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OP-12711-714 97
15N-49246

EL SALVADOR: MACRO-ECONOMIC ASSESSMENT
AS OF AUGUST 1980

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August 25, 1980

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I. INTRODUCTION

The purpose of this report is two-fold: (1) to present a macro-overview of El Salvador's current economic situation and outlook for 1980-81, including analysis of the balance of payments, trends in money supply, prices, the GDP, employment, government revenues and expenditures and the current mood of the private sector; and (2) briefly state the economic justification for a Mission-proposed \$20 million ESF program to finance imports of essential raw materials and intermediate goods by the industrial sector for the purpose of assisting in the reactivation of the Salvadoran economy. This justification appears in the Annex of this report.

II. THE BALANCE OF PAYMENTS

The balance of payments projections for 1980 and 1981 are presented in Table 1. In my previous reports, I have placed my own projections alongside the unofficial projections of the central bank. However, the central bank's current unofficial projection strikes me as reasonable and conservative, and I have accepted it for both years. In the case of certain key items such as imports, the net private capital outflow and the official capital inflow, it was agreed* that it would be prudent to define a range rather than offer a single figure. Thus, two alternative estimates were made for both 1980 and 1981.

*By the technician in charge of the central bank's balance of payments section and myself.

The detailed assumptions underlying the projections are presented in the footnotes of Table 1. The main conclusions are as follows:

1. The overall balance of payments deficit may be a manageable \$100 million in 1980; however, for 1981, the outlook is for an increase of the deficit to a range of \$150 to \$200 million. As we shall see in the following section, El Salvador does not have the international reserves to cover the combined deficits of 1980 and 1981 unless the authorities agree to sell their gold stock, an option the authorities do not consider feasible for both political and economic reasons (discussed further in Section III).

2. The 1981 projection must be understood as being "requirements" or "gap" oriented. Specifically, the Salvadoran authorities cannot actually tolerate a decline in reserves of \$150 to \$200 million in 1981 on top of a decline of about \$100 million in 1980. The decline in reserves projected illustrates the magnitude of the foreign exchange resources gap. It is not a prediction of what will in fact take place. In practice, the authorities will have the following options:

(a) seek additional external financial assistance, either in

the form of official loans,* new loans from the commercial banks or additional assistance from the IMF in the form of a second and third tranche stand-by (the authorities are most reluctant to follow this course); or (b) cut down on imports. Since the latter were conservatively projected to increase by only 15% in 1981 over 1980, most of which is likely to be taken up by inflation, a cut-back in imports is likely to be inconsistent with the reactivation of the economy next year.

3. Exports were projected to decline significantly in 1980 and to contract further in 1981 as a result of reduced production of coffee and cotton. Coffee sales in 1980 were depressed by institutional problems (abolition of the private coffee company and substitution by the government controlled Coffee Institute) as well as by currently depressed prices which caused the Institute to discontinue sales in July. Coffee exports are projected to decline further in 1981 as a result of reduced production (owing to neglect, shortages of fertilizer and insecticides, and inroads made by coffee rust); and as a result of reduced stock carry-over from prior years.

*Additional official project-related assistance would have to be accompanied by a significant improvement in project implementation performance if the additional funds are to be of much help in financing the 1981 deficit.

4. A sharp decline in cotton exports was projected for 1981 as a result of a significant (20 to 25%) cut-back in cotton production related to fear and uncertainty in the countryside which interfered with planting, as well as reluctance by growers under current political conditions to incur the high cost outlays associated with cotton production.*

5. Exports of goods (mostly manufactures) to the CACM were projected to recover in 1981 to the 1979 level on the assumption of the implementation of the economic reactivation program.

6. Imports were projected to increase in 1981 by about 15% in current prices on the assumption of the implementation of a reactivation program on a modest scale.

7. As a result of these assumptions, the current account deficit is projected to rise substantially -- from a surplus of \$11 million in 1979 to a deficit of \$94 to \$170 million in 1980 and to a minus \$290 to \$370 million in 1981 (see Table 1). It is hoped that this increase will be partially compensated by a reduction in the private capital outflow in 1981. However, even under the most optimistic

*It is believed that a substantial shift of lands from cotton to grains, particularly corn, has taken place. Costs of planting grains are much less.

assumptions with regard to the private capital outflow and long-term capital inflow, a significant increase in the overall balance of payments deficit appears unavoidable unless additional long-term financing can be secured or imports held down to the 1980 level. The latter would inevitably mean a cut-back in real terms (since import prices are likely to increase in 1981), which in turn would make it impossible to implement even a modest economic reactivation program.*

III. TRENDS IN INTERNATIONAL RESERVES

Trends in both gross and net international reserves for the period 1975 through August 8 of 1980 are presented in Table 2. Note that the level of reserves reached a peak in August of 1979 but declined sharply thereafter. Net international reserves were \$292 million on August 10, 1979, then declined to \$135 million at the end of the year. They dropped to a minus \$14 million on April 4, 1980, but have recovered somewhat since. I understand that the reserve situation was much more serious in June-July 1980 (than in either April or August) as a result of the paralysis in coffee exports, but no figures for these months are available.

*The government will attempt to reduce the importation of discretionary consumer goods to increase the availability of foreign exchange for raw materials and capital goods. However, the extent to which this can be done is limited.

It is clear that the country's international reserves are insufficient to cover the balance of payments deficit projected for 1980-81 unless the authorities decide to liquidate their gold stock. That stock is valued at \$21.8 million on the basis of the old official price of \$42.22 per ounce. The current market price of gold is about \$650. At that price, the gold stock would be worth about \$335 million. After deducting the value of the gold pledged as collateral for some bank loans that the authorities negotiated earlier this year, they would still be left with a net amount of \$265 to \$280 million which, if it were fully disposed of, might just about cover the balance of payments deficits projected for 1980 and 1981 in Table 1.

The authorities are understandably reluctant to sell their gold for both sentimental reasons ("we cannot sell our national heritage") and practical considerations. The latter include the fear that the move would further undermine confidence by the private sector and the foreign financial community, thus encouraging capital flight and making it more difficult to obtain loans and foreign investment; there is also the fear that the move will be politically embarrassing

and give rise to accusations of mismanagement. The government views its gold stock as a last-ditch reserve to be used only in case of dire emergency.

IV. DEBT SERVICE CHARGES

Fortunately, El Salvador has traditionally followed a conservative policy with respect to external indebtedness, and the ratio of debt service charges to exports is relatively low. Data on debt service charges on the external public debt, presented in Table 3, show that the percentage of debt service charges (interest plus amortization) as a percent of merchandise exports ranges between 2.6 and 4.5 percent over 1979-82. This ratio may increase somewhat in future years as a result of El Salvador's current balance of payments difficulties and its need to resort to increased commercial bank borrowing.

V. THE MONETARY AGGREGATES AND THE PRICE LEVEL

Data on the major monetary variables are presented in Table 4. The monetary outlook looks less disturbing now than it did in mid-June. For example, between December 28, 1979 and April 4, 1980, total bank credit expansion proceeded at an annual rate of 51%. On the other hand, between December 28, 1979, and August 8, 1980, the annual rate of increase declined to 27%. Similarly, total credit extended by the central

bank, which increasing at an annual rate of 134% between end of 1979 and April 1980, is down to a rate of increase of 70% for January-August 1980.* The money supply actually declined between the end of 1979 and August 8, 1980, though this is mostly a seasonal factor. During the full twelve-month period ending in August 1980, the money supply expanded by 19.4%, which compares with an average annual rate of increase of 35% for the first quarter of 1980 (see Table 4)..

In my June 23 report, I noted with alarm the magnitude of the budget in the government's National Emergency Plan, particularly the extent to which it was to be financed from internal sources. Indeed, the Plan provides that of a total financing requirement of 61,800 million, 2817 million** would be financed from internal sources. This amount constitutes 58% of the money supply in circulation at the end of 1979.

Fortunately, it now appears that no attempts are being made to attain the ambitious expenditure targets set in the Plan. The central bank is keenly aware of the inflationary impact that central bank financing of the Plan's huge financial gap would entail. In addition, the Junta has also been

* Still dangerously high.

**Equal to \$326.8 million at the official exchange rate of US\$1=22.50.

cautious with respect to the increase in actual government expenditure, both current and investment, that it authorized. (This point is discussed further in Section VI.)

The behavior of the price level during the first half of 1980 underlines the need to proceed with great caution in the area of monetary and fiscal expansion. Between December 1978 and December 1979, the consumer price index increased by 15%, while during the first six months of 1980 the annual rate of increase accelerated to 24% (Table 4). The continuation of such a rate of expansion for another six to twelve-month period could make it difficult to maintain the current exchange rate.

I understand that the monetary program for 1980 calls for an expansion of total bank credit by 21% and for central bank credit by 26%. These rates of increase are understandable in light of the illiquidity of the banking system, the shortage of working capital in the private sector and the need to reactivate the economy. Still, if continued beyond 1980, such rates of increase would be inconsistent with the reduction of inflationary pressure.

VI. GOVERNMENT REVENUES AND EXPENDITURES

The central bank's unofficial projections of Central Government revenues, expenditures, and the deficit for 1980

are presented in the last column of Table 5. Note that revenues are expected to be at roughly the same level as in 1979, which is 10% below the level projected in the Emergency Plan. On the other hand, current expenditures are also expected to fall significantly below the target budgeted in the Plan -- by 23%. Thus, it appears that the government has pursued -- at least so far -- a conservative fiscal policy, keeping expenditures in line with the availability of fiscal resources. Capital expenditures at 500 million are roughly in line with those scheduled in the original budget and in the Emergency Plan.

The projected overall deficit of 300 million is some 55 million below the amount scheduled in the original budget, and falls short by 147 million of the amount provided in the Emergency Plan. Thus, the Central Government's fiscal operations now appear far less inflationary than they did at the time the Plan was published three months ago.

The record so far suggests that the monetary-fiscal authorities are aware of the need to hold down public expenditures to a level that can be accommodated by available external resources, the surplus in the budget's current account and the very limited degree of internal credit creation that the economy can absorb, given the constraints imposed by the

objectives of moderating inflationary pressures and the balance of payments disequilibrium.

VII. GDP AND EMPLOYMENT

The central bank's current 1980 GDP projection (in terms of constant 1962 colones) appears in Table 6. It anticipates a decline (in real terms) of only 1.5% in 1980. However, this central bank projection must be understood as being no more than a target which is most unlikely to be attained. The Ministry of Planning informally projects a decline of 2.5% in the 1980 real GDP on the assumption of implementation of the Emergency Plan. Without its implementation, the GDP is expected to drop by at least 5%. In my view, the expectation of even a 5% decline on the real GDP is still optimistic. Given the fact that private investment must be expected to be very low this year -- perhaps even close to zero -- and that this decline is certain to have a multiplier effect on income and consumption -- I would project the decline in the real GDP to be in the range of 6 to 9%. It is obviously too late in the year to hope for implementation of the reactivation plan in 1980.

There are no official statistics on unemployment. However, an estimate was made by Gustavo Leiva, head of a team

working on "Social Progress Indicators" for the Ministry of Planning in El Salvador under a ROCAP contract. On the basis of a sample survey conducted in January-February of 1980, he concluded that the "open" unemployment rate was only about 7.5%, but that about 50% of the work force was under-employed. After reducing under-employment to an open unemployment equivalent level, Leiva concluded that the overall unemployment rate (inclusive of under-employment) was 38%.

The number of workers in the manufacturing sector that lost their jobs during the year early in February of 1980 is estimated at over 15,000, which constitutes about 20% of the labor force employed in "large" and "medium" manufacturing establishments (defined as those that employed more than 5 people). Unemployment in the construction industry was recently estimated at 60% on the basis of a sample survey. Assuming that Leiva's 38% figure is on the high side, we hypothesize that 30 to 35% of the total Salvadoran labor force is unemployed after converting under-employment to an open unemployment equivalent basis.

VIII. THE VIEWPOINT OF THE PRIVATE SECTOR

I found the private sector considerably more optimistic than during my previous visits. At first blush, this may

appear surprising since violence, which the private sector still views as its major problem by far, has not abated. The newspapers record the toll: the daily body count is 25 to 30; kidnappings, bombings and burnings of business establishments are continuing (the restaurant La Carreta was burned during my stay). The destruction of buses has become the leftist favorite target with over 100 reportedly destroyed so far this year. The left apparently still dominates many unions as attested by the 24-hour interruption of all power production which forced the government to militarize all power installations and other key public services.

Yet, the outlook of the private sector leaders I have interviewed was considerably more up-beat than on my previous visits. Major factors behind this change of mood include:

1. There is considerably more dialogue between the private sector and the Junta. The private sector feels that its viewpoint is much better understood.

2. The armed forces are seen as playing a much more active role. Declaration of the state of siege put an end to the mass street demonstrations that interrupted all productive and commercial activity. The armed forces are seen as carrying the war to the enemy. Guerrillas are pursued and engaged.

The private sector was cheered by the capture of Samayoa, the former Minister of Education turned guerrilla leader; and feels that it is no longer the only or even the main target of leftist violence. The active role played by the security forces has reduced the amount of pressure that the extreme left is able to bring to bear against the private sector.

3. The extreme left has unwittingly promoted an alliance between the Junta government and the private sector through indiscriminate resort to violence. For a while, the strategy of the government was to placate the left. When that policy failed dismally, the government had no alternative but to answer force with force. In the process, it has allied itself with "the productive forces."

4. The private sector was encouraged by the failure of the two recent attempted general strikes in July and August. "We were in this together with the government," they said. They feel that these strikes have marked a turning point in the attitude of the government. Previously, the Ministry of Labor automatically took the side of the strikers, forcing businesses to continue the full payment of wages to striking workers. This came close to bankrupting a number of firms. Now, the government has shifted its stand, considers the

strikes disruptive and illegal, and has dropped its demand for wage payments to strikers.

5. The private sector is also cheered by what they perceive as increased cooperation of the population with the authorities. They feel that the public is tired of the violence. Public indifference has given way to cooperation with the authorities. They see the left as having been rejected. People are less fearful now that the authorities are fully committed to the struggle.

6. The police and the security forces are also seen as being more effective. The installation of three telephones inviting hints from anonymous callers with regard to suspected guerrilla holdouts has triggered a number of successful crack-downs and discovery of arms caches.

It was made clear to me that the above does not mean that the private sector likes JRG policy or that it thinks that the reforms launched early this year were well-advised. The private sector is still critical of the reform program, noting that no compensation has been paid so far and that the rules of the game still have not been clearly defined. There is still fear that confiscations may extend to new areas. The banking and foreign commerce reforms, in particular, are

described as unnecessary and are viewed as doing more harm than good. Still, there is a feeling by most private businessmen (at least by those that have not been directly affected by the reforms) that they can live with them, and that the greatest threat by far is the continuing violence. On this score, I found, for the first time, real hope along with a determination to hang on.

IX. SUMMARY AND CONCLUSIONS

1. The current account of the balance of payments moved from a slight surplus in 1979 to a projected deficit of \$95 to \$170 million in 1980, depending on the behavior of imports during the balance of the year. Next year's current account deficit is projected to be significantly higher -- in the range of \$290 to \$370 million (line 5 of Table 1).

2. Main factors behind El Salvador's balance of payments difficulties include reduction in the marketing of coffee (in 1980), and in its production (in 1981); and a sharp reduction in the production of cotton in 1981. The decline in the exportation of manufactured products to the CACM in 1980 is also a contributing factor.

3. On capital account, the substantial private capital outflow in 1979, projected to continue through 1980, is

contributing to the balance of payments problem. The increase in the net capital inflow on "official" and "banking" accounts are not sufficient to offset the negative factors (the private capital outflow and the deficit on current account). The result is a serious disequilibrium in the overall balance of payments projected at about \$100 million in 1980 and at \$150 to \$210 million for 1981 (line 7 of Table 1).

4. The level of international reserves is far too low to permit the financing of these deficits. Imports will either have to be cut back or additional financing secured. The further cutback of imports would probably make it impossible to implement the economic reactivation program next year.

5. Fortunately, the country's debt service charges are still very low. The ratio of debt service charges to merchandise exports fluctuates between 2.5 and 4.5 percent over 1979-82.

6. The monetary-fiscal picture is more encouraging than it looked two months ago. Still, the rate of increase of total bank credit, and particularly of central bank credit, that has taken place so far this year and is scheduled for the balance of the year in the 1980 Monetary Program appears high. If total bank credit should continue to expand by 21% in 1981, there

would be little hope of achieving a reduction in the rate of inflation which has been running at an annual rate of 24% during the first half of 1980.

7. Central Government revenues have been falling behind target, but the authorities have compensated by also holding down current expenditures. Capital expenditures are expected to be approximately as budgeted. The overall Central Government deficit in 1980 is now projected at about £300 million, substantially above the 1979 level but still some 33% below the level budgeted in the National Emergency Plan. There is increasing evidence that the Plan will not be implemented -- at least not to the extent its budget calls for -- as the meeting of its expenditure targets financed, in large part, by internal credit creation would add substantially to inflationary pressures.

8. The 1980 GDP is projected to decline by some 6 to 9% in real terms (the government is more optimistic). Unemployment -- including allowance for under-employment -- is estimated at 30 to 35%, though reliable data are lacking.

9. While the level of violence is continuing unabated, the private sector is encouraged by the active role assumed by the security forces, the failure of the general strike

called in August, the perceived rejection of the left by the general population, and the fact that the government, in its bitter struggle with the extreme left, is seen as making common cause with the private sector. Communications between the private sector and the government have improved markedly in recent months. Still, it is far too early to state that the general security situation has improved or that an end of the violence is in sight.

TABLE 1

EL SALVADOR: BALANCE OF PAYMENTS
PROJECTIONS FOR 1980 AND 1981
 (In Millions of U.S. Dollars)

	1979	1980		1981	
	<u>1,134</u>	<u>1,006</u>	<u>998</u>	<u>963</u>	<u>963</u>
1. Exports (FOB)					
Coffee ^{1/}	685	589	589	525	525
Cotton ^{2/}	88	86	80	64	64
Sugar ^{3/}	27	11	11	19	19
Shrimp	12	14	12	15	15
Other (to rest of World) ^{4/}	51	56	56	60	60
To CACB ^{4/}	272	250	250	280	280
2. Imports (CIF) ^{5/}	-1,040	- 960	-1,027	-1,100	-1,180
3. Services (Net) ^{6/}	- 140	- 180	- 180	- 200	- 200
4. Transfers (Net)	56	40	40	50	50
5. Balance on Current Account	11	- 94	- 169	- 287	- 367
6. Capital (Net)	- <u>119</u>	- <u>3</u>	- <u>72</u>	- <u>140</u>	- <u>160</u>
Private ^{7/}	- 192	- 205	- 130	- 30	- 30
Official ^{8/}	40	87	87	90	110
Banking Long-Term ^{9/}	33	115	115	80	80
7. Overall Balance	- <u>108</u>	- <u>97</u>	- <u>97</u>	- <u>147</u>	- <u>207</u>

Source: ROCAP Economic Advisor with substantial assistance from
 Research Department of Central Bank

Footnotes to Table 1

1/Coffee: For 1980, assumptions as follows:

Sold during first half of 1980:

1,700,000 quintales at \$170 per quintal \$289 million

Projected to be sold during rest of year:

2,000,000 quintales at \$150 per quintal 300

Total for 1980 \$589 million

For 1981:

Exportable amount from 1980/81 crop:

3,000,000 quintales

Carry over from prior year: 500,000

Total 3,500,000 quintales

3,500,00 at \$150 \$525 million

2/Cotton: For 1980:

From 79/80 crop 1,150,00 quintales

From new 80/81 crop 50,000

Total 1,200,000 quintales at \$71.5 \$ 85.8 million

For 1981:

1980/1981 crop (25% reduction from

1979/80) 900,000 quintales

Less exported in 1980 - 50,000

Less internal consumption -200,000

Plus amount exported

imported 1981 from new

1981/82 crop +150,000

Total exportable in 1981 800,000 quintales

800,000 quintales at \$80 per quintal	\$64.0 million
<u>3/Sugar: For 1980:</u>	
800,000 quintales at \$13.40 per quintal	10.7 million
For 1981:	
Total exportable crop is estimated at	
1,025,000 quintales	
Sold in advance (in futures market)	
at \$16 per quintal:	
875,000 at \$16	14.0 million
Available to be sold at market price:	
150,000 quintales at \$30	4.5 million
Total	<hr/> \$18.5 million

4/Other Products (mostly manufactures):

For 1980, conservatively projected on basis of exports during January-April 1980. (Exports to the CACM over January-April 1980 were \$101 million, or \$304 million at annual rate.) The projection for 1981 assumes a moderate recovery over 1980, though exports of these "other goods" are still projected to fall below the 1979 level in real terms.

5/Imports: For 1980:

Obtained by projecting actual imports over January-May at annual rate. (The high figure is based on foreign

exchange transactions, the lower one on import licenses issued.)

For 1981:

Projected at 15% above the 1980 level.

6/Net Services:

Some increase in the net deficit on service account is projected for 1981 as a result of increases in interest payments on foreign loans.

7/Net Private Capital Outflow:

Projected by the Central Bank as a residual. The Central Bank estimated the maximum decline in foreign exchange reserves that it would permit -- about \$40 million -- then estimated independently the other items in the balance of payments, except for the net private capital outflow which was obtained as a residual. The country's short-term indebtedness (falling due in 1980), with expected coffee stocks pledged as collateral, is estimated as follows:

Outstanding Indebtedness of private

Coffee exporters (as of Dec. 31, 79) US\$ 45.0 million

Outstanding Indebtedness of Coffee

Institute as of Dec. 31, 79
(Direct loans and advances)

197.0

Total Debt Outstanding with Coffee
Pledged as Collateral

242.0 million

8/Official long-term capital inflow:

Central Bank projection. The alternative (and higher) projection for 1981 reflects the hope for an increase in IDI funds to finance the reactivation program.

9/Includes only credits of over one year. The decline in 1981 reflects the fact that El Salvador may not be able to obtain additional medium-term loans from the Central American Monetary Stabilization Fund or from foreign commercial banks.

TABLE 2

EL SALVADOR: INTERNATIONAL RESERVES,
1975-1980
(In millions of U.S. dollars)

<u>End of Year</u>	<u>Gross International Reserves</u>	<u>Net International Reserves</u>
1975	127.6	130.1
1976	213.8	205.6
1977	233.7	205.7
1978	288.0	234.4
1979	161.5	134.6
April 6, 1979	296.0	269.4
August 10, 1979	311.0	291.7
December 28, 1979	161.5	134.6
April 4, 1980	104.6	- 14.4
August 8, 1980	144.8	- 2.1

Source: Banco Central de Reserva, Revista Mensual for March 1980, and Reporte Monetario Semanal for Dec. 28, 1979; April 4, 1980, and August 8, 1980

Table 3

Service Charges on the External
Public Debt

(In million of dollars)

	(1) Amortization	(2) Interest	(3) Total Charges	(4) Merchandise Exports (Projected)	(5) Service Charges as % of Exports %
1979	15.6	14.1	29.7	1134	2.6
1980	18.2	17.3	35.5	1006	3.5
1981	21.0	22.0	43.0	963	4.5
1982	18.0	25.0	43.0	1100	3.9

Source: World Bank for 1979. Revista Mensual, March 1980; for 1980-82, unpublished data.

TABLE 4

TRENDS IN BANK CREDIT, BANK DEPOSITS AND MONEY SUPPLY
DEC. 28, 1979 TO APRIL 4, 1980
(In Millions of Colones)

	<u>Dec. 28, 1979</u>	<u>April 4, 1980</u>	<u>Aug. 8, 1980</u>	<u>Percent Increase Dec. 28, 79 - Aug. 8, 80 at annual rate</u> %
Total Credit of Banking System	3,228	3,638	3,730	25.7
Total Credit Extended by Central Bank	1,561	2,084	2,195	69.6
Deposits of Savings and Loan Associations	441	352	464	8.9
Deposits of Commercial Banks	1,716	1,735	1,729	1.3
Money Supply (Currency plus demand deposits, excluding govt. deposits)	1,408	1,531	1,269	-15.6 ^{1/}
Consumer Price Index (Dec. 1978 = 100)	114.8	121.2 (March)	128.5 (June)	23.9 ^{2/}

^{1/} The contraction is mostly a seasonal phenomenon. The money supply is subject to sharp seasonal fluctuations, bottoming in August and peaking in Jan. - Feb. Note that between Aug. 10, 1979 and Aug. 8, 1980, the money supply expanded from ₡1,063 million to ₡1,269 million, or by 19.4%.

^{2/} Dec. - June at annual rate.

Source: Central Bank. Reporte Monetario Semanal
of Jan. 1, 1980, April 10, 1980, and August 8, 1980.

Table 5

SUMMARY OF FISCAL SITUATION OF CENTRAL GOVERNMENT
1978-1980
(IN MILLIONS OF COLONES)

	Actual 1978	Actual 1979	Original Budget	1980	
				Emergency Plan	Current Estimates
Current Revenues	1027.0	1215.4	1292.8	1324.8	1200
Current Expenditures	782.8	838.2	1123.0	1294.4	1000
Surplus on Current Account	244.2	377.2	169.8	30.4	200
Capital Expenditures*	<u>341.8</u>	<u>414.8</u>	<u>524.4</u>	<u>477.8</u>	<u>500</u>
Direct Investment (Physical and Financial)	119.4	171.8	326.4	381.5	302
Transfers	123.0	131.1	124.1	94.1	124
Prior Year Obligations	99.4	111.9	73.9	2.2	74
Amortization of Public Debt	33.0	28.8	28.7	28.7	29
Total Expenditures (Net of Amortization)	1124.6	1253.0	1647.4	1772.2	1500
Overall Deficit*	- 97.6	- 37.6	-354.6	-447.4	-300
Financing Required (Net)**					
External	96.7	30.0	143.7	214.4	150
Internal (and change in Cash Balance)	.9	7.6	210.9	233.0	150

* Excluding amortization

** Net of amortization payments

Source: Central Bank

TABLE 6

GROSS DOMESTIC PRODUCT
(In Millions of Constant 1982 Colones)

	1978		1979 ^{1/}		1980	
	Q	Increase %	Q	Increase %	Q	Increase %
<u>Consumption</u>	<u>3,384.7</u>	<u>3.5</u>	<u>3,247.5</u>	<u>-4.1</u>	<u>3,203.0</u>	<u>-1.4</u>
Private	2,953.5	2.6	2,798.8	-5.2	2,727.9	-2.5
Public	431.2	9.6	448.7	4.1	475.1	5.9
<u>Gross Internal Domestic Investment</u>	<u>795.6</u>	<u>4.2</u>	<u>629.8</u>	<u>-20.8</u>	<u>710.7</u>	<u>12.8</u>
Fixed Capital Formation	751.9	11.0	700.7	- 6.3	725.5	3.5
Private	505.6	17.4	445.0	-12.0	391.6	-12.0
Public	246.3	- 0.1	255.7	3.8	333.9	30.6
Changes on Inventories	43.7	-	-70.9	-	-14.9	-
Exports	689.8	15.5	849.3	23.1	769.6	-9.4
Imports	1,296.8	8.3	1,196.9	-7.0	1,206.5	.8
GDP	3,583.3	4.8	3,529.7	-1.5	3,476.8	-1.5

Source: For 1978-79, Central Bank. For 1980, "target" projection by Central Bank.

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August 25, 1980

ANNEX

THE CASE FOR A \$20 MILLION ESF TO FINANCE THE IMPORTATION OF RAW MATERIALS FOR THE INDUSTRIAL SECTOR

In this Annex, I will briefly summarize the case for a \$20 million ESF program to finance the importation of raw materials and intermediate goods for the industrial sector.

I. Economic Justification: Establishment of Need

The foregoing macro-economic survey presents a number of facts that support the need for a program that has the following characteristics: (a) provides immediate foreign exchange to cover the balance of payments deficit; (b) is quick-disbursing; (c) assists the private sector, whose supply of working capital was adversely affected by strikes, violence, the reduced liquidity of the banking system and the closing of the revolving lines of credit traditionally provided by foreign banks.

Specifically, the major arguments establishing need are as follows:

1. The balance of payments deficit: the overall balance of payments deficit was estimated at about \$100 million in 1980 and \$150 to \$210 million in 1981 (see Table 1).

2. The low level of international reserves: net international reserves were negative on April 4, 1980 and August

Annex A-1

Import Requirements:

Major Raw Materials and Intermediate
Goods Needed by the Industrial Sector
According to the Asociación Salvadore-
ña de Industriales (ASI).

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8, 1980 (Table 2). The sale of the country's gold stock was shown to be an unattractive alternative which the authorities would consider only in an extreme emergency.

3. The GNP in real terms may decline by 6 to 9% in 1980. The unemployment rate (with allowance for under-employment) was estimated to range from 30 to 35 percent.

4. Reduction in the supply of working capital in the private sector. This development is due to the following factors:

a. Decline of sales in the internal market owing to the contraction of incomes (resulting from factory closings, strikes, threat of violence, reduced exports, and sharp decline in private investment).

b. Direct interference with industrial production as a result of strikes and labor unrest.

c. Large-scale capital flight in both 1979 and 1980.

d. Difficulty of obtaining credit from domestic banks as a result of the reduction in bank liquidity (due to withdrawal of deposits, capital flight and delays in the recovery of bank loans).

e. Reluctance of foreign banks to renew traditional lines of credit or make new loans.

To document the latter point, ASI representatives reported that they participated in a mission last June to persuade

Annex A-2

Data on Import Requirements of Inter-
mediate Goods for the Industrial Sector,
1975-79, Provided by the Central Bank.

U.S. commercial banks to re-open traditional lines of credit. The amount sought was only \$60 to \$80 million. The mission was a failure. U.S. commercial banks informed the delegation that no loans could be contemplated as long as tranquility in the country was not restored. The central bank received the same message.

II. THE MAGNITUDE OF THE NEED

What is the overall annual financial requirement for the importation of raw materials and intermediate goods for the industrial sector? Two estimates were made available to me. Data prepared by the central bank (presented in Annex A-2) shows that total imports of intermediate goods were 7948 million (\$339 million) in 1978 and 7938 million (\$383 million) in 1979. The second estimate by the Asociación Salvadoreña de Industriales (ASI) is somewhat higher; it estimates the annual requirement at \$463 million (see Annex A-3).

These estimates refer to the total import requirement for raw materials and intermediate goods, not to a foreign exchange gap. The major part of this import requirement will be covered through foreign exchange earnings derived from the export of primary products and manufactured goods (the latter mostly to the CACM). The total foreign exchange gap in 1981 was estimated in the balance of payments analysis at \$150 to \$200 million.

Annex A-3

Financing Required for the Importation of
Intermediate Goods for the Industrial
Sector According to the Asociación Salvado-
reña de Industriales (ASI).

The annual credit requirement of the industrial sector is estimated by ASI at a much lower figure -- 490 million (\$196 million - See Annex A-3). Moreover, this line of credit will be "revolving" with an average maturity of only four months. What is needed, according to ASI, is a standing line of credit to the industrial sector of only 163 million (\$65 million) which would, by turning over three times a year, generate a total amount of credit of 490 million (163 million x 3) per year, equal to US\$ 196 million.

What proportion of this requirement will be met by the ESF program? It is expected that there will be a multiplier effect to the \$20 million in foreign exchange resources that AFD proposes to provide under the ESF. The Central Bank would be expected to make available at least another \$20 million in matching funds. Thus, a minimum of \$40 million would become available for the purpose. On the assumption that it would turn over three times during the year, it would provide some \$120 million in credit for working capital*. Thus, the combined ESF-Central Bank contribution would meet about 61% (\$120 million out of \$196 million) of the total estimated annual credit requirement of the industrial sector.

* though not, of course, \$120 million in foreign exchange since a substantial proportion of the finished output would be sold in the domestic market.

III. THE BENEFICIARIES

While the primary beneficiaries are the companies receiving the credits, the benefits will be broadly disseminated in the economy. The increase in unemployment in the manufacturing sector during the 12 months, ending in February of 1980 is estimated at 15,200. Hopefully, the reemployment of many of these would be made possible by the reactivation of the industrial sector. Consumers stand to benefit from increased industrial production, while producers in the agricultural sector will experience an increase in demand for their products. The foreign exchange gap will be reduced to the extent that a portion of the increased manufacturing output made possible by the program can be marketed abroad.

Still, it would be most desirable to design the project so as to ensure that small industrial establishments are included among the direct beneficiaries of the credits provided under the project. The mechanism for channelling funds to that sector exists. It consists of the Sociedad de Comerciantes e Industriales Salvadorense (SCIS) which has some 2500 members, including 500 small industrial enterprises; the Fondo de Financiamiento y Garantía para la Pequeña Empresa (FICAPE), an autonomous public institution whose primary function is to provide small loans to small enterprises;* and the Cooperativa de Crédito y Ahorro para

*Beneficiaries of FICAPE's loans must have assets of no more than Q100,000 (\$40,000) and no less than Q5,000 (\$1,900). They also must have a minimum of three employees.

Pequeños y Medianos Comerciantes e Industriales, a credit coop which, according to the information provided to me by the President of SCIS, is the most effective organization for channelling credit to small industrial establishments. It is strongly recommended that \$3 million be set aside for lending to small industrial enterprises through FIGAPE and the cooperative.

Note that the major need of the small industrial enterprises is not for foreign exchange but for working capital loans. Thus, the Central Bank would be asked, as part of this project, to set aside a revolving fund of 7.5 million colones (equal to \$3 million) to lend in local currency to small industrial establishments through FIGAPE and the cooperative.

IV. SOME KEY ISSUES

1. Why does our assistance have to take the form of an ESF grant rather than a 20 or 25-year development assistance loan?

Given El Salvador's rather low current debt service ratio, it is certainly true that El Salvador could service a long-term loan on concessionary terms. However, the basic condition for ESF assistance --- critical economic and political conditions is certainly met in El Salvador at this time. Moreover, the type of assistance that El Salvador needs is quick-disbursing balance of payments assistance which the ESF program has been designed

to provide. Project assistance, while essential to El Salvador's long-term development requirements, would not meet the present emergency need nearly as well, particularly, in view of the fact that the current pipeline of projects (and the dislocation caused by the political turmoil) is already severely straining the implementing capacity of the bureaucracy.

2. Is the shortage of working capital that the ESF program is addressing the most important bottleneck to economic recovery?

Admittedly, no. The most important obstacle by far to economic recovery is the state of violence. However, the absence of working capital in the industrial sector is a significant obstacle to that sector's recovery. Failure of the economy to recover would mean persistence, or even aggravation, of the present serious unemployment problem which may pave the way to further violence and make the job of restoring order more difficult to achieve.

3. Will the funds get to the people who need them the most?

Disbursements will obviously have to be monitored by the Mission. By providing that a set amount be channelled to small industrial enterprises through the coop and FIGAPE, the program will ensure that this sector, which complains that it has been consistently neglected in the past, would be able to actively participate in the recovery program.

It is envisaged (on a very preliminary basis) that direct implementing responsibility will be vested in ASI (for loans to medium and large firms) and in the coop and FIGAPE (for the portion channelled to small enterprises), with the Central Bank and the mission performing a monitoring role.

The detailed mechanism designed to ensure the appropriate handling and monitoring of the proposed revolving fund will be worked out after approval in principle on providing ESF assistance has been received.

ANIMALES DE RAZA FINA EN PIE
AVES DE CORRAL DE RAZA FINA
TRIGO
CEBADA
MALTA
ACEITES MINERALES
ACEITES VEGETALES
PLANTAS MEDICINALES
ASFALTO
ALQUITRAN
ACEITE DE HULLA
CUEROS CRUDOS
CUEROS CURTIDOS
PRODUCTOS QUIMICOS INDUSTRIALES
PRODUCTOS QUIMICOS FARMACEUTICOS
PRODUCTOS QUIMICOS BIOLÓGICOS
SULFOS
VACUNAS
ANTIBIOTICOS
MATERIALES CURTIENTES, NATURALES Y QUIMICOS
PRODUCTOS QUIMICOS PARA LIMPIEZA DE MAQUINARIAS
DETERGENTES, SUAVISANTES Y OTROS MATERIALES QUIMICOS INDUSTRIALES
PRODUCTOS DE MADERA PARA USO INDUSTRIAL
CORCHOS Y MATERIALES DE CORCHO
CAUCHO Y PRODUCTOS DE CAUCHO
HIERRO EN LINGOTES
ZINC, COBRE, BRONCE, ESTAÑO, PLOMO, HIERRO, ALUMINIO, Y OTROS MINERALES EN FORMAS PRIMARIAS COMO DECIR: LINGOTES, VIRUTAS, ARENAS

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PLANCHAS, LAMINAS, TUBOS, VARILLAS, PERFILES, ANGULOS Y DEMAS
FORMAS PARA LA INDUSTRIA.

CARTON, PAPEL, CARTULINA Y ARTICULOS DE ESTOS MATERIALES
INSTRUMENTOS CIENTIFICOS

INSTRUMENTOS PARA DETERMINAR CALIDAD DE MATERIALES

INSTRUMENTOS DE INGENIERIA Y ARQUITECTURA

HERRAMIENTAS DE MANO

HERRAMIENTAS AGRICOLAS

MAQUINARIA EN GENERAL, SUS REPUESTOS Y ACCESORIOS

DERIVADOS DEL PETROLEO' COMO DECIR: PRODUCTOS Y SUB-PRODUCTOS
QUE NO SEAN GASOLINA Y SIMILARES.

PLASTICOS EN FORMAS PRIMARIAS COMO DECIR: LAMINAS, TUBOS, PLAN
CHAS, BLOQUES, GRUPOS.

RECINAS SINTETICAS

RECINAS PLASTICAS

VEHICULOS Y EQUIPOS DE TRANSPORTE

HILOS, HILAZAS, TEJIDOS DE MEZCLAS DE TODA CLASE DE FIBRAS

MAQUINAS, EQUIPOS Y SUS REPULSTOS Y ACCESORIOS

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SECTOR INDUSTRIAL

Código	Descripción	1975		1976		1977		1978		1979	
		Miles	%								
4000	Productos elementales	10,000	1.5	10,500	1.5	11,000	1.5	11,500	1.5	12,000	1.5
4001	Alimentos	4,000	0.6	4,200	0.6	4,400	0.6	4,600	0.6	4,800	0.6
4002	Teleros	2,000	0.3	2,100	0.3	2,200	0.3	2,300	0.3	2,400	0.3
4003	Textiles	1,000	0.1	1,050	0.1	1,100	0.1	1,150	0.1	1,200	0.1
4004	Alfalfa y forraje	3,000	0.4	3,150	0.4	3,300	0.4	3,450	0.4	3,600	0.4
4005	Industria de la madera	5,000	0.7	5,200	0.7	5,400	0.7	5,600	0.7	5,800	0.7
4006	Industria de papeles	1,000	0.1	1,050	0.1	1,100	0.1	1,150	0.1	1,200	0.1
4007	Industria de caucho	2,000	0.3	2,100	0.3	2,200	0.3	2,300	0.3	2,400	0.3
4008	Industria de cerámica	3,000	0.4	3,150	0.4	3,300	0.4	3,450	0.4	3,600	0.4
4009	Industria de vidrio	2,000	0.3	2,100	0.3	2,200	0.3	2,300	0.3	2,400	0.3
4010	Industria de metales	10,000	1.5	10,500	1.5	11,000	1.5	11,500	1.5	12,000	1.5
4011	Industria de maquinaria	5,000	0.7	5,200	0.7	5,400	0.7	5,600	0.7	5,800	0.7
4012	Industria de productos químicos	3,000	0.4	3,150	0.4	3,300	0.4	3,450	0.4	3,600	0.4
4013	Industria de otros productos	2,000	0.3	2,100	0.3	2,200	0.3	2,300	0.3	2,400	0.3
4014	Industria de otros productos	1,000	0.1	1,050	0.1	1,100	0.1	1,150	0.1	1,200	0.1
4015	Industria de otros productos	1,000	0.1	1,050	0.1	1,100	0.1	1,150	0.1	1,200	0.1
4016	Industria de otros productos	1,000	0.1	1,050	0.1	1,100	0.1	1,150	0.1	1,200	0.1
4017	Industria de otros productos	1,000	0.1	1,050	0.1	1,100	0.1	1,150	0.1	1,200	0.1
4018	Industria de otros productos	1,000	0.1	1,050	0.1	1,100	0.1	1,150	0.1	1,200	0.1
4019	Industria de otros productos	1,000	0.1	1,050	0.1	1,100	0.1	1,150	0.1	1,200	0.1
4020	Industria de otros productos	1,000	0.1	1,050	0.1	1,100	0.1	1,150	0.1	1,200	0.1
4021	Industria de otros productos	1,000	0.1	1,050	0.1	1,100	0.1	1,150	0.1	1,200	0.1
4022	Industria de otros productos	1,000	0.1	1,050	0.1	1,100	0.1	1,150	0.1	1,200	0.1
4023	Industria de otros productos	1,000	0.1	1,050	0.1	1,100	0.1	1,150	0.1	1,200	0.1
	TOTAL	250,000	100	255,000	100	260,000	100	265,000	100	270,000	100

Elaborado por el INEC, 1975/1979

ASOCIACION SALVADOREÑA DE INDUSTRIALES

SAN SALVADOR, EL SALVADOR, C. A.



MEMORANDUM

PARA : SEÑOR MINISTRO DE PLANIFICACION Y COORDINACION
DEL DESARROLLO ECONOMICO Y SOCIAL,
LIC. ATRILIO VIEYTEZ

DE : ASOCIACION SALVADOREÑA DE INDUSTRIALES

ASUNTO : CRECIMIENTO Y NECESIDADES FINANCIERAS DEL
SECTOR INDUSTRIAL.

FECHA : Mayo 19, 1980

1. PRODUCTO TERRITORIAL BRUTO A PRECIOS CORRIENTES

Se estima en 1.432 millones de colones para el año de 1980, sin deducir la pérdida de producción durante los primeros 4 meses de dicho año debido a la problemática socio-política y económica.

2. FINANCIAMIENTO NECESARIO

Considerando la íntima correlación entre el financiamiento y el PTB del sector, es necesario un 34.24% de financiamiento, o sean unos ₡490 millones.

Considerando el estado de recesión de la economía y la iliquidez consiguiente, la necesidad de refinanciamiento más amplio es indispensable. Dicho refinanciamiento se estima en un 18% del volumen total del crédito, vale decir unos ₡88 millones. Este refinanciamiento debería de ser a plazo mayor de un año, pues de lo contrario, la iliquidez se haría presente.

Lo expresado indica que para capital de operación se necesitarían unos ₡402 millones y para refinanciamiento ₡88 millones.

Es obvio que si el PTB estimado fuese menor, el volumen del crédito también lo sería, aunque no de manera proporcional, debido a que el volumen de refinanciamiento se considera constante y, como es na

tural, al no generarse capital de trabajo propio de las empresas debido a una disminución en sus niveles de producción, se presentaría un estado de iliquidez que sólo podría resolverse aumentando el refinanciamiento.

3. NECESIDAD DE DIVISAS

Para satisfacer las necesidades de materias primas y demás necesarios para la producción y consecuentemente para alcanzar el PIB estimado, habría necesidad de \$463 millones. Esto desde luego con la reserva de que habría que deducir las importaciones ya efectuadas durante los primeros 4 meses de 1980, lo que daría por resultado una necesidad de \$309 millones para el resto del año, si es que el proceso de importación fue normal durante el primer cuatrimestre.

4. MEIDAS COLATERALES A NIVEL DEL SISTEMA BANCARIO

- a)- Un estricto control del ingreso de las divisas provenientes de las exportaciones de aquellas empresas que tienen un mercado internacional para sus productos;
- b)- Un control efectivo mediante el análisis de Estados Financieros periódicos, para garantizar el uso de los créditos;
- c)- Flexibilidad de parte del sector bancario a fin de considerar con prioridad la necesidad de reactivar la economía sin referencia con demasiado énfasis hacia los aspectos de garantía de los créditos, siempre y cuando las empresas beneficiarias acusen una razonable situación financiera y con un record crediticio aceptable.
- d)- En los casos de empresas que requieran financiamiento por encima de los límites que una institución financiera en particular pueda otorgar a una sola persona, deberán hacerse los arreglos necesarios para consorcios entre varias instituciones financieras;
- e)- Regular a las empresas el reparto de utilidades, como medida transitoria y de emergencia, indispensable para la rehabilitación económica del país.
- f)- Facilitar a las empresas el otorgamiento de avales por parte del sistema bancario, cuando existan fuentes de financiamiento externo;
- g)- Que el refinanciamiento de deudas sea flexible para evitar el estrangulamiento del proceso de producción.

5. ACCIONES DE "ASI"

ASI está dispuesta a colaborar con el Gobierno, con el sector bancario y con los empresarios, en el sentido de dar la asistencia técnica que sea requerida, así como la información que se considere necesaria a fin de facilitar y expeditar el proceso de financiamiento y consiguientemente de reactivación del sector. A tal efecto se propone:

- i - Realizar reuniones periódicas para hacer conciencia entre los empresarios en el sentido de moderar si no mantener los niveles de precios de los artículos que producen para aliviar la presión inflacionaria.
- ii - Hacer conciencia sobre la importancia de suministrar información veraz, constante y oportuna para tener elementos de juicio a nivel de la empresa, así como a nivel del sector, para facilitar el proceso de reactivación y el establecimiento de programas tendientes a fortalecer la industria en general.
- iii- Se harán viajes y se realizarán programas de divulgación para restaurar la confianza en el país en el exterior e internamente.
- iv - Se asesorará y orientará a los empresarios sobre la forma en que puedan mejorar sus mercados externos.
- v - En fin, ASI realizará todos los esfuerzos a su alcance para contribuir a la rehabilitación de la economía y al gradual restablecimiento de condiciones económicas que conduzcan eventualmente a una paz social y a un mayor bienestar del pueblo salvadoreño.

6. ACCIONES COMPLEMENTARIAS DEL GOBIERNO

El Gobierno por su parte deberá adoptar una política efectiva de apoyo a la industria nacional, dando preferencia, en igualdad de condiciones de precio y calidad, al producto manufacturado en el país.

ASOCIACION SALVADOREÑA DE INDUSTRIALES


ALFREDO CHEDRAUI S.
DIRECTOR EJECUTIVO