/Dec 1982.

Expenditures in highway and road construction peaked one year later - 1979 - than the peak in private sector construction, but the 29 percent decrease to its low point two years later, was greater than the fall in private sector construction. Again, assuming that the 1982 level of highway and road construction was equal to 1981, total expenditures would have to be increased by 118 percent to equal that of 1979.

It would appear that a 137 percent increase in private sector construction and a 118 percent increase in public sector construction are unattainable goals for a single year. What percentage increase, therefore, is feasible? There are several ways to calculate this. One would be to take a look at the availability of additional sources of financing. Another would be to ascertain the capacity of the economy to absorb a particular level of growth. Perhaps a third would be to investigate the capability of the construction delivery system, i.e. institutional capacity, available land, labor, materials, etc.

We assumed that a 50 percent growth in private sector construction investment is reasonable. This would imply an increase in investment of ₡85 million bringing total private sector construction investment to ₡225 million in 1983.

With commercial and industrial construction at an historic low (€8.3 million in 1981), and with the large amount of unused capacity in commerce and industry, it is likely that the private investment increase will be derived from residential construction. The huge over-supply of upper-income housing indicates that little demand will come from this segment of the market. This leaves middle and lower income housing development as the only category in which investments can be made to boost private sector construction activity. If all €85 million were invested in middle and lower income housing, an additional 5 to 6,000 units would be built in 1983, over last years level. Based on information obtained from various housing institutions and groups, this increase is feasible.

Public works goals are harder to handle, simply because only highway and road construction information is available, albeit the largest and most important portion of expenditures. However, if we assume that a 50 percent increase in investment in this segment is feasible also, an additional investment of €33 million would be required. On the other hand, if the GOES spends all €99.7 million in this year's budget for highways and roads, then a 50 percent increase would require an additional 50 million in this activity.

#### Selecting Programs and Projects

As has been pointed out previously, programs and projects selected for inclusion in the PREN's construction sector were not based on a set of rational, consistent criteria. To help rectify that omission, and assist the programs and projects to meet the stated objectives and goals, we propose the following criteria for selection:

- a) Construction projects must be productive; not merely providing employment, but also improving the productive base of the economy.
- b) There must be no critical constraints: for example, housing planned in areas where land is not available.
- c) Projects must be ready for construction almost immediately. At the least, the bid documents must be prepared, in the case of public works

projects, and the housing contractor must have completed working drawings and specifications.

d) The foreign exchange component must be low.

e) The projects must generate a maximum amount of employment.

f) The implementing and finance agencies must be either working at below capacity, or demonstrate that they have the capability to increase their activities in the amount required.

If all new projects developed in the construction sector meet this set of criteria, then, given effective implementation, the objectives of the PREN will be met.

## F. Recommendations

### New Financing

We suggest that the GOES supply an additional ₡135 million to the construction sector, of which ₡85 million will be directed to the housing sector, and ₡50 million for public works, mostly road and highway projects. The ₡135 million will be generated in part by increasing the Housing Investment Guaranty allocation to \$25 million (₡62.5 million) in 1983. HIG money in the amount of \$5 million has already been authorized, but not yet contracted. therefore, GOES should initiate steps immediately to contract this loan. USAID has budgeted \$10 million in HIG funds for 1983; this would be increased to \$20 million. USAID should request that AID's Office of Housing and Urban Development send a team to El Salvador immediately to prepare the PID. If AID acts expeditiously, the \$20 million loan could be authorized in three to four months.

The BCR will lend an additional ₡72.5 million to complement the AID financing. This money will be derived from the ₡500 to 600 million in new lending authority that the BCR will have this year and adds to housing expenditures budgeted for 1983.

The implementing agency for the ₡50 million public works project will be the GRE program of MOP, while the implementing agency for the housing program will be one, or several, of the housing finance agencies. The PID will determine the appropriate agency or agencies. Construction will be carried out by private contractors, to the maximum extent possible.

Based on an estimated investment of ₡1,500 per person/month of labor, the housing projects will generate 57,000 person months of on-site employment, while the public works project will generate 50,000 person/months, based on estimated ₡1,000 of investment per person/month.

TABLE Y-9  
 CONSTRUCTION PROGRAM  
 (millions of colones)

Source of Financing	Housing	Public Works	Total
USAID HG	62.5	----	62.5
BCR	22.5	50.0	72.5
	<hr/>	<hr/>	<hr/>
Total	85.0	50.0	135.0

Source: Checchi and Company

One factor might inhibit the rapid implementation of an enlarged HIG Program. Once a loan contract is signed between the U.S. investor and the Salvadoran government, AID requires that loan proceeds be placed in an escrow account in the U.S. Construction of the housing is then financed on an interim basis by the borrower using his own or borrowed funds. When the borrower has completed a section of the housing project and mortgages are originated for all the units in that section, he may then draw down from the escrow account a sum equal to the total of the mortgages. In the meanwhile, the Central Bank must provide foreign exchange to cover the purchase of imported goods and components used in construction.

We would recommend therefore the AID explore the possibility of permitting the borrower to use his existing portfolio of mortgages to secure the loan. The borrower could then obtain the loan proceeds almost immediately after signing the loan agreements. As mortgages are originated from sales of HIG-financed units, they would be swapped for the older mortgages. In this manner, El Salvador would have immediate use of the foreign exchange generated by the HIG Program rather than have to wait and sustain short term foreign exchange cash flow problems.

SECTION VI  
SOCIAL ASPECTS

A. Summary and Critique of the Reactivation Plan

This plan's basic premise is that all reactivation activities have the ultimate purpose of improving people's lives. It notes that social programs can support the three major economic activities, industry, agriculture, and construction, through manpower, business and institutional organization, business management training, construction of buildings for social services, and humanitarian action.

The plan covers four major areas:

- Principal Actions (within each social area)
- Emergency Actions
- Institutional and Coordination Mechanisms
- International Technical Assistance

The plan states that the ultimate goal in the social area is to restore already programmed activities. It is important to note that no new activities are planned--what is now contemplated to be carried out with GOES or external resources, will be implemented more effectively so that the general population experiences a continuity of service and senses governmental beneficence.

Principal Actions

Actions are presented within major social areas for 1983:

- a. Education
- b. Health and Nutrition
- c. Labor
- d. Crime Prevention and Justice Administration
- e. Infants, Youth and Family
- f. Integrated Community Development
- g. Integrated Rural Development
- h. Population

The actions under each social area are summarized in Exhibit VI-1 at the end of this section. A brief review of the social programs results in the

following observations;

- Education and health projects are the only areas which have developed an extensive set of physical goals (construction of X number of schools, building Y number of rural water systems).

- Many projects are will be carried out with international donor funding (UNICEF, IDB, AID) which implies that these are 'pipeline' projects, i.e. they have been planned for several years, and fortunately funds will be available for their implementation during 1983.

The conclusion drawn is that the PREN is an attempt to focus on the need to maintain general social services. Two areas, labor and justice administration, need to be discussed further given their implications for reactivation.

Labor is identified as the social area most closely connected with reactivation, and we agree with that point. However, under labor, a series of activities are suggested which at this time may actually impede reactivation rather than accelerate it. The activities include: (a) promotion of collective bargaining and union formation, (b) study of minimum wages, (c) a program to reduce workplace hazards, (d) promotion of social welfare at the workplace and through recreation, (e) cooperative development and training, and (f) expansion of social security services.

Somehow these activities seem to emanate from a fictional full-employment economy rather than the actual situation with more than 350,000 unemployed persons. The emphasis now should not be on workplace conditions or higher pay, but on creation of employment. In fact, it is our understanding that there are few labor problems as those who have jobs strongly desire to keep them. This matches observations made in December, 1981, when Checchi and Company prepared an industrial recovery plan for El Salvador. For the time being, we feel that it would be wise to channel these GOES resources into activities more closely related to reactivation.

Justice administration, on the other hand, has been grossly understated in terms of its impact on reactivation, especially given the discussion of

expectations in the Global Aspects section above. Contemplated activities are: (a) maintenance of the justice system, (b) institutional strengthening to reduce the delay in the administration of justice, (c) extension of the Defense of Individual Liberty to more persons, (d) modernization of penal centers, and (e) provision of new resources to the General Prosecutor, and (f) creation of an Institute of Criminal Investigation. These activities simply do not reflect the almost total collapse of the country's criminal justice system, nor the implications of the collapse.

One of the major contributors to anxiety, and reduced expectations, and private investment is the collapsed criminal justice system. If anything can upgrade expectations, it will be the re-institution of this system, and if any international donor desires to affect the social and economic reactivation of this country, it would do well to support activities which will serve as a basis for bringing criminals, especially murderers, to trial again..

#### Emergency Actions

These actions will provide assistance to the approximately 250,000 individuals displaced from their homes due to the conflict. CONADES (National Commission on Displaced Population Assistance) will coordinate the efforts. The support projects are as follows:

- Food distribution
- Health (primarily vaccination, campaigns and other preventative measures)
- Temporary employment
- Relocation

These programs are definitely important in their provision of transitional assistance to displaced persons. Some economic impact will be created in the temporary employment activities, the housing programs and the expenditures made in setting up new homes. Food distribution and health appear to be primarily pass-through activities from external donors. Approximately \$20 million (\$8 million) will be used to generate transitional jobs.

### Employment for Unqualified Labor

Basically this sector describes the same Public Sector Employment Generation Project described in the Construction Sector of the PREN.

### Assistance for Disaster Victims

This program provides assistance to 8,000 families who lost their homes during the torrential storms in September, 1982. Families will be provided with a building lot, building materials, technical assistance, and will be expected to construct their homes in a self-help manner. The budget for this program is \$25 million.

### Institutional and Coordination Mechanisms

MINPLAN nominates itself as the coordinator of the economic reactivation activities, and the organization in charge of rationing available resources.

### International Technical Cooperation

This sector provides a brief recapitulation of social projects which will receive funding from abroad.

### Critique

There seems to be little connection between these social plans and the economic reactivation presently required; attempts to hitch them to the economic reactivation program were not convincing. While it is very important to continue social services, the economic reactivation plan could practically stand alone without this section. Further, there are few stated goals, except for specific construction projects of educational and health facilities. If there are to be any additional social programs they will most certainly have to be funded by international donors. Resources for such activities as labor union development, which could actually impede reactivation, might best be shifted to more important employment generation areas. Criminal justice is of high importance, both to individuals and institutions, and

could improve the investment climate. Employment generation is important to maintaining aggregate demand, but is covered most effectively in the construction section.

If the implementation factors developed in the Global Aspects section above are applied to the Social Programs, the following conclusions are reached.

Implementation Factor

Conclusion

Maximum employment.

Impression is that employment will be generated most intensively by Public Sector Employment Generation Project, Displaced Persons Employment Project, and construction of various centers and buildings.

Minimum start-up time.

No indication given.

Utilization of existing, unused capacity.

No indication given.

Critical constraints.

No analysis given. We do not want to imply that these aspects should be overplanned, but rather it is counter-productive, for example, to build a clinic if medical personnel are not available to staff it.

Low import component.

No analysis, but we assume that in most cases the import content would be relatively low.

Production-oriented.

Almost none of these activities are framed in such a way as to be supportive either directly or indirectly of production.

With regard to the Ministry of Planning acting as the coordinating entity for the PREN, we are not impressed with the influence which this organization has up on other Ministries, Agencies, and the private sector. Its staff can be utilized to assist in providing timely research to the CREN, but we do not believe it appropriate for MINPLAN to be the implementing agency for the reactivation program.

B. Priorities in Health and Education as Determined by Delphi Exercise

During the course of this study, little time was available to contact the many various Ministries and Agencies which provide social services. However, the Human Resources and Humanitarian Affairs Officer of AID had a very strong interest in the nature of our study as it provided an opportunity to explore further what various social experts considered as priorities during this critical time. Specifically, AID wanted to "ascertain the facts about the current status of the educational and health services provided nationwide."

Our team wanted to take a more in-depth look at the kinds of social projects which could relate most directly to economic reactivation. The concern by most parties knowledgeable of Salvadoran social problems was that social services have been given too low a priority due to traditional neglect, and now the conflict, and the economic decline. If these services are allowed to decline too much, they say, serious social repercussions could result.

The HR/HAO planned a two-day workshop in which 18 educational and 22 health experts from all parts of the country gathered to discuss these social topics. The Ministry of Planning was especially helpful in carrying out this effort, and both the Ministers of Education and Health came to share views and observe the exercise. The study methodology employed was the "Delphi" technique. This technique primarily uses a survey instrument to gather responses from participants. The results are quickly tabulated, returned to the participants and discussed. Three cycles of this survey were completed and on the second day the two groups reached concensuses regarding their respective fields. The results of this process were enlightening, with both groups indicating additional planning as their greatest need.

After the groups completed the three cycles, they were asked to think of specific activities in their fields which could complement the economic reactivation process, which would help them do their jobs, and which at the same time could contribute economically, especially through more employment creation. They were asked to consider the question: "On a broad scale, what projects at this time could make a difference to the common man?" The results of the surveys follow below:

### Education

1. Fifty-five percent of the expert group suggested the repair of school buildings and 28 percent suggested school furniture and equipment repair. There are approximately 3,500 public schools of which one-half are estimated to be in need of physical repair. The GOES budget is very limited in terms of maintenance money which can be supplied this year. Contracts could be awarded through educational district offices for individuals to work on the school buildings.
2. Local production of didactic materials and books was suggested by 33 percent of the group. In the earlier Delphi cycles 83 percent responded that there was a scarcity of such materials. We can only assume that a large part of these materials are imported presently and the problem stems from the scarcity of foreign exchange.
3. Promotion of handicrafts was suggested by 28 percent of the respondents. It was suggested that school facilities, in some cases, could serve as sites for craft instruction and artisan cooperative development. (For additional discussion of artisan development, see the section on Industry).
4. Creation of a small business loan fund for technicians who have graduated from technical schools was also suggested. There are estimated to be 15,000 such graduates, but no statistics exist on the number gainfully employed. (Some discussion of this is also covered in section on Industry).
5. Other suggestions were training and employment of women to provide basic education to community members; construction of sports facilities; provision of more classrooms; strengthening the Qualified Labor Project; and development of farms and orchards to provide practical experience for students.

## Health

1. The health expert respondents indicated environmental sanitation to be their number one priority because the major fatal disease among infants is diarrhea caused by unsanitary conditions. Environmental sanitation was the means identified in the Delphi exercise to increase preventive health care instead of concentrating on curing the ill. This priority was translated into the following projects:

- a) Development of a latrine fabrication program. Basically, this would involve hiring labor to mix and pour concrete into standard latrine base forms, digging pits, and setting up community latrines. Latrines could be built in many communities as models, and the program could sell latrines to individual families, or families could construct their own latrines once having understood the health advantages.
- b) Development of drinking water supply projects including construction of water reservoirs, systems combining drinking water with irrigation, and manufacturing water filters for the home. The Health Ministry has 35 such drinking water systems already designed but which lack funding under its PLANSABAR (National Plan for Basic Rural Sanitation). These 35 projects would employ approximately 7,000 workers, (no time estimate was given), and provide drinking water to 70,000 persons. An additional 150 such projects have been identified, but have not been designed.

Other related suggestions included the processing of garbage into fertilizer, and swamp and tidal basin drainage to eradicate malaria and bring such lands into production.

Drug manufacture--Public health experts identified the lack of an adequate supply of drugs and medicines as one of their major problems, and they believe that additional local fabrication of medicines would be desirable. The Ministry of Health currently purchases and distributes about \$4 million in medicine annually. One suggestion was to request that AID provide medicines or their raw materials in a sale arrangement to local private factories who would process, package and sell them to the Ministry of Health. Industry lists provided by the BCR include several local drug and medicine manufacturers. The respondents

suggested that some additional form of quality control be provided to protect the Ministry's clients. Respondents also suggested that the manufacture of certain medical equipment be investigated to determine the volume of demand and the feasibility of local manufacture.

3. In the area of nutrition the following suggestions were made: development of home orchards, poultry raising, and manufacture of Mixtamal.

4. The Ministry's buildings were noted as needing repair, a possible job creation project.

#### C. Political Constraints

There seem to be no political constraints to expanding most social area activities. Everyone agrees that these are high priority areas which have received inadequate attention in the past. These activities would affect a considerable number of lower income persons.

It is not clear whether the political will exists to make inroads into criminal justice problems. The almost complete collapse of the system (there are still 200 civilian deaths per month), makes it appear as an almost impossible task. The constraint in this case is not formally a political one, but rather one which derives from threats to the personal security of persons who would attempt to set the situation right. The GOES, to its credit, has recently asked AID for assistance in judicial reform and human rights. This bodes well for economic reactivation as no one, especially investors, can function normally in an environment where killers and kidnapers commit crimes with impunity. Appropriate assistance could begin by providing an assessment of the criminal justice codes and the legal and judicial institutions charged with their administration, with an eye toward modernization and assisting the system to function again.

#### D. Economic Constraints

The primary economic constraint to making the social area a useful component of economic rehabilitation is the lack of GOES financial resources. The immense demands on the budget for defense, and public sector salaries, has left social programs with few funds for materials, transport and other expenses.

If any additional activity is desired, it will be necessary to seek new financial resources, most likely from external donors. Given the tenuous character of the tax bill before the Constituent Assembly, resources may be stretched even further. AID has suggested to our team that an additional \$10 to \$15 million may be available for health purposes and the GOES would do well to pursue those funds.

E. Recommendations

We recommend that international donor support be sought for the following projects and amounts:

<u>Project</u>	<u>Amount</u>
School building and furniture repair program	\$2 million
Rural water systems	6 million
Rural latrine program	3 million
PL-480 type drug and medicine program	4 million

Exhibit VI-1

SUMMARY OF SOCIAL PROGRAMS INCLUDED IN THE PREN

Social Area	Program	Goal
1. Education	a. Literacy	50,000 persons
	b. Regionalization and Nuclearization	Continuation
	c. Revision of Plans and Study Programs	Planning basic education curriculum
	d. Expansion of Service Coverage	Construction of 11 metropolitan schools Construction of 3 national institutes Construction of new rural schools Building teachers' training center Building for PLANALIBRE
2. Health and Nutrition	a. Increasing Service, Step II	Construction, equipping and implementing 93 health posts, 13 health units, and 8 health centers.
	b. Rural potable water, Step II	Supplying 138 rural communities with drinking water
	c. Basic rural health	30 well, water system and latrine projects
	d. Potable water for land reform communities	30 water systems
	e. Management of water system	Community Education
	f. Marginal community health	Health services, vaccination, education in 130 communities
	g. Nutrition	Food donations for 850,000 persons

<u>Social Area</u>	<u>Program</u>	<u>Goal</u>
3. Labor	<ul style="list-style-type: none"> <li>a. Promotion of collective bargaining and union formation. Study of minimum wages.</li> <li>b. Program to reduce workplace hazards.</li> <li>c. Promoting social welfare at the workplace and through recreation.</li> <li>d. Professional training.</li> <li>e. Cooperative development and training.</li> <li>f. Expansion of services of social security.</li> </ul>	<p>Construction of 3 professional training centers.</p>
4. Crime Prevention and Justice Administration	<ul style="list-style-type: none"> <li>a. Maintenance of justice system</li> <li>b. Institutional strengthening to Judicial Power to reduce delay in administration of Justice.</li> <li>c. Increase of the coverage of the Defense of Individual Liberty.</li> <li>d. Modernization of Penal Centers.</li> <li>e. Provide new resources to the General Prosecutor.</li> </ul>	

<u>Social Area</u>	<u>Program</u>	<u>Goal</u>
5. Infants, Youth and Family	a. Expansion of programs in day care, boarding schools substitute homes, clinics 2nd adoption centers	
	b. Marginal communities (UNICEF project)	Integrated care for 2000 infants
	c. Preventive education regarding crippling diseases	Construction of Paraplegics Center  Creation of Institute of Special Education
	d. Youth Vocational Workshops	Construction of Ilobasco complex (€3.5 million)  Development of a pork rearing project
	e. Family protection	
6. Integrated Community Development (Ministry of the Interior, DIDECO)	a. Northeast Zone	UNICEF €35 million
	b. Northern Zone	€33 million
	c. Cabanas	BCIE €10 million
	d. Marginal communities	AID/€7.5 million
7. Integrated Rural Development (OAS)	a. Model farms	
	b. Model homes and home economics	
	c. Production centers for women	
	d. Juvenile Homes and Farms	
	e. Training, Technology transfer, and Technical Cooperation	
	f. Rural Day Care	
	g. Integrated Social Services	
	h. Community Organization	
	i. Life Skills	
	j. Project Monitoring	

<u>Social Area</u>	<u>Program</u>	<u>Goal</u>
8. Population	<ul style="list-style-type: none"> <li>a. Mother-Child Health and Family Planning</li> <li>b. Education Curriculum</li> <li>c. Migratory areas</li> <li>d. Demographic economic and social studies</li> <li>e. Population Policy, Programming Coordination and Evaluation</li> </ul>	
9. Emergency Actions for Displaced Persons	<ul style="list-style-type: none"> <li>a. Feeding</li> <li>b. Health</li> <li>c. Employment</li> <li>d. Relocation</li> </ul>	
10. Employment for Unqualified Persons		
11. Attention to Disaster Victims		Will benefit 8,000 families.
12. Institutional and Coordination Mechanism		
13. International Technical Cooperation		

APPENDIX A

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CLOSED BUILDING MATERIAL  
MANUFACTURERS

INDUSTRIAS CERRADAS

1.- INDUSTRIAS METALICAS, S. A. ( IMSA )

- 1.- Grifería en bronce
- 2.- Grifería en cromo para baño y lavamanos.
- 3.- Válvulas de paso y para empotrar
- 4.- Tapones para baño y para pila
- 5.- Duchas metálicas
- 6.- Cerradura Doral

2.- MEDISA TUDESA

- 1.- Perfiles metálicos ( polines )
- 2.- Tubería Industrial cuadrada y redonda y rectangular
- 3.- Puertas metálicas.

3.- FUCASA

- 1.- Cerraduras y bisagras

4.- CORTES, S. A.

- 1.- Proceso de corte en lámina galvanizada, lisa y acanalada

5.- INDUSTRIAS SAGGUI

- 1.- Bisagras

6.- SIDERURGICA CENTROAMERICANA DEL PACIFICO ( SICEPASA )

- 1.- Lingote de acero para producir toda la línea siderúrgica.



INDUSTRIAS QUE HAN REDUCIDO SU PRODUCCION

1.- CORINCA, S. A.

Trabaja la línea de aceros y laminados en un 75%.

Trabaja la línea de trefilados en un 25%.

2.- ACEROS, S. A.

Trabaja la línea de aceros y laminados en un 25%

No está trabajando la línea de trefilados.





	Nacional	Centroamericana	México	Colombia	E.E.U.U.	Japón	Europa <sup>2</sup>
5- Costanera Metálica para soporte de techo			x B.				
6- Alambre de Amarre -	x B.		x B.				
7- Clavo de Alambre -	x B.		x R.				
8- Clavo de Acero -						x	
9- Artefactos loza sanitaria			x B.	x B	x B		
1- lavamanos - <i>bathroom sinks</i>							
2- sanitarios - <i>toilets</i>							
3- Accesorios para la instalación de artefactos sanitarios -tubos de abastop acopladores- desagues- sifón					x	x	
10- Chapas Cilíndricas - <i>Cylinder Door knobs</i>				x R.	x B		x B.
11- Chapas de Parche - <i>Levered " "</i>	x M			x R	x B.		x B.
12- Bisagras de todo tamaño -				x B	x B.		x B.
13- Plywood para puertas - <i>Plywood for Doors</i>			x B				
14- Durapanel para puertas - <i>Durapanel " "</i>			x B				
15- Fibrex para puertas - <i>Fibrex " "</i>	x R						
16- Haladeras- pasadores -				x B	x B		x B
17- Grifos de Bronce - <i>Bronze Faucets</i>					x B	x B	x B
18- Grifos para lavamanos - <i>Bathroom Faucets</i>					x B	x B	x B
19- Válvulas de bronce- (de entrada - de paso)-				x R	x B	x B	x B
20- Tubería Industrial cuadrada y redonda -			x B				
21- Lámina galvanizada - <i>Zinc sheets</i>			x B				x B
lisa - <i>smooth</i>							
canal - <i>undulating</i>							

	Nacional	Centroamericana	México	Colombia	E.E. U.U.	Japón	Europa
22- Lámina de Hierro - <i>Steel sheet</i>						x	x
23- Estaño							x
24- Plomo			x	x			
25- P.V.C. - <i>PVC</i>	x B						
Tubería - <i>Tubes</i>							
Accesorios - <i>Accessories</i>							
26- Pinturas - <i>Paints</i>					x B		
Anticorrosivos - <i>Anti-corrosives</i>							
Aceite - <i>Oil</i>							
Agua - <i>Water</i>							
Barniz							
Solventes - <i>Solvents</i>							
27- Pegamentos - <i>Glues</i>					x B		
28- Madera - <i>Wood</i>					x B		
29- Herramientas - <i>Tools</i>	x B						
Palas							
Picos							
Plochas							
Azadones							
Barras							
30- Carretillas	x B						
31- Herramientas para el trabajador				x	x	x	x
Martillo - <i>Hammer</i>							
Serruchos							
Almádanas							
Niveles							
Cucharas							
Plomadas, etc.							

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	<u>Nacional</u>	<u>Centroamericana</u>	<u>México</u>	<u>Colombia</u>	<u>E.E.U.U.</u>	<u>Japón</u>	<u>Europa</u>
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32	Electricidad	x R		x R		x B	
	Póliducto						
	Alambre TN						
	Cajas rectangulares y octogonales						
	Cajas Térmicas						
	Dados térmicos						
	Cuerpos terminal						
	Switch						
	Tomacorriente						
	Placas						
	Tiñeres						
33-	Equipo y Repuestos para construcción:						
	Concreteiras						
	Carros de Volteo						
	Vibradores						
	Grúas						
	Compactadores						

Calificación del Producto:

- B= Bueno
- R= Regular
- M= Malo