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PARAGUAY:

**USAID LOAN RESCHEDULING FEASIBILITY
BANCO DE DESARROLLO
COMDESA**

**Prepared for:
Agency for International Development
LAC/PS
Contract No. LAC-0619-C-00-7038
(Task No. 34)**

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International Science and Technology Institute, Inc.

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BANCO DE DESARROLLO (COMDESA) PARAGUAY ASSESSMENT

TABLE OF CONTENTS

I.	Executive Summary and Recommendations	1
II.	Project Context	4
	II.1 The Paraguayan Economy	4
	II.2 USAID/Paraguay Problem Loan Strategy	9
III.	Project Description	10
	III.1 Overview of USAID Medium-Term Loan Program	10
	III.2 History of Banco de Desarrollo (COMDESA) Loan	10
IV.	Project Assessment	12
	IV.1 Purpose	12
	IV.2 Methodology	13
	IV.3 Findings	14
	IV.3.1 Scope of Assistance	14
APPENDICES	.....	31

BANCO DE DESARROLLO (COMDESA) PARAGUAY ASSESSMENT

DETAILED OUTLINE

Executive Summary

- II. Project Context
 - II.1. The Paraguayan Economy
 - II.1.1. Macroeconomic Indications/Observations
 - II.2. USAID/Paraguay - Problem Loan Strategy
- III. Project Descriptions
 - III.1. Overview of USAID Medium Term Loan Program
 - III.2. History of Banco de Desarrollo (COMDESA) S.A.
 - III.2.1. History of Banco de Desarrollo (COMDESA) Loan
 - III.2.2. General Background of Problem
 - III.2.3. Goals & Objectives of COMDESA
- IV. Project Assessment
 - IV.1. Purpose
 - IV.2. Methodology
 - IV.2.1. Planning
 - IV.2.2. Document Review
 - IV.2.3. Interviews
 - IV.2.4. Negotiations

IV.3. Findings

IV.3.1. Scope of Assistance/Terms of Reference

IV.3.2. Analysis of COMDESA'S Financial Statements

IV.3.3. Review of Regulatory Policies

IV.3.4. Review of Negotiations

IV.3.5. Development of options for Repayment of Debt

IV.3.6. Project Constraints

IV.4. Recommendations

IV.4.1.

IV.4.2.

IV.4.3.

IV.4.4.

APPENDICES

1. Paraguay: Key Economic Indicators
2. Economic Performance of Lower Middle Income Countries- Selected Indicators
3. Medium and Long Term Debt Burden of Lower Middle Income Countries
4. Central Bank of Paraguay comfort letter, dated Sep. 6, 1973
5. Jose Diaz Memorandum, dated Feb 1, 1989
6. Dollar/Guarani Quotes: 1982-1988
7. Peter Orr Memorandum, dated Dec. 20, 1988
8. Draft of Options, undated
9. Progress Report, dated Jan. 22, 1989
10. Memorandum to Dr. Carlos Knapps, dated Jan 26, 1989 (English)
10. Memorandum to Dr. Carlos Knapps, dated Jan 26, 1989 (Spanish)
11. Memorandum to Dr. Crispiniano Sandoval, dated Jan 26, 1989
12. Secondary Market Rates for Government Debt in Default
13. Statement of Work/ TSO
14. Legal Opinion of Dr. Esteban Burt

EXECUTIVE SUMMARY

ASSESSMENT OF BANCO DE DESARROLLO (COMDESA) PARAGUAY

AID Project No. : 598-0619
ISTT Contract No. : LAC-0619-C-00-7038
Dates : January 12. - February 7., 1989
Consultant : Donn R. Davis

USAID/Paraguay requested the consulting services of the International Science and Technology Institute (ISTI) under the subject contract for an assessment of the feasibility of rescheduling two AID outstanding loans (526-L-019 and 526-L-025) which were not specifically guaranteed by the government of Paraguay. In addition, the consultant was to meet with senior management of both COMDESA and the Banco Central, to establish a mutually agreeable exchange rate to facilitate the repayment of the loans. Specifically, the consultant was to:

- 1) Analyze COMDESA'S financial statements for the last five years, its present portfolio, terms of lending, and capital structure. Review appropriate regulatory policies, particularly as they bear on feasible debt repayment options;
- 2) Review with Central Bank officials the salient factors in the above analysis and determine whether additional factors need to be considered in developing a negotiable plan;
- 3) Develop several options for repayment of the AID debt. Each option will be accompanied by cash flow analyses with sensitivity analysis for critical factors such as future movements of the free market exchange rate;
- 4) Provide an oral presentation of the above analysis to a joint AID/COMDESA/CENTRAL BANK Meeting.

This project began on Jan. 12, 1989 and was to end on Feb. 6, 1989. On Feb. 2-3, there was a military coup/revolution in Paraguay, with an immediate change in government on Feb. 3. While this will not materially change any of the recommendations in the report, some senior people in government who are mentioned in this report definitely will be replaced. It also caused a delay and the addition of two extra days of work in the USA, to make appropriate

changes and get it typed, because secretarial services were not available in Paraguay Feb. 3/4.

The methodology used in this assessment was to establish a work plan that involved the collection of information, the conduct of interviews, analysis of information and data, the negotiation of critical issues, the development of options, and the preparation of the report. The consultant was assisted in this project at various times by USAID officers from Bolivia and Montevideo, and from Asunción throughout the project.

The collection of information, review of files, investigation of banking procedures, review of loan portfolio, and compliance to the terms of the agreement took place in the offices of USAID, COMDESA, Banco Central del Paraguay, and the offices of the Superintendent of Banks. Interviews were held with officers of all these institutions. Negotiations to determine potentially feasible options, (but only for discussion purposes and without any commitment), were held with the four institutions mentioned above with the objective to determine that which would be reasonable to consider as a final solution to the problem loans.

The heart of the problem with these two dollars loans is that at origination, the guarantee of the government was not obtained. This is not the usual case of a dishonest borrower who misused or diverted funds, nor is the cause focused on COMDESA itself. The cause of this problem is exactly the same as similar ones which governments, banks and private companies in the developing world are facing today. The problem is the result of a contractual financial commitment denominated in dollars between an institution in the USA and a bank domiciled in a developing country whose cashflow is limited to local currency income. The problem is then compounded as a function of an inflationary environment, with the inevitable subsequent devaluations of the local currency. It is a microcosm of similar problems endemic throughout the developing country world. Early solutions are not expected to be found for these problems.

Following an intensive review of the financial statements of Banco de Desarrollo (COMDESA) for the past five years, it is abundantly clear that this bank cannot service the dollar loan debt payable and currently past due, to USAID. This is because of thin spreads and insufficient cash flow. Additionally, high legal reserves exacerbate the problem.

This opinion is fortified upon reviewing written comments to the financial statements made by the Central bank and Superintendent of Banks, as well as discussions with the management of COMDESA concerning their projected cash flows. The basic problem is that their spreads between gross loan income, at about 28% p.a., and their average cost of funds of about 25/26 % p.a. simply is not sufficient to pay their operating and general expenses and service the debt. On top of this purely financial perspective in strictly guarani terms, the specter of some 30 % p.a. inflation, with subsequent devaluations causes the problem to become even worse. Please refer to Appendix 6, which shows month end guarani rate of exchange quotes against the US dollar beginning at Gs. 160 at the end of January 1982 and Gs. 1025 at year end 1988. This is a gain of 541%. It means the Guarani of year end 1988 had a relative value of

less than 20% of the 1982 Guarani. It is difficult to service a dollar debt in this kind of environment when the company, in this case a bank, cannot increase its own prices to offset the effect the inflation/devaluation.

In the consultant's view, the global problem is getting worse, not better. More permanent solutions probably will be forthcoming from a combination of sources such as multilateral institutions, bilateral entities, and commercial banks acting in concert to retire outstanding obligations so that new investment capital can once again flow to the developing countries.

It is recommended that:

(1) USAID Representatives make a concerted immediate effort to establish a relationship with the new President of the Central bank, the Minister of Finance, and with any new directors. It is recommended that the Economics counselor and the US Ambassador assist in this project by doing the same. The positive features of debt-equity swaps should be mentioned.

(2) USAID should not attempt to refinance the two past due subject loans for account of COMDESA, because of their absolute inability to repay the loan. Do not even consider refinancing the loan to COMDESA with the guarantee of the Central bank, because COMDESA can't service it.

(3) If USAID's solution to this problem is limited to refinancing the past due debt of COMDESA, that it do so only whereby the Central bank is the direct obligor, or credit taker. This can be achieved, to the benefit of all parties, under any of the the following three mechanisms;

A. COMDESA delivers Gs. 1,705,000,000 to the Central bank in payment the debt to USAID at a rate of Gs. 550 and the Central bank assumes the loan refinancing as the borrower, that is, the loan is rescheduled for 10 years, with equal semi-annual payments at a fixed lower than market rate of interest.

B. COMDESA enters the secondary market for official debt in default to buy past due obligations of Industria Nacional de Cemento, which are guaranteed by the Central bank, at an indicated rate of \$0.40-\$0.60 or better, using dollars obtained from the free market (Gs. 550 x \$3,100,000 = Gs. \$1,705,000,000 / Gs. 1100 = \$1,550,000) and deliver the past due Central bank guaranteed obligations to them in consideration of their assuming the debt as obligor of the the refinanced loan to 10 years with equal semi-annual payments at a fixed lower than market rate of interest.

C. COMDESA delivers Gs. 1,705,000,000 (Gs. 550 x \$3,100,000) to the Central bank and the Central bank enters the secondary market for past due official debt of Paraguay, such as the Industria Nacional de Cemento notes guaranteed by the Central bank, to retire it permanently, and simultaneously assume the refinanced debt of COMDESA to USAID by means of a 10 year loan with equal semi-annual payments at a fixed lower than market rate of interest.

II. Project Context

II.1. The Paraguayan economy

The following sections are direct quotes from a paper authored by Hugo Llorens, Economic Counsel, US. Embassy, Paraguay, entitled, "Foreign Economic Trends and their Implications for the United States", August 1988. Please refer also to Appendix 1 entitled "Paraguay: Key Economic Indicators", for additional statistical insights.

BACKGROUND (QUOTE)

During the heavy construction phase of the Itaipu hydroelectric dam project (1971- 81), the Paraguayan economy registered the fastest growth rates of any economy in the South American Continent (eight percent per annum). Beginning in 1982 a series of negative exogenous and endogenous variables combined to reduce sharply these rates of growth, thus creating a pattern of intermitent periods of recession (1982, 1983 and 1986) and modest recoveries (1984-85, 1987-88). Among the negative consequences of the relative downturn include not only reduced levels of real growth, but also abnormally high inflation rates, declining living standards, a flattening of investment levels, a deterioration in the Balance of Payments and large increments in external indebtedness.

Despite the relative decline in Paraguay's economic fortunes, the Paraguayan economy demonstrated its resilience during the past two years, recovering as it has from a devastating 1986 drought. On the back of a bullish agricultural sector that remains on a long term growth path in terms of output and infrastructure, the picture has brightened considerably. Nonetheless, the ability of the economy to increase its rate of growth above current levels in a sustainable manner is inexorably linked to the requirement for internal economic policy initiatives that have been noticeably absent since 1982. Efforts to streamline the cumbersome public sector apparatus would go far to open new horizons for faster paced development, and would permit the elimination of a number of exchange rate and fiscal disincentives that represent a major drag on private sector activity. Assuming positive economic reforms are adopted, Paraguay's long term growth potential is exceptional.

ECONOMIC REFORMS (QUOTE)

While the 1987-88 recovery has justifiably fueled optimism, concern remained about the 19 month absence of sorely needed short term and medium term economic reform measures. On July 4, 1988, the National Economic Policy Council announced the promulgation of corrective measures. The measures called for the adoption of a devaluation in the official exchange rate (from 320 guaranies per dollar to 400 guaranies per dollar) for public sector imports and external debt payments. The measures also eliminated several

"special" exchange rates of 126 and 240 guaranies per dollar used by various state owned industries applied to the repayment of certain old external agreements. To finance the higher cost to the public sector of the new exchange rate terms, effective July 1, by 10 percent and 15 percent, water, telephone, and telegraph utility rates were raised respectively. Electricity rates were also hiked by a total of 63 percent, to be gradually implemented over the coming year. Similarly, cement prices for the state run industry were increased by 26.5 percent. In conjunction with the above package, commercial bank loan and deposit rates were raised, narrowing the negative gap between existing rates and inflation. The implementation of these reform measures was a long awaited step in the right direction, that, in the case of the exchange rate, simplified the system. Nonetheless, the gap between the new import/external debt repayment rate (400 guaranies per dollar) and the existing real market rate (above 900 guaranies per dollar) remains large, resulting in significant Central Bank subsidies of the public sector --(more than 50 cents on the U.S. dollar) -- and unnecessary Central Bank foreign exchange reserve losses continue. Also, the failure of the government to provide a more realistic exchange rate for exports, is a serious shortcoming. Above all, the measures fail to address the fiscal, monetary and even exchange rate distortions that are at the heart of Paraguay's economic difficulties.

INFLATION (QUOTE)

One of the salient characteristics of Paraguay's economic travails since 1982 has been the rapid increase in inflation rates above the modest 10 percent per annum rates that prevailed during the previous two decades. Since 1985, consumer prices have increased an average of 30 percent per year, more than doubling price levels every three years. These high-by-Paraguayan-standards inflation rates are linked to the deterioration in Paraguay's public finances. Attempts to finance the chronic fiscal deficits by resorting to money supply expansions and borrowing from the Central Bank have engendered strong demand-pull pressures on consumer prices. Similarly, Government of Paraguay attempts to finance devaluations in the official exchange rate regimen have required large upward adjustments in public sector service prices (electricity, petroleum products, telephone, and water) which have also propelled cost-push effects on price levels.

In the first half of 1987, inflation rates, fueled by government decreed increases in utility rates and petroleum prices coupled with a 35.5 percent expansion in money supply (M1), hit record annual levels of nearly 45 percent. A relative tightening of credit levels as a consequence of cyclical factors in the second half of the year managed to contain the growth path in prices. In 1987, consumer prices settled at 33.3 percent. Despite continued rapid credit growth, 1988 inflation rates should be lower than in 1987. This is attributable to the relative strength of Paraguay's currency vis-a-vis those of key trading partners such as Brazil and Argentina, which has ensures stable, and in many cases, declining import prices on a variety of consumer products. Decreed utility price hikes in July should accelerate inflation in the second half, although inflation should be somewhat lower than in 1987. It is important to underscore that while Paraguay's recent price index increases are high compared to its traditionally low inflation standards in general,

these increases are significantly below those of neighboring Brazil and Argentina.

FISCAL (QUOTE)

Paraguay's public finances weakened considerably during the past five-to-six years and today represent the number one economic policy deficiency. A sharp falloff in public sector revenues beginning in 1982, combined with an acceleration in fiscal expenditures to finance a number of large public sector projects sowed the seeds for the large chronic fiscal deficits. In an effort to mitigate strong inflationary pressures inherent in the deficit, the government resorted to heavy Central Bank subsidies of the public sector enterprises by providing highly preferential exchange rates for public sector imports and external debt payments. These subsidies (Central Bank reserve losses), if accounted for, would currently balloon the fiscal deficit from four percent of GDP to above seven percent of GDP. The July government-decreed 25 percent devaluation in the official exchange rate regimen and the concomitant utility rate hikes are expected to reduce somewhat the level of subsidies in the second half of 1988. Similarly, efforts at budget cutting and an improvement in revenues, such as those derived from foreign trade, should marginally improve the fiscal accounts. However, the existing subsidies, at several hundred million dollars per year, is unsustainable in the medium term (three-to-five years). Adopting needed revenues measures to ensure that the non-financial public sector pays its way is a prerequisite short term measure. For the medium term, policy proposals to reduce the size and scope of the public sector remain the surest guarantee to sustainable growth in Paraguay.

BALANCE OF PAYMENTS (QUOTE)

BACKGROUND: During the period 1975-81, Paraguay consistently maintained balance of payments surpluses, while sustaining deficits in its trade and current account. The surpluses were made possible by the largest capital inflows derived for the construction of the Itaipu hydroelectric dam project in partnership with Brazil. With the conclusion of the heavy construction phase of Itaipu in 1982, Paraguay suffered severe balance of payments problems. These problems were compounded by sharp drops in international multilateral and private bank lending. Other factors adversely impacting on the balance of payments were drops in Paraguay's terms of trade, and negative climatic patterns' damage of exports crops (1983 and 1986). The failure to maintain market exchange rate incentives for exports represented the chief endogenous policy factor hampering export activity. In 1987-1988 improved export oriented agricultural production and higher export prices brightened the balance of payments picture.

EXTERNAL DEBT (QUOTE)

During the period 1981-87, Paraguay's disbursed public and private debt increased from \$1.0 billion to \$2.0 billion. During the same time frame, external debt service obligations skyrocketed from \$109 million per year to \$299 million. In 1987, Paraguay's debt service included \$180 million paid on principal and \$120 million in interest. In terms of actual payments, Paraguay's debt service payments as a percentage of total 1987 registered exports stood at 78.7 percent. Debt Service payments are projected to climb to \$340 million, although the debt service to export ratio should drop to 69 percent. The heavier debt burden has not prevented Paraguay from servicing the debt and avoiding across the board rescheduling agreements with its international creditors. The government has conducted ad hoc rescheduling agreements with some of its private creditors and is attempting a major rescheduling agreement with its largest bilateral creditors, Brazil. Nonetheless, the heavy debt burden continues to strain Central bank foreign exchange reserve levels, and has forced Paraguay into total arrears estimated at \$150 million.

Of the \$2.0 billion in total registered external debt, approximately 39.0 percent is held by the central government and an additional 61 percent is owed by the public sector enterprises. The largest debtors are: 1) The National Steel Company (ACEPAR) with \$325 million, or 16.4 percent of total debt; 2) The National Electric Company (ANDE) with \$252 million, or 12.5 percent of total debt; and 3) The National Cement Company (INC) with \$216 million, or 10 percent of total debt.

Among Paraguay's principal multilateral creditors are the Inter-American Development Bank (\$450 million), and the World Bank Group (\$410 million). Of the bilateral creditors, Brazil is the largest lender, with a credit balance of \$400 million, and France is second with \$200 million. By contrast, Paraguay's debt to the U.S. is an insignificant \$50 million.

U.S. creditors should take warning that recent Paraguayan judicial decisions (subject to appeal) questioning the concept of repayment of loans in foreign exchange, applicable to external debt obligations between international private banks and Paraguayan private firms, could result in major losses for international creditors here. This factor places in doubt the viability of all loans that are not guaranteed by the Paraguayan Government. (UNQUOTE)

The consultant cannot add much in constructive commentary on the Paraguayan economy to that mentioned above in Mr. Hugo Llorens's paper of August 1988. Since that time, however, some additional financial information on the current state of the economy was published in December 1988, and may be of interest. Toward the end of last year, there was a steady decrease in the level of foreign exchange reserves. This was caused by a reduction of income from exports, a decrease in new international investment, and fewer incoming transfers of capital from abroad. The deterioration of reserves could improve with the beginning of the export season in March. Actual available trade figures are unreliable since they do not reflect the total amount of goods exported or imported into the country. Some economists suggest that the figures represent only 40-50 percent of the true value of the country's trade.

The Central bank reported that as of September 30, 1988, net foreign exchange

reserves had descended to a level of \$169 million, at the same time that pending past-due external debt obligations totalled \$240 million. At present, the country seems to be servicing a part of its debt, on a selective basis and carrying another part in default. The overall budgeted dollar income requirements for 1988 was some \$600 million, a portion of which would be offset by exports, incoming transfers, and investments from abroad.

From all of the above, it seems clear that there will be considerably difficulty in servicing the external debt of Paraguay for the foreseeable future and that the deficit gap will widen. In the opinion of the consultant, the market value of Paraguayan financial obligations is not likely to increase in the near future.

II.1.1. Macroeconomic Indicators/Observations

While the above section on the Paraguayan economy is less than optimistic, the record should show that it is not alone in the troubled developing world debt situation. On a global basis, developing world debt continues to grow. From 1983 to the end of 1988, the developing nations total foreign debt grew from slightly less than \$700 Billion to an estimated year end \$1.25 Trillion in principal, a growth of about 40% according to the Oct. 3, 1988 issue of "Business Week". The seventeen most indebted countries, namely, Argentina, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, The Ivory Coast, Jamaica, Mexico, Morocco, Nigeria, Peru, The Philippines, Uruguay, Venezuela and Yugoslavia increased their debt by almost \$100 Billion to \$500 Billion, between 1982 and 1987, according to the September 1988 issue of Global Finance. Debt-to-GNP ratios have not improved in most of these countries and debt-to-exports ratios increased suggesting even more problems in servicing their international debt. Per capita income generally has declined in most of these countries for the same period.

The table in Appendix 2 from the "World Development Report, 1988" showing Medium and Long Term Debt Burden of Lower and Middle Income Countries, along with selected indicators such as debt per capita, debt per GNP, debt to exports, interest per capita, interest per exports, interest per debt, and short term debt to long term debt. From this table one can get an idea of where Paraguay stands among this grouping of countries. In Appendix 3, an additional appreciation for the economic performance of Paraguay, relative to other developing countries with similar problems, can be seen in the table entitled Economic Performance of Lower Middle Income Countries - Selected indicators. The source of this table also is the "World Development Report 1988".

The purpose of this section and these tables is to attempt to understand the position of Paraguay relative to other developing countries in order to evaluate the likelihood of repayment in a timely manner. If this debt were owing to private sector creditors, timely collection would be highly questionable. Paraguay, however, has tried to keep current repayments to its most important creditors, which are primarily bilateral and multilateral

lenders. Unless Paraguay implements some of the positive corrective measures recommended by the Central Bank near year end 1988, it will be difficult for it to continue to service even official debt in a timely manner. Hopefully, the new government will deal with the major problems such as streamlining and allocating fewer resources to the public sector companies, and more thoughtful exchange rate policies.

11.2. USAID/Paraguay Problem Loan Strategy.

The current strategy of USAID/Paraguay has been to open and maintain discussions between all parties to this problem, namely, COMDESA, Banco Central del Paraguay, the Superintendent of Banks Office, and USAID in an effort to resolve the problem forthwith after a rather elongated two-year period of facing past-due obligations without payment. These discussions have been aimed at obtaining a satisfactory rescheduling of the two loans, which only can be considered as truly satisfactory if the Banco Central del Paraguay is the ultimate credit-taker or is the guarantor. USAID has some reasonably compelling arguments to support the premise that the government of Paraguay, indeed, is a party to the contract between USAID and COMDESA for the following reasons:

1) The agreement was signed under the auspices of the Alliance for Progress and under the overall considerations of the signatories of the Act of Bogota and the Charter of Punta del Este.

2) Initial disbursement of funds under the agreement were made through letters of credit, whereby the "Account Party", which in commercial banking means the borrower, was the Government of Paraguay.

3) There exists a "comfort" letter dated September 6, 1973, signed by the President and the General Manager of the Banco Central, which strongly suggests active support for the loan. See Appendix 4.

4) Additional and numerous correspondence from other government offices, such as the Ministry of Finance, suggests that the establishment of this new medium term lending institution in Paraguay was done with the support of the Paraguayan government, which felt that it could contribute to the economic development of the country.

Given all of the above, the strategy of USAID is to assure that proper responsibility will be accepted by all parties to this solution and that USAID's considerable contribution to the process is its willingness to reschedule the loan under highly favorable terms. It should be noted that rescheduling this loan, especially if it is done under similar terms to that of the original loans, is a notable contribution to the solution. In today's financial world, it is difficult for even a Central bank in a developing country to obtain a dollar loan, or a voluntary rescheduling, let alone one which may enjoy a fixed and unusually low interest rate. The benefits to the Central bank of such a rescheduling would have to be seen as not only assisting a troubled local bank under its administration/jurisdiction, but also to help protect and attempt to assure an attractive continued source of

funds in the future. The record should show that USAID is interested in solving this problem in such a fashion that COMDESA would avoid going into bankruptcy. The Central bank should take this into consideration.

It is noted also that USAID's strategy does not include payment for less than face value, plus accrued interest, nor will it consider reinvestment of a partial payment in settlement of the debt, even though such a process could retire the entire obligation including interest in about 8-10 years. The policies of the U.S. government and the integrity of the USAID program take precedence over a specific transaction in Paraguay.

III. Project Description

III.1 Overview of USAID Medium Term Loan Program

In the middle 1960's a void was perceived in Latin America whereby there appeared to be very few financial institutions which had both the capacity, in terms of human resources and funding, and the willingness to make medium term loans (from 4-8 years) for productive purposes. Officers of USAID tried to fill this void with a kind of medium term funding program.

Usually this assistance took the form of soft loans, with maturities of from 10 to 20 years, at fixed lower than market interest rates. Often the beneficiaries of such loans were financial companies or banks which focused on the agricultural sector, although not exclusively so.

The typical loan had as its purpose the purchase or importation of agricultural equipment, which normally would require 5-8 years to repay from the proceeds of annual crops. The program seemed to work quite well in most countries until some rather heavy devaluations occurred, usually after 1982.

III.2 History of Banco de Desarrollo (COMDESA) S.A.

The Banco de Desarrollo was founded originally under the name Compañía Paraguaya de Desarrollo S.A. (COMDESA). Later, on September 6, 1976 they modified the statutes to reflect a change of name to Banco de Desarrollo S.A.

The purpose of the bank was to promote the establishment and expansion of companies in Paraguay which would contribute to the economic development of the country. On June 11, 1984, the Central bank authorized COMDESA to receive demand deposits, savings accounts, and fixed time deposits, as well as authorizing certain international operations.

The statutes of COMDESA generally follows the general banking law in Paraguay, such as capital to total liabilities ratios of 20 % or greater, but also relieves them from certain obligations of maintaining a given percentage of loans in various economic sectors. COMDESA is required to allocate 20% of annual profits to legal reserves. COMDESA does enjoy a unique advantage in that it can write loans with a readjustment clause related to the US dollar, because of the USAID dollar funding. In practice today, however, most

borrowers are reluctant to sign such a commitment because of inflation/devaluation. The bank has over 240 shareholders, with the largest single shareholder (ADELA Investment Company S.A.) holding 16.2 % of the shares. This may be a relative source of comfort to creditors.

It should be noted that in the past few years, the bank has transformed itself more along the lines of a standard commercial bank than that of a development bank. The fact that it now is involved in credit card activities, albeit a very small proportion of the total loan portfolio, is not a source of comfort to USAID officers, because of past negative experience with credit cards on the part of banks in other countries.

An analysis of COMDESA's loan activities was performed by Mr. José Díaz, of the USAID Bolivia Controller's office. His report is included in Appendix 5.

III.2.1 History of Banco de Desarrollo (COMDESA) Loan.

On August 28, 1970, a loan agreement was signed between COMDESA and AID (AID 526-L-019) for \$2,600,000., for a twenty year period with the final maturity falling due in May 1991. As of December 31, 1988, the amount outstanding under this loan was \$956,286. The loan currently is five semi-annual payments past due.

On August 7, 1973, a second loan agreement was signed between AID and COMDESA (AID 526-L-025) for \$3,000,000. The maturity of the loan is November 1993. As of December 31, 1988, the amount outstanding under the loan was \$1,602,591. This loan also is five payments past due. The proceeds of the loans which COMDESA made to its clients were in guaranies, in amounts equivalent to dollars at the rate of exchange at the time of disbursement. Prior to 1982, the rate of exchange was Gs. 126-US\$ 1. The loans, however, were written with dollar readjustment clauses, which did not present a problem until the exchange rate increased from Gs. 126 to Gs. 160 in 1981.

The readjustment clause caused great problems for COMDESA's clients, when the rate of exchange began to increase rapidly in the early 1980's. Today, there exists an accounting difference of opinion between COMDESA and government banking officials as to which rates of exchange for both loans on the asset side, and borrowings on the liability side of the balance sheet, should properly be used. The Central bank passed a regulation in 1986 decreeing that all private sector foreign debt be repaid at the free market rate of exchange. COMDESA refuses to accept this.

III. 2.2 General Background of the Problem

The historic problem is that either the guarantee of the government, or of the Central bank, was not obtained. Aside from that, and more currently, the Superintendent of Banks and the Central bank of Paraguay have not approved the balance sheet and profit and loss of COMDESA since 1985. The position of the government is that free market guarani rates of exchange should be used with respect to accounting for the USAID loans, because in December 1986, the

Central Bank promulgated a new regulation requiring that all private company debt be paid at a free market rate of exchange. As of December 31, 1988, this rate was Gs. 1025 to U\$S 1.

COMDESA's position is that there has been a historical commitment of the Central bank to provide dollars to it for servicing the USAID dollar loans at the official rate of exchange. It is their position that since inception of the loan, the Central bank provided dollars to them at official rates until 1986, when the new regulation came into effect. COMDESA feels the prior commitment excludes them (grandfathers them) from this regulation. Since presentation of its 1986 financial statements to the government authorities, COMDESA has refused to implement the requested accounting entries. They feel the request is inappropriate to them. It should be noted that everyone involved is acutely aware that if the accounting entries were insisted upon, in the absence of a significantly large new capital investment or some kind of government rescue program, COMDESA no longer could meet the minimum banking standards for banks, such as the capital to total assets requirement. Additionally, COMDESA feels that the banking authorities' acceptance of all banks' accounting for their dollar deposits abroad at a rate of GS. 126, is a broad concession to avoid massive non-compliance with financial structural requirements, and suggests that serious disparities already exist in the accounting systems for banks. Another point of COMDESA is that none of the bank's statements reflect anything near true value, because there does not exist an accepted mechanism for revaluing fixed assets, even though the free market guarani has devalued from Gs. 126 to over Gs. 1100 in the past seven years. See Appendix 6, entitled, Dollar/Guarani Quotes: 1982-1988. In short, there currently is a standoff between COMDESA and the Paraguayan banking authorities.

In the last few months, Mr. Peter Orr, USAID Representative stationed in Montevideo, Uruguay has had meetings with officials at the Central bank, the Superintendent of Banks' office and with COMDESA, in an attempt to get a solution process started. This report is an outgrowth of this process which began several months earlier.

III.2.3 Goals and Objectives of COMDESA

The goal of COMDESA is to survive. In order to do so, a solution to the dollar loan problems will have to be found.

IV. Project Assessment

IV.1 Purpose

The purpose of this project is to assess the feasibility of rescheduling two outstanding loans from USAID to COMDESA. Each loan currently is five semi-annual payments past due. In addition to this, the consultant was to meet with the management of COMDESA and with appropriate banking authorities in the country in order to develop options for solving the debt repayment problem. The consultant will perform a financial analysis of COMDESA and provide recommendations in the form of a final report. The consultant also was to perform whatever negotiations seemed relevant, under the guidance of Mr. Peter Orr, with consideration given to the fact that any final decision will rest in

Washington D.C. The consultant worked closely with USAID officials in Asunción to achieve the above stated objective.

IV.2 Methodology

The methodology used in this assesment was to establish a work plan that involved the collection of information, the conduct of interviews, analysis of information and data, the negotiation of critical issues, the development of options, and the preparation of the report. The consultant was assisted in the beginning and the end of the project by USAID officers from Bolivia and Montevideo, and by USAID officers in Asunción throughout the project.

IV.2.1 Planning

Planning for this project originally took place with a memorandum dated December 20, 1988 from Mr. Peter Orr, AID Representative to Mr. Julio Basualdo, PA outlining the background on prior negotiations relative to the COMDESA loan rescheduling effort. Mr Orr's memorandum is Appendix 7. The memorandum outlined some parameters for negotiations. Upon arrival in Asunción on January 15, 1989, discussions were held in the U. S. Embassy concerning the problem and a work plan was developed by Messrs. Julio Basualdo, John Davison, and Donn Davis. Appendix 8 is an undated initial draft of options and liquidity approach written by the consultant, as a start to the project. The consultant agreed to prepare a progress report following the first week in Paraguay, for focusing purposes, with copies to Mr. Peter Orr, Mr. John Davison and ISTI, in Washington D.C. (See Appendix 9).

IV.2.2 Document Review

A considerable number of documents were received by the consultant and by Mr. José Díaz, USAID officer from Bolivia, as well as Mr. Julio Basualdo.

The documents included, at least, five years financial and income statements of Banco de Desarrollo S.A., the two Alliance for Progress (USAID) loan agreements with COMDESA, the Paraguayan Banking law, the statutes of COMDESA, US Embassy Asunción economic reports and articles, the list of shareholders of COMDESA, financial information of COMDESA, such as an aging of past due loans, the loan book and maturities schedule of COMDESA, original correspondence of COMDESA beginning about 1973, and various correspondence and memoranda between COMDESA and the Central bank, and between USAID and the Central bank.

IV.2.3 Interviews

The consultant had interviews with USAID officers, the management and officers in COMDESA, Dr. Carlos Knapps, Director, Dr. Cesar Romeo Acosta, President, Dr Crispiniano Sandoval, Jefe de Estudios Económicos, all in the Central bank, Dr. Estigirribia, Superintendant of Banks and his assistant Dr. Rodriguez, Mr. Hugo Llorens, U.S. Economic Counselor, and the U.S. Ambassador in Asunción.

Following interviews with Dr. Knapps and Dr. Sandoval. memoranda were written to them at their request and are included in the Appendix under the numbers 10 (English and Spanish) and 11. Also, Mr. Julio Basualdo wrote to the President

of the Central bank, providing information to him for the subsequent visit by USAID representatives. Because government officials reported the legality of the suggested options, a legal opinion was requested of Dr. Esteban Burt, of the firm, Peroni, Sosa & Altamirano, and is included in Appendix 14.

IV.2.4 Negotiations

Discussions concerning the maximum rate, or capacity to generate guaranies to bring the loans current or to repay them, were held with senior management of COMDESA. Discussions of the various options were held with officers of USAID, and with senior officials of the Central bank.

Some early indication rates on the secondary market for official Paraguayan debt in default, as well as other countries for comparison purposes, were obtained through Bank of America NT & SA, in Santiago, Chile. Appendix 12 exhibits a Reuters screen for quotes on January 13, 1989, which was obtained in order to provide a more realistic basis for some of the options recommended in this report.

IV.3 Findings

IV.3.1 Scope of Assistance/Terms of Reference

The complete Statement of Work for this TSO is in Appendix 13.

IV.3.2 Analysis of COMDESA's Financial Statements

Following an intensive review of the financial statements of Banco de Desarrollo (COMDESA) for the past five years, it is abundantly clear that this bank cannot service the dollar loan debt payable, and currently past due, to USAID. This due to thin spreads and insufficient cashflow. Additionally, high legal reserves exacerbate the solution.

This opinion is fortified upon reviewing written comments to the financial statements made by the Central bank and Superintendent of Banks, as well as discussions with the management of COMDESA concerning their projected cash flows. The basic problem is that their spreads between gross loan income, at about 28% p.a., and their average cost of funds of about 25/26 % p.a. simply is not sufficient to pay their operating and general expenses and service the debt. On top of this purely financial perspective in strictly guarani terms, the specter of some 30 % p.a. inflation, with subsequent devaluations causes the problem to become even worse. Please refer to Appendix 6, which shows month end guarani rate of exchange quotes against the US dollar beginning at Gs. 160 at the end of January 1982 and Gs. 1025 at year end 1988. This is a gain of some 541%. It means the Guarani of year end 1988 had a relative value of less than 20% of the 1982 Guarani. It is difficult to service a dollar debt in this kind of environment, when a company, or in this case a bank, can not increase its own prices to offset the inflation/devaluation.

The consultant spread the first set of financial statements from 1984 through

1987 (1988 has not yet been reviewed by the Superintendent of Banks), in strictly guarani terms and accepting all rates of exchange as published. Some comments of the consultant are noted below the tables and the standard bank evaluation model ratios are included after the financial set describing the sources and applications of funds. The spread is in millions of guaranies and, for ease of interpretation in terms of dollars, may be thought of roughly (at a recent rate of Gs.1000 to \$1) as thousands of dollars. So the first number appearing, namely, 217 under the 1984 column may be thought of (for awhile) as \$217,000.

Banco de Desarrollo (COMDESA)

G's. '000,000	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>
<u>ASSETS</u>				
(1) Cash & D/F Bks	217	747	1877	2120
(2) Devel. Loans	794	1128	1506	2547
Other Loans	310	271	182	219
For drafts purch	0	0	28	89
Discounted Docs	0	59	102	161
Loans to Fin Inst	0	180	0	0
Trade Adv's	0	0	14	125
Credit Card/Cons	0	0	108	202
Overdrafts	<u>0</u>	<u>62</u>	<u>100</u>	<u>392</u>
TOTAL LOANS	1104	1700	2040	3739
LESS:				
Loan Loss Res	<u>-47</u>	<u>-85</u>	<u>-37</u>	<u>-34</u>
NET LOANS	1057	1615	2003	3701
(3) Gross Fix Ass	74	89	108	163
LESS: Deprac. & Amort.	-10	-12	-19	-32
Other Real Est Owned	181	96	103	111
Inv. Oth. Ca's	200	221	199	199
Oth Assets	<u>44</u>	<u>35</u>	<u>216</u>	<u>410</u>
TOTAL ASSETS	1763	2791	4487	6672

NOTES:

- (1) Offshore deposits in correspondent banks are reported at a rate of Gs. 126, and therefore understated.
- (2) A portion of the development loans have dollar readjustment clauses, but are not accounted for as such in the statements. This account is understated.
- (3) Real estate is understated because there is no accepted system for reevaluation of fixed assets.

LIABILITIES

Gs. '000,000	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>
DEPOSITS				
Demand Deps	15	538	1145	1397
(4) Savings Deps	<u>75</u>	<u>614</u>	<u>1739</u>	<u>2800</u>
TOTAL DEPS	90	1152	2884	4197
D/T Cen Bank				
(5) Borrowings	40	26	42	137
Liab's on Imp's	800	715	644	875
Accrued Int.	0	0	1	137
Oth Liab's	18	21	18	49
TOTAL DEBT	<u>50</u>	<u>118</u>	<u>127</u>	<u>325</u>
	890	859	814	1474
TOTAL LIAB'S	998	2032	3716	5720
EQUITY				
Common Stock	735	741	751	919
(6) Ret'd Earng's	<u>30</u>	<u>18</u>	<u>20</u>	<u>33</u>
EQUITY	765	759	771	952
TOT LIAB & EQU	1763	2791	4487	6672
(7) Past Due Loans	293	205	122	134
Non-Accrual Loans	0	98	16	8

NOTES:

- (4) Offshore savings accounts are understated at a rate of Gs.126.
- (5) Borrowing, principally USAID's loans, are understated at a rate of Gs. 240.
- (6) Retained earnings are overstated.
- (7) Past due loans are understated.

INCOME STATEMENT

Gs. '000,000	<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>
Interest Inc.	211	287	486	801
Interest Exp.	<u>30</u>	<u>80</u>	<u>170</u>	<u>337</u>
NET INT. INC.	181	207	316	464
Prov. Loan Loss (-)	<u>-0</u>	<u>-85</u>	<u>-37</u>	<u>-40</u>
INT. INC. NET OF LN LS PROV	181	122	279	424
Other Inc.	10	105	48	36
Fx Trading	<u>-40</u>	<u>0</u>	<u>0</u>	<u>0</u>
TOTAL NON INT. INC.	-30	105	48	36
NON INT EXPENSE				
Salaries & Emp Ben	40	88	122	174
Gen & Admin	40	71	116	157
Dep./Amort	3	5	7	13
Other Exp	<u>17</u>	<u>24</u>	<u>33</u>	<u>44</u>
TOTAL NON INT EXP	100	188	278	388
Inc. Bef Tx & Sec's	51	39	49	72
App Inc Tax	<u>21</u>	<u>21</u>	<u>29</u>	<u>39</u>
NET INCOME **	30	18	20	33
Common Stk Issue	<u>0</u>	<u>6</u>	<u>10</u>	<u>168</u>
CHANGE IN EQUITY	30	24	30	201

**NOTES

Net Income is overstated.

CHANGES IN FINANCIAL POSITION

Gs. '000,000	<u>1985</u>	<u>1986</u>	<u>1987</u>
<u>SOURCES</u>			
NET INC	18	20	33
Chg's not Req Fds:			
Dep/Amort	5	7	13
Prov Loan Loss	<u>85</u>	<u>37</u>	<u>40</u>
TOTAL FROM OPS	108	64	86
Increase in:			
Deposit	1062	1732	1313
Accrued Exp's	3	0	31
FDS Borr/Repuch	0	16	95
Term Debt	0	1	136
Oth Borrowings	0	0	429
Common Stk & Surp	6	10	168
Decrease in:			
Oth Assets	<u>73</u>	<u>0</u>	<u>0</u>
TOTAL SOURCES OF FUNDS	1252	1823	2258
<u>APPLICATIONS</u>			
Increase in:			
Cash & D/P	530	1130	243
Loans O/S	643	425	1738
BP&E	18	19	55
Other Assets	0	168	202
Decrease in:			
Accrued Exp	0	3	0
Funds Borr/Rep	14	0	0
Oth Borrowing	17	62	0
Decrease in Equity:			
Other	<u>30</u>	<u>18</u>	<u>20</u>
TOTAL APPLICATIONS	1252	1823	2258

FINANCIAL RATIOS

Gs. '000,000

<u>Liquidity</u>		<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>
Prim Assets/Dem Dep	(%)	1446.67	138.85	163.93	151.75
Purch Funds/Total Fds	(%)	90.32	39.14	19.22	19.43
Purch Funds/Ear Ass	(%)	76.09	43.59	33.63	27.10
Loans/Total Deps	(%)	1174.44	140.19	69.45	88.18
Loans/Total Funds	(%)	113.66	85.31	56.11	71.05
Earning Assets/Tot Dep	(%)	1226.67	147.57	70.74	88.99
<u>Profitability</u>					
Net Inc/Earn'g Assets	(%)	2.72	1.06	0.98	0.88
Net Inc/Tot Assets (ROA)	(%)	1.70	0.64	0.45	0.49
Net Inc/Equity (ROE)	(%)	3.92	2.37	2.59	3.47
Net Int Inc/Earn'g Ass	(%)	16.39	12.18	15.49	12.42
Oper Exp/Oper Inc	(%)	14.22	27.87	34.93	42.07
Int Exp/Tot Dep	(%)	33.33	6.94	5.89	8.03
Loss Prov/Net Inc +Loss Prov	(%)	0.00	82.52	64.91	54.79
<u>Asset Quality</u>					
Past due loans/Tot loans	(%)	26.54	12.06	5.98	3.59
Non Acc loans/Tot loans	(%)	0.00	5.76	0.78	0.21
Renegot'd loans/Tot loans	(%)	0.00	0.00	0.00	0.00
Charge offs/Tot loans	(%)	0.00	0.00	0.00	0.00
Loan Loss Res/Tot loans	(%)	4.26	5.00	1.81	0.91
Loss Res/Non Acc loans	(%)	N/A	86.73	231.25	425.00
Charge offs/Non Acc loans	(%)	0.00	0.00	0.00	0.00
<u>Capital Adequacy</u>					
Equity/Total Assets	(%)	43.39	27.19	17.18	14.27
Equity/Tot Deposits	(%)	850.00	65.89	26.73	22.68
Equity+Loss Res/Tot loans	(%)	73.55	49.65	39.61	26.40
Past due+Non Acc loans/Eqty	(%)	38.30	39.92	17.90	14.92
Net Inc-Cash Div/Equity	(%)	3.92	2.37	2.59	3.47
Cash Dividends/Equity	(%)	0.00	0.00	0.00	0.00
Cash Dividends/Net Income	(%)	0.00	0.00	0.00	0.00

Financial Ratios: (cont'd)

Gs. '000,000

<u>Growth</u>		<u>1984</u>	<u>1985</u>	<u>1986</u>	<u>1987</u>
Total Assets Growth	(%)		58.31	60.77	48.70
Total Loan Growth	(%)		53.99	20.00	83.09
Core Deposits Growth	(%)		3486.67	112.83	22.01
Equity Growth	(%)		-0.78	1.58	23.48
Net Income Growth	(%)		-40.00	11.11	65.00
Earnings Retention	(%)	100.00	100.00	100.00	100.00
Sustainable Growth	(%)	4.08	2.43	2.66	3.59
Actual Asset Growth	(%)		58.31	60.77	48.70
Total Deposit Growth	(%)		1180.00	150.35	45.53
Net Income/Total Assets (ROA)	(%)	1.70	0.64	0.45	0.49
Net Income/Equity (ROE)	(%)	3.92	2.37	2.59	3.47
Leverage	(%)	2.30	3.68	5.82	7.01

Summary of Key Financial Data

Income Statement:

Net Interest Income	181	207	316	464
Provision for Loan Loss	0	85	37	40
Non-Interest Income	-30	105	48	36
Non-Interest Expense	100	188	278	388
Net Income	30	18	20	33

Balance Sheet:

Loans	1104	1700	2040	3735
Loan Loss Reserve	47	85	37	34
Total Assets	1763	2791	4487	6672
Subordinated Debt	0	0	0	0
Inter. & Ht. Sr. Debt	0	0	0	0
Equity	765	759	771	952

The second set of numbers analyzed here is the year end 1987 balance sheet shown under Column A, as published, and under Column B, as it is estimated by the consultant to look as if all the foreign exchange rate changes were made as requested by the banking authorities in Paraguay. One can quickly see that net worth is seriously reduced by about 83% to Gs. 155 million, or \$155 thousand, and definitely would be substantially negative after the 1988 corrections are received and reflected.

FINANCIAL INFORMATION BANCO DE DESARROLLO COMDESA

- (A) AS PUBLISHED AND SUBMITTED TO BANKING AUTHORITIES
 (B) SPREAD WITH FX ADJUSTMENTS REQUESTED BY BANKING AUTHORITIES PLUS FREE MARKET RATE ON OFFSHORE DOLLARS

Gs. '000,000	Dec 31, 1987	<u>(A)</u>	<u>(B)</u>
<u>ASSETS</u>			
Cash & D/F BKS		2120	3035
For Drafts Purch		89	89
Devel Loans		2547	*3081
Other Loans		219	412
Discounted Docs		161	161
Trade Advances		125	125
Credit Card/Consum		202	202
Overdrafts		<u>392</u>	<u>392</u>
TOTAL LOANS		3735	4462
LESS: Loan Loss Res		<u>-34</u>	<u>-34</u>
NET LOANS		3701	4428
Gross Fixed Assets		163	163
Less: Dep & Amort		-32	-32
Oth Real Est Owned		111	111
Env Oth Co's		199	199
Other Assets		<u>410</u>	<u>410</u>
TOTAL ASSETS		6672	8374

LIABILITIES

<u>DEPOSITS</u>	<u>(A)</u>	<u>(B)</u>
Demand Deposits	1397	1397
Saving Deposits	<u>2800</u>	<u>4085</u>
TOTAL DEPOSITS	4197	5482
D/T Cen Bank	137	137
Borrowings	875	2442
Liab on Imports	137	137
Accrued Interest	49	49
Oth Liabilities	<u>325</u>	<u>300</u>
TOTAL DEBT	1474	3065
TOTAL LIABILITIES	5720	8547
EQUITY		
Common Stock	919	919
Retained Earnings	<u>33</u>	<u>-764</u>
EQUITY	952	155
TOTAL LIABILITIES & EQUITY	6672	8704
Past Due Loans	134	
Non-Accrual Loans	8	

There are a few presumably unencumbered assets, (a title search was not made) like the bank building (market value Gs. \$600 million) which would be theoretically available to creditors, but only after employee accrued benefits, salaries, and other pending items would take precedence. If USAID has to foreclose, and it may very well have to consider it if there is a complete lack of cooperation on the part of the government, the amount available would be insignificant. This is not the desired course of USAID, but it may have to consider protecting the integrity of its program.

A third set of figures consisting of cash flow projections has been provided by COMDESA and is shown below in two tables for the years 1985 through 1992. An average rate of inflation of 30% was assumed and the relevant rate of exchange used in the projections is shown at the bottom of each column. The projected loss is shown as LOSS FX, and is located directly above the line TOTAL ASSETS. The third set of projections includes an income statement.

PROYECTION BALANCE SHEET

Gs '000,000

ASSETS	1985	1986	1987	1988
AVAILABILITY				
Cash local currency	231.00	554.00	48.00	167.00
Cash Fx currency	<u>20.00</u>	<u>428.00</u>	<u>764.00</u>	<u>793.00</u>
TOTAL	251.00	982.00	812.00	960.00
RESERVE				
Res on dep in local curr	500.00	1,220.00	1,787.00	2,319.00
Res on dep in Fx curr	<u>9.00</u>	<u>216.00</u>	<u>405.00</u>	<u>785.00</u>
TOTAL	509.00	1,436.00	2,192.00	3,104.00
LOAN				
Loan in Fx currency		35.00	179.00	1,009.00
Loan in local currency	1,119.00	1,622.00	3,312.00	4,052.00
Revalue loan in local cur	534.00	953.00	1,062.00	1,047.00
(Loan loss provision)	(85.00)	(37.00)	(34.00)	(34.00)
(Unearned Interest)	(27.00)	(48.00)	(76.00)	(81.00)
TOTAL	1,541.00	2,525.00	4,443.00	5,993.00
OTHER ACCOUNTS				
Premises	44.00	44.00	44.00	44.00
Other fixed assets	33.00	45.00	87.00	132.00
Uncollected interest	47.00	30.00	42.00	29.00
Other assets	355.00	535.00	767.00	523.00
Loss Fx	<u>0.00</u>	<u>424.00</u>	<u>912.00</u>	<u>1,449.00</u>
TOTAL	479.00	1,078.00	1,852.00	2,584.00
TOTAL ASSETS	2,780.00	6,021.00	9,299.00	12,641.00
LIABILITIES				
DEPOSITS				
Demand Deposits	540.00	1,164.00	1,398.00	1,590.00
Savings acc in loc curr	442.00	1,439.00	2,159.00	3,619.00
Savings acc in Fx curr	29.00	680.00	1,285.00	2,591.00
Time Deposits	<u>155.00</u>	<u>170.00</u>	<u>460.00</u>	<u>241.00</u>
TOTAL	1,166.00	3,453.00	5,302.00	8,041.00
DEBTS				
Due to Central banks	41.00	55.00	48.00	57.00
Due to USAID	714.00	1,624.00	2,311.00	2,814.00
Due to oth inst.	<u>0.00</u>	<u>13.00</u>	<u>63.00</u>	<u>202.00</u>
TOTAL	755.00	1,692.00	2,422.00	3,073.00
OTHER ACCOUNTS				
Call money	0.00	0.00	250.00	350.00
Other Liab	<u>102.00</u>	<u>125.00</u>	<u>407.00</u>	<u>168.00</u>
TOTAL	102.00	125.00	657.00	518.00
CAPITAL AND RESERVE				
Capital	600.00	600.00	750.00	750.00
Reserve	140.00	151.00	168.00	259.00
Retained Earnings	0.00	0.00	0.00	0.00
Profit	<u>17.00</u>	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>
TOTAL	757.00	751.00	918.00	1,009.00
TOTAL LIABILITIES	2,780.00	6,021.00	9,299.00	12,641.00
Exchange Rate (1 U\$=)	240.00	665.00	899.00	1,000.00

PROJECTION BALANCE SHEET

Gs '000,000

ASSETS	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>
AVAILABILITY				
Cash local currency	674.02	703.22	767.48	855.94
Cash Fx currency	<u>2,306.39</u>	<u>3,298.14</u>	<u>4,287.58</u>	<u>5,573.85</u>
TOTAL	2,980.41	4,001.35	5,055.06	6,429.79
RESERVE				
Res on dep in loc curr	2,782.94	2,903.51	2,208.08	2,249.64
Res on dep in Fx curr	<u>1,286.33</u>	<u>1,839.45</u>	<u>2,391.28</u>	<u>3,108.67</u>
TOTAL	4,069.27	4,742.96	4,599.36	5,358.31
LOAN				
Loan in Fx currency	882.01	1,232.28	1,081.96	1,406.55
Loan in local curr	4,918.12	5,131.19	5,600.13	6,172.58
Revalue loan in loc curr	0.00	0.00	0.00	0.00
(Loan Loss provision)	(700.00)	(750.00)	(750.00)	(750.00)
(Unearned interest)	<u>(222.50)</u>	<u>(232.14)</u>	<u>(253.36)</u>	<u>(279.26)</u>
TOTAL	4,877.62	5,381.32	5,678.73	6,549.88
OTHER ACCOUNTS				
Premises	451.00	451.00	451.00	451.00
Other fixed assets	132.00	132.00	232.00	232.00
Uncollected interest	182.76	190.68	208.11	229.38
Other assets	1,083.89	519.34	1,616.46	1,648.94
Loss Fx	<u>3,546.00</u>	<u>4,336.00</u>	<u>5,343.00</u>	<u>6,300.37</u>
TOTAL	5,395.65	5,629.02	7,850.57	8,861.69
TOTAL ASSETS	17,322.95	19,754.65	23,183.72	27,199.66
LIABILITIES				
DEPOSITS				
Demand Deposits	1,908.00	2,289.60	2,747.52	3,297.02
Savings acc in loc curr	4,342.80	5,211.36	6,253.63	7,504.36
Saving acc in Fx curr	4,275.15	6,113.46	7,947.50	10,331.76
Time Deposit	<u>289.20</u>	<u>347.04</u>	<u>416.45</u>	<u>499.74</u>
TOTAL	10,815.15	13,961.46	17,365.10	21,632.88
DEBTS				
Due to Central Bank	62.70	68.97	75.87	83.45
Due to USAID	1,822.50	1,561.95	1,204.12	800.68
Due to other inst.	<u>266.80</u>	<u>306.47</u>	<u>682.83</u>	<u>826.85</u>
TOTAL	2,152.00	1,937.39	1,962.82	1,710.98
OTHER ACCOUNTS				
Call money	2,850.00	2,350.00	2,350.00	2,350.00
Other Liab	<u>496.80</u>	<u>496.80</u>	<u>496.80</u>	<u>496.80</u>
TOTAL	3,346.80	2,846.80	2,846.80	2,846.80
CAPITAL AND RESERVE				
Capital	750.00	750.00	750.00	750.00
Reserve	259.00	259.00	259.00	259.00
Retained Earnings	0.00	0.00	0.00	0.00
Profit	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>	<u>0.00</u>
TOTAL	1,009.00	1,009.00	1,009.00	1,009.00
TOTAL LIABILITIES	17,322.95	19,754.65	23,183.72	27,199.66
Exchange Rate (1 U\$S=)	1,500.00	1,950.00	2,535.00	3,295.50

STATEMENT OF OPERATIONS

	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>
Interest Income	1,366.00	1,507.00	1,590.00	1,833.00
Fees	246.00	295.00	354.00	424.00
Other Income	<u>65.00</u>	<u>78.00</u>	<u>94.00</u>	<u>113.00</u>
TOTAL	1,677.00	1,880.00	2,038.00	2,370.00
Int Exp on Deposit	1,169.00	1,509.00	1,877.00	2,163.00
Non Int Exp Personnel	304.00	349.00	402.00	462.00
Other	<u>240.00</u>	<u>266.00</u>	<u>297.00</u>	<u>341.00</u>
TOTAL	1,713.00	2,124.00	2,576.00	2,966.00
LOSS	(36.00)	(244.00)	(538.00)	(596.00)
LOSS Fx	<u>(2,087.00)</u>	<u>(546.00)</u>	<u>(469.00)</u>	<u>(361.00)</u>
TOTAL LOSS	(2,123.00)	(790.00)	(1,007.00)	(957.00)

From all of the above financial information the consultant cannot see any feasible manner of rescheduling these loans for account of COMDESA alone, if USAID expects to be repaid. The only reasonable and logical basis for even considering refinancing this debt would be on the basis that the borrower is the Central bank of Paraguay.

IV.3.3 Review of Regulatory Policies

The financial statements of COMDESA were discussed with the Superintendent of Banks. He said the quality of the loan portfolio was quite high, with very few problem loans. He declined to offer any opinions on the management of the bank, although he did say at the end of the interview he thought Mr. Julio Sauca was a good and experienced manager. Following later discussions with Dr. Carlos Knapps, Director, Dr. Cesar Romeo Acosta, President, and Dr. Crispiniapolis Sandoval, Jefe de Estudios, it was generally felt that the Central bank wished to "assist" in the problem, but offered no tangible solutions. They were expecting this from USAID. We tried unsuccessfully to have a follow-up interview with the Superintendent, Dr. Estigarribia. He did receive, however, copies of memoranda that went to Dr. Knapps and Dr. Sandoval.

In the meeting with Dr. Knapps, the consultant and Mr. Julio Basualdo, USAID pressed the continuation of the conversation which Mr. Peter Orr, USAID had had with him. Dr Knapp's recollection of prior conversations was that the Central bank surely wanted to assist in this matter, but hadn't committed to assume the loan of COMDESA. He requested consideration of several options, prior to agreeing to anything. At that point, a description of various options was given to him. He showed considerable interest in the debt-equity swap option and asked us to discuss the options also with Dr. Sandoval. In order to assist him, he also asked us to prepare a memo to him outlining the various options and to discuss them as well and in detail, with the President

of the bank, Dr. Cesar Romeo Acosta. Prior to the subsequent interview with him, Mr. Julio Basualdo wrote to Dr. Acosta, outlining the suggested options. Discussions were then held with Dr. Sandoval who asked for a memorandum describing in general what some other countries were doing in the area of debt-equity swaps. Copies of the memos to Dr. Knapps and Dr. Sandoval are included in the Appendix.

The general feeling on the part of all the officers in the Central bank was that COMDESA would never be able to service the dollar loans and that the Central bank was not willing to extend any special assistance facilities to it, like a rediscount line, because it was a private bank. One officer suggested that COMDESA now is bankrupt. They also emphasized that new solutions must be sought. While this easily could be a negotiating or posturing position, they certainly were given solutions to the problem by the USAID group.

If these officials cannot readily see the value of retiring other official debt which has the guarantee of the Central bank, and which debt most international creditors are unwilling to refinance, perhaps members of the new government will appreciate the unique opportunity available to them through this proposal. In the opinion of the consultant, it is incredible that the directors of the Central bank are failing to avail themselves immediately of an opportunity to manage their own debt position intelligently.

IV.3.4 Review of Negotiations

A review of the negotiations, prior to the revolution and change of government, suggested that at least three directors of the Central bank were favorably interested in some of the options. Also, key staff members have been apprised of them.

It should be noted that each option, aside from outright repayment of the loan, involved consideration by USAID of a 10 year low interest fixed rate loan. This alone, when combined with the prospect for retiring other debt, should arrest the attention of serious Central bank officers, immediately.

An integral part of the success of several of the options is the ability of COMDESA to deliver about Gs. 1.7 billion, over an unspecified period of time, to the Central bank or to free market exchange dealers. This assumption was included in most conversations because the senior management of COMDESA said it could deliver that amount. The consultant could see possibly Gs. 600 million arising from a mortgage, or sales leaseback of the bank building, and probably another Gs. 600 million from maturing loans over a reasonably short period, because over 95% of the portfolio matures within a year. It was suggested that if the dollar loan problem could be solved, perhaps some new investment would be forthcoming. If the dollar loan problem

was solved, perhaps some bank would be willing to provide a correspondent bank line of credit to COMDESA.

As of the date of this report, there has been no official reaction to the suggested options for solutions to this problem loan, and problem bank. Once some additional time for study of the options transpires, it is felt the Central bank will respond to them.

A comment on the overall effect of the revolution which took place Feb. 3-4, relative to negotiations, may be appropriate. On Feb. 5, General Andres Rodriguez was sworn-in as the new President of Paraguay, replacing ousted President Alfredo Stroessner. Because of the degree of closeness between former President Stroessner and some key people in government, it is not certain as yet which of the Central bank directors will remain in their positions. It seems clear to most observers that Dr. Cesar Romeo Acosta will be among the first to leave, along with the Minister of Industry, Dr. Ugarte Centurion. It is not clear as to the fate of Dr. Carlos Knapps, who was known to be close to President Stroessner. It may be that a new set of negotiations will have to take place in the near future, with new people. It seems unlikely that the new team will place a high priority on this past due \$3 million loan problem, when the country currently is over \$250 million in arrears of official debt.

On the other hand, there are some positive developments in the sense that a few usually capable people, like Minister of Finance, Dr. Enzo Debararui, and Dr. Agona, now are in senior positions in government and may be called upon to lend support in the resolution of this problem. Because the government now is new, some new approaches may be acceptable and the thought of establishing a precedent may not destroy the project, automatically.

In any event, the Central bank directors now have the proposed list of options. If there is no response from them within a month, or so, it is suggested that a visit be made to the new President of the bank, as well as any new directors.

IV.3.5 Development of Options for Repayment of Debt

The first approach to seeking a solution to this problem was to look at traditional liquidity management techniques of the bank, as well as a review of its cashflow, with particular emphasis on the spread between gross interest income and cost of funds. This proved to be unrewarding. A memorandum on the liquidity management exercise and some initial thoughts on other options is shown in Appendix 8.

A second set of 16 options was prepared after the first week and after having had some meetings with banking authorities and with officers in

COMDESA. A memorandum describing these options was sent to Mr. Peter Orr, Representative, who was in Washington DC, and who discussed them with other officers there. Most of these options were rejected by USAID for reasons of establishing the precedent of accepting something less than face value of the obligation, plus interest, in settlement of the debt. Also, consideration of reinvestment of the funds was rejected. The record should show that while some options involving reinvestment in zero accrual US Treasury strips were not acceptable for policy reasons, they would provide a mechanism for full recovery of the debt. It was decided that the preferable option was either to be paid in full, or to persuade the Central bank or the government to assume the refinancing of the obligation of COMDESA.

The final list of options for consideration was presented verbally and in writing to the President of the Central bank and to Dr. Knapps, a director of the bank. Copies of the options also were given to Dr. Crispiniapolis Sandoval, Jefe de Estudios, and to Dr. Oscar Estigarribia, Superintendent of Banks. The list of these suggested options are as follows:

1. COMDESA buys dollars from the Central bank at an exchange rate of Gs. 240 and repays the entire debt to USAID (Gs. 240 x \$3,100,000 = Gs. 744,000,000)
2. COMDESA buys dollars from the Central bank at an exchange rate of 550 and pays the entire debt to USAID (Gs. 550 x \$3,100,000 = Gs. 1,705,000,000)
3. COMDESA delivers Gs. 1,240,000,000 to the Central bank in payment of the debts to USAID at an exchange rate of Gs. 400 and the Central bank assumes the loan refinancing obligation, that is, it will reschedule the loan from USAID for 10 years, with equal semi-annual payments at a fixed interest rate acceptable to USAID.
4. COMDESA delivers Gs. 1,705,000,000 to the Central bank in payment of the debt to USAID at a rate of Gs. 550 and the Central bank assumes the loan refinancing, that is, it reschedules the loan from AID for 10 years, with equal semi-annual payments at a fixed interest rate acceptable to USAID.
5. The Central bank gives the same refinancing facilities to COMDESA that they provided to the Banco Nacional de Trabajadores, that is, a substantial line of credit for discounting notes and the Central bank assumes the refinancing obligation of COMDESA to USAID in dollars for 10 years. Simultaneous to this, the Central bank permits COMDESA to pay them Gs. 1,705,000,000 (based on a fixed rate of Gs 550) over 10 years at an interest rate acceptable to both parties.
6. COMDESA enters the secondary market in New York in order to buy past due official debts of the Government of Paraguay (at an indicated rate of \$0.35 per dollar), using dollars obtained from the free market

(Gs. 550 x \$3,100,000 = Gs. 1,705,000,000 / Gs. 1,100 = \$1,550,000) and delivers the past due official obligations to the Central bank in consideration of their assuming as obligor the refinancing of the USAID debt, in the form of a rescheduled 10 year loan. COMDESA will seek the purchase of official debt totalling, more or less, about \$4,000,000 in secondary market discounted loans, which other banks have refused to refinance, for about \$1,550,000 and, the Central bank will have in the end a 10 year rescheduled loan at a fixed rate.

7. COMDESA delivers Gs. 1,705,000,000 (Gs. 550 x \$3,100,000) to the Central bank and the Central bank will enter the secondary market in order to purchase past due official debt of the Government of Paraguay, to retire it permanently, and simultaneously assumes the refinanced debt of COMDESA to USAID by means of a 10 year rescheduled loan at a fixed rate of interest. The Central bank would look specifically for official past due obligation from banks which are refusing to refinance them. This option would solve all three problems.

8. The Central bank makes a significant investment in COMDESA, by purchasing common stock of the bank and, at the same time, assumes the refinanced loan from USAID for a period of 10 years at a fixed interest rate. COMDESA then would continue as a mixed company.

IV.3.6 Project Constraints

The largest constraint to a solution to this problem probably is the economy of Paraguay itself. Major fiscal and foreign exchange actions will have to be taken to turn around the current trend of depletion of foreign exchange reserves. While 30% average rate of inflation is not high for most Latin American countries, it is for Paraguay, which has enjoyed much lower rates prior to the 1980's.

The second constraint is the degree of reluctance to which senior officers and directors of the Central bank are willing to consider relatively new country debt management techniques, such as debt-equity swaps, even though it can clearly be shown to benefit the country.

The third constraint may be the timing of the revolution, but only in the sense that it could delay consideration of the problem. The risk of what might happen to COMDESA during the interim period prior to the new Central bank, director's willingness to deal with USAID's suggested options, could be considerable, if it is widely felt that the COMDESA management was unusually close to departing officials in the Stroessner government. The consultant feels strongly, however, that the new government is a notable improvement over the old one and that there are many in it now who are much better equipped to deal with Paraguay's problems, including this one.

A final constraint to the solution of this problem is a general unwillingness of commercial banks to commit new funds to Paraguay.

IV.4 Recommendations

It is recommended that:

- (1) USAID Representatives make a concerted immediate effort to establish a relationship with the new President of the Central bank, the Minister of Finance, and with any new directors. It is recommended that the Economics counselor and the US Ambassador assist in this project by doing the same. The positive features of debt-equity swaps should be mentioned.
- (2) USAID should not attempt to refinance the two past due subject loans for account of COMDESA, because of their absolute inability to repay the loan. Do not even consider refinancing the loan to COMDESA with the guarantee of the Central bank, because COMDESA can't service it.
- (3) If USAID's solution to this problem is limited to refinancing the past due debt of COMDESA, that it do so only whereby the Central bank is the direct obligor, or credit taker. This can be achieved, to the benefit of all parties, under any of the following three mechanisms;
 - A. COMDESA delivers Gs. 1,705,000,000 to the Central bank in payment the debt to USAID at a rate of Gs. 550 and the Central bank assumes the loan refinancing as the borrower, that is, the loan is rescheduled for 10 years, with equal semi-annual payments at a fixed lower than market rate of interest.
 - B. COMDESA enters the secondary market for official debt in default to buy past due obligations of Industria Nacional de Cemento, which are guaranteed by the Central bank, at an indicated rate of \$0.40-\$0.60 or better, using dollars obtained from the free market (Gs. 550 x \$3,100,000 = Gs. \$1,705,000,000 / Gs. 1100 = \$1,550,000) and deliver the past due Central bank guaranteed obligations to them in consideration of their assuming the debt as obligor of the the refinanced loan to 10 years with equal semi-annual payments at a fixed lower than market rate of interest.
 - C. COMDESA delivers Gs. 1,705,000,000 (Gs. 550 x \$3,100,000) to the Central bank and the Central bank enters the secondary market for past due official debt of Paraguay, such as the Industria Nacional de Cemento notes guaranteed by the Central bank, to retire it permanently, and simultaneously assume the refinanced debt of COMDESA to USAID by means of a 10 year loan with equal semi-annual payments at a fixed lower than market rate of interest.

APPENDIX 1

-2-

I. PARAGUAY: KEY ECONOMIC INDICATORS

	<u>1986</u>	<u>1987</u>	<u>Percent Change</u>	<u>1988/1/</u>	<u>P. C/</u>
<u>Exchange Rate</u>					
Official Export Rate	320	550	-	550	
Average Market Rate	670	840	-	910	
<u>Income, Production, Employment</u>					
GDP at Current Prices/1/2/	1,751,648	2,387,496	36.3	3,246,995	
GDP at Constant 1982 Prices/1/2	733,428	755,430	3.0	785,647	
Per Capita GDP (constant prices- guaranies)	203,730	203,730	0.0	205,767	
Minimum Wage (Guaranies/month)	72,090	103,000	42.9	130,000	
Labor Force (Thousands)	1,217	1,257	3.3	1,298.5	
Unemployment rates (nationwide)/1/	11.0	11.6	-	10.8	
Underemployment rate (nationwide)/1/	20.7	22.9	-	20.4	
Consolidated Public Sector Deficit as a percent of GDP /6/	-	-	-	-	7.2
<u>Money and Prices</u>					
Money Supply (M1)/1/2/	173,131	257,923	49.0	373,988	
Consumer Price Index (1982)/7/	171.6	228.8	33.3	297.3	
<u>External Accounts</u>					
Merchandise Exports (FOB)/1/4/5	316.0	379.8	20.2	492.0	
Merchandise Imports (CIF)/1/4/	578.0	620.0	7.3	670.0	
Exports to the U.S. pct share (FOB)/9/	9.8	6.3	-	3.7	
Imports from the U.S. pct (CIF)/8/	8.6	8.0	-	7.7	
Merchandise Trade Balance share FOB/1/4	-262.0	-240.2	-	-178.0	
Current Account Balance/1/4	-350.0	-320.0	-	-260.0	
Balance of Payments/1/4/	-220.0	-240.0	-	-130.0	
External Debt (Public)/3/4	1,966.0	2,042.0	3.9	2,200.0	
Debt Service paid	214.7	299.7	39.3	341.0	
as a % of exports/1/3/4	67.9	78.7	-	69.3	
Foreign exchange reserves/1/3/4	364.8	405.1	11.0	335.0	

/1/ Estimates or Projections.

/2/ Millions of guaranies.

/3/ End of period.

/4/ Millions of U.S. Dollars.

/5/ Embassy export estimates are derived from registered exports based on volume and international price, and not on lower government fixed dollar prices for exports.

/6/ Includes deficit financed through the preferential exchange rate system.

/7/ Uses Central Bank, Fetranban and Embassy price estimates.

/8/ Based on Paraguay Central Bank data: A large percentage of U.S. exports to Paraguay are destined for third countries and therefore not incorporated in local import accounts

/9/ Uses USDOC estimates.

- 31 -

Appendix 2

Economic Performance of Lower Middle Income Countries - Selected Indicators
(Ranked by Growth of Private Consumption Per Capita)

Average Annual % Growth Rates (1950-1986)

Base Items (1986 data):

Private Consumption per capita, GDP, GDP Inflation, Merch. Exports (quantum), Merch. Imports (quantum), Terms of Trade (1980=100), Primary Exports (% Exports), Agriculture Sector (% GDP)

	Private Consumption per capita	GDP	GDP	Inflation	Merch. Exports (quantum)	Merch. Imports (quantum)	Terms of Trade (1980=100)	Primary Exports (% Exports)	Agriculture Sector (% GDP)
*Nicaragua	-12.4	0.2	0.2	56.5	-3.2	-0.6			
Zimbabwe	-5.9	-4.7	2.6	13.0	-2.7	-6.7	97	89	23
*Nigeria	-5.5	-13.7	-3.2	10.5	-6.0	-17.2	86	64	11
*Honduras	-5.5	-2.6	0.6	5.2	2.6	0.7	44	98	41
*Guatemala	-4.3	-9.8	-1.2	11.3	-2.5	-7.1	103	89	27
*Chile	-3.7	-7.4	0.0	20.2	3.9	-9.3	107	68	..
*Bolivia	-3.4	-17.3	-3.0	683.7	0.0	-3.9	75	91	..
*Cote d'Ivoire	-3.3	-21.6	-0.3	8.3	3.5	-5.4	46	98	24
Syrian Arab Rep.	-3.3	3.1	1.5	6.2	1.5	-5.0	92	91	36
*Dominican Rep.	-2.8	-0.7	1.1	15.9	-3.6	0.4	74	72	22
Liberia	-2.5	-16.7	-1.3	1.1	-2.0	-8.8	104	71	17
RE: Salvador	-2.1	-0.8	-1.0	14.9	-6.3	0.9	97	99	37
*Ecuador	-1.7	-5.6	1.8	29.5	8.4	-3.3	114	77	20
*Jamaica	-1.6	0.8	0.0	19.8	-7.2	-1.9	56	97	14
*Peru	-1.5	-13.9	-0.4	100.1	0.1	-6.7	109	34	6
Yemen Arab Rep.	-1.0	-12.9	4.3	13.1	1.9	-7.8	66	78	11
*Costa Rica	-0.9	0.7	1.3	32.3	1.2	-2.9	99	..	34
*Philippines	-0.8	-17.6	-1.0	18.2	-1.7	-6.0	106	64	21
Papua New Guinea	-0.6	-3.0	1.8	5.1	3.2	0.0	101	60	26
*Paraguay	-0.4	-6.0	1.1	19.0	1.6	-5.4	90	9	34
MAURITIUS	-0.4	11.7	4.4	8.1	10.4	2.8	82	81	27
*Egypt Arab Rep.	-0.3	-2.8	4.7	12.4	7.1	5.2	99	58	15
*Morocco	0.4	-2.2	3.3	7.7	3.8	0.8	70	82	21
*Seychelles	0.6	10.0	8.2	11.0	13.8	-0.5	98	53	..
*Colombia	0.6	0.1	2.1	22.6	4.6	-3.6	62	74	..
*Congo People's Rep.	..	-5.7	5.1	..	..	2.0	91	51	..
*Yemen	1.0	-1.2	3.7	8.9	-0.6	-2.8	51	2	..
Thailand	2.2	0.8	4.8	3.0	9.2	2.0	81	40	16
*Turkey	2.4	5.1	4.9	37.3	19.9	9.9	83	58	..
Indonesia	3.1	3.7	3.4	8.9	2.0	-1.0	102	64	18
Jordan	5.6	-5.8	5.1	3.2	5.7	0.1	64	79	26
BENCHMARKS							97	41	8
Developing economies	0.9	2.4	3.2	64.3	4.8	0.5			
Highly indebted countries	-1.7	-6.3	0.7	91.6	1.6	-7.2	91	42	..
Low income economies	3.5	13.2	7.5	8.1	6.5	7.2	92	62	..
China and India	4.6	14.9	8.6	5.3	9.5	11.9	91	64	32
Other low income	-0.1	0.4	2.9	19.1	0.6	-0.1	105	34	31
Lower middle income	0.2	-3.8	1.8	22.9	2.4	-2.4	93	68	38
Upper middle income	-0.1	-1.9	2.5	72.0	5.6	-0.1	96	72	22
Industrial market economies	2.0	2.8	2.5	5.3	3.3	4.8		61	..
Japan	2.2	3.2	3.7	1.6	6.4	3.5	109	21	..
United States	2.5	5.1	2.1	..	-2.7	9.0	156	..	..

* Rescheduling Countries & Non-rescheduling Troubled Debtors Countries
Notes: Lower middle income countries with insufficient data are excluded from the table
Source: World Development Report 1988

32

Appendix 3

Medium and Long Term Debt Burden of Lower Middle Income Countries ... Selected Indicators a,
(Ranked by Debt Per Capita)

	Debt per capita (\$)	Debt: GMP (%)	Debt: Exports (%)	Interest per capita (%)	Interest: GMP (%)	Interest: Exports (%)	Interest: Debt (%)	Short- Term: Debt (%)
*Nicaragua	1571.47	198.2	2130.7	6.18	0.8			
*Costa Rica	1495.77	97.8	271.8	83.46	5.5	8.4	0.4	16.
*Chile	1469.67	120.1	340.1	124.18	10.1	15.2	5.6	8.2
*Congo, People's Rep.	1430.50	152.1	366.9	39.50	4.2	28.7	8.4	7.1
*Jamaica	1273.75	147.5	225.4	91.25	10.6	10.1	2.8	18.7
*Cote d'Ivoire	883.64	106.8	..	..	..	16.1	7.2	3.8
Yemen, PDR	875.91	189.7	1444.0	10.00	2.2	..	..	7.2
Jordan	855.28	68.9	163.4	50.00	4.0	16.5	1.1	6.1
*Ecuador	830.94	74.4	303.9	67.50	6.0	9.6	5.8	23.8
Tunisia	719.32	61.5	188.8	41.64	3.6	26.7	8.1	5.5
Papua New Guinea	659.41	93.1	188.3	41.18	5.8	10.9	5.8	9.2
*Peru	625.56	50.5	359.7	16.77	1.4	11.8	6.2	2.7
*Bolivia	617.88	90.9	600.7	20.00	2.9	9.9	2.7	14.3
*Honduras	548.22	72.4	241.3	20.00	3.4	19.4	3.2	8.6
*Paraguay	483.68	51.5	212.8	23.68	2.5	11.4	4.7	10.4
*Egypt, Arab Rep.	477.57	58.8	291.6	15.41	1.9	10.4	4.9	6.2
Turkey	462.37	42.3	221.1	30.37	2.8	9.4	3.2	16.8
*Colombia	449.03	41.7	202.1	33.45	3.1	14.5	6.6	21.7
Mauritius	449.00	33.4	50.4	29.00	2.2	15.1	7.0	10.9
Liberia	435.65	99.0	234.7	6.52	1.5	3.3	0.5	5.9
*Dominican Rep.	417.58	55.5	194.3	27.58	3.7	3.5	1.1	3.5
*Philippines	377.35	72.2	252.1	19.00	3.4	12.8	6.0	7.0
Botswana	322.73	36.2	34.6	24.51	2.8	12.1	5.1	10.1
*El Salvador	315.71	40.2	152.0	15.13	1.6	3.0	1.1	1.1
Syrian Arab Rep.	283.33	17.1	163.0	2.00	0.5	..	..	..
*Guatemala	281.22	31.7	192.6	19.02	2.1	4.0	2.8	29.7
Thailand	268.63	35.2	116.1	19.60	2.6	13.0	6.8	8.7
*Cameroon	264.00	25.4	103.4	17.62	1.7	8.5	7.3	15.8
Yemen Arab Rep.	250.24	41.1	1224.8	5.12	0.8	6.9	6.7	21.5
*Indonesia	214.72	49.7	225.4	14.20	3.3	25.1	2.0	10.8
*Nigeria	212.18	45.0	319.1	3.79	0.8	14.9	6.6	15.0
Zimbabwe	202.07	33.2	..	..	..	5.7	1.8	1.5

a The latest available data consistent for cross-country analysis are from 1980.
 * Rescheduling Countries & Non-rescheduling Troubled Debtor Countries
 Source: World Development Report, 1988

33



BANCO CENTRAL DEL PARAGUAY

8114

BC/P. N° 220.-

Asunción, setiembre 6 de 1973

Señores
 COMPANIA PARAGUAYA DE
 DESARROLLO S.A. (COMDESA)
Presente

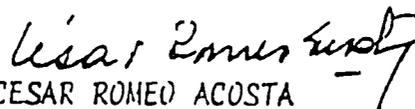
De nuestra mayor consideración:

Tenemos el agrado de dirigirnos a Uds. a fin de manifestarles que el Banco Central del Paraguay no tiene objeción alguna que formular al Convenio de Préstamo N° 526-L-025, por U\$S. 3.000.000.- firmado el 7 de agosto ppdo. entre COMDESA y la Agencia para el Desarrollo Internacional (AID), de los EE.UU.

Este Banco, como lo ha venido haciendo, cooperará con COMDESA para el buen desarrollo de sus operaciones y fundamentalmente para la ejecución de este segundo préstamo de AID, así como para que la Compañía Paraguaya de Desarrollo S.A. pueda cumplir con los compromisos contraídos en esta ocasión.

Con tal motivo, aprovechamos la oportunidad para saludarles muy atentamente.


 AUGUSTO COLMAN VILLAMAYOR
 Gerente


 CESAR ROMEO ACOSTA
 Presidente

JDSG/frb

39

APPENDIX 5

MEMORANDUM

DATE: Febrero 1, 1989

From: José Diaz, COM/AFARS /...L ;L

To: Mr. Peter Orr, AID Representative

Through: Mr. John R. Davison, Controller -j)

Subject: Revisión de la Cartera de COMDESA

Antecedentes

El Banco de Desarrollo del Paraguay S.A. fué constituido originalmente bajo la denominación de Compañía Paraguaya de Desarrollo S.A. (COMDESA). Posteriormente en fecha Septiembre 6 de 1976 se modificaron los estatutos en lo relativo a la denominación, la que fue cambiada por Banco de Desarrollo del Paraguay S.A.

El objeto del Banco es el de promover el establecimiento, ampliación y modernización de empresas que contribuyan al desarrollo económico del Paraguay y ayudar a los empresarios del país con la provisión de capital y asesoramiento técnico así como fomentar la participación del público inversionista en la explotación de aquellas.

El Banco Central del Paraguay en fecha 11 de junio de 1984 autorizó a COMDESA recibir depósitos en cuentas corrientes de ahorros y a plazo fijo, y a realizar transferencias de fondos de plaza a plaza e internacionales.

Cabe señalar que el funcionamiento del Banco se rige por las normas del Banco Central del Paraguay.

Los estados contables están estructurados de acuerdo con las normas establecidas por el Banco Central del Paraguay y principios de contabilidad generalmente aceptados.

El Banco crea una reserva legal del 20% anual de las utilidades netas de cada ejercicio. El Banco aplica dicho porcentaje sobre utilidades operativas antes del impuesto a la renta. Esta reserva se efectúa por disposición de la Ley General de Bancos.

Préstamos de AID

- AID 526-L-019: Convenio de préstamo firmado entre AID y COMDESA en fecha agosto 28 de 1970 por un monto de US\$ 2.600.000,00. El saldo de esta deuda al 31 de diciembre de 1988 fué de US\$ 956.296,57 equivalente a Gs 229.508.777,40 con un tipo de cambio oficial de Gs.240 por cada US\$ 1,00. La última cuota vence en marzo de 1991. Se debe señalar que COMDESA lleva una demora de 5 semestres en el pago de su deuda a USAID.

- AID 526-L-025: Convenio de préstamo firmado entre AID y COMDESA en fecha agosto 7 de 1973 por un monto de US\$ 3.000.000,00. El saldo de ésta deuda al 31 de diciembre de 1988 fue de US\$1.602.591,85 equivalente a Gs.384.622.044,00 al tipo de cambio oficial de Gs.240,00 por cada US\$1,00. La última cuota vence en noviembre 19 de 1993. Al igual que el caso del préstamo anterior, COMDESA lleva una demora de 5 semestres en el pago de su deuda a USAID.

Estos fondos fueron otorgados por COMDESA en guaraníes con su equivalencia en dólares estadounidenses a empresas industriales, agropecuarias, etc. es por eso que se denominó el crédito como "Préstamos para Desarrollo" con cláusula de revalúo. Los mismos están sujetos a revalúo en la medida en que el Banco Central del Paraguay modifica el tipo de cambio oficial del dolar estadounidense en relación al guaraní.

Al 31 de diciembre de 1988 estos préstamos estaban revaluados al tipo de cambio de Gs. 240.00 por dolar.

Cartera del Banco

- Para efectuar la revisión de la cartera del Banco se efectuó un seguimiento de su composición, antigüedad de los préstamos, su elegibilidad, las carpetas de préstamos (por muestreo) y su imputación contable. El saldo de la Cartera del Banco al 31 de diciembre de 1988 fue de Gs. 4.702.927.048
- En la revisión de la cartera se observó que el saldo correspondiente a la cuenta "Préstamos con Cláusula de Revaluó" muestra un saldo de Gs. 57.142.360, provenientes de un tipo de cambio de Gs. 240,00 por US\$1,00. En mi opinión esta cuenta esta subvaluada, tomando en cuenta que el dolar estadounidense en el mercado libre ya ascendió a Gs. 1.025,00 al cierre del ejercicio.
- En mi opinión, luego de la revisión efectuada de la cartera, la misma se considera razonable al 31 de diciembre de 1988 excepto por el cambio oficial mencionado en el párrafo anterior.

Previsión para incobrables

El Banco sigue la política del aumento de la previsión para incobrables de acuerdo con la evaluación mensual de la cartera de colocaciones, practicándose a fin de año un ajuste de acuerdo al monto específico de aquellos que se estima de difícil cobrabilidad. Al 31 de diciembre de 1988 la previsión para incobrables fue de Gs. 34.251.903,00 la que consideramos razonable dado el análisis.

Estados financieros del Banco

Luego de nuestro examen efectuado sobre la exposición de los Estados Financieros del Banco, debemos mencionar lo siguiente:

1/2

1. Cuentas de Activo

- a) Se pudo observar que las partidas del efectivo en lo que se refiere a moneda extranjera están valuadas al tipo de cambio de Gs. 126,00 por dolar estadounidense. Estas partidas son:
 - i) Efectivo en M.E.
 - ii) Corresponsales en el exterior
- b) La cuenta Encaje Legal M.E. también está valuada en Gs. 126,00
- c) La cuenta de cartera anticipo a exportadores esta valuada a Gs. 550,00.
- d) La cuenta préstamos con cláusula de revalúo que corresponde a préstamos con fondos provenientes de AID esta valuada a Gs. 240,00.

2. Cuenta de Pasivo

- a) Las obligaciones por concepto de "Depósitos en cuenta de ahorro en ME" estar valuadas a Gs. 126,00
- b) La cuenta "Préstamos de corresponsales en el exterior" está valuada a Gs. 126,00
- c) La cuenta "Préstamos Varios del Exterior" que corresponde a las obligaciones con USAID esta valuada a Gs. 240,00

3. Resolución del Directorio del Banco Central del Paraguay

La Resolución No. 2, Acta No. 168 de fecha diciembre 10 de 1986 del Directorio del BCP indica que: Las entradas y salidas de capital, préstamos externos y créditos de proveedores, reembolso de capital a corto y largo plazo del Sector Privado, deberán ser registrados al tipo de cambio del mercado libre. Esta disposición no fue acatada por el Banco por lo que consideramos subvaluados tanto las cuentas de activo como las de pasivo que hemos citado anteriormente.

Finalmente, nos llamó la atención el informe de auditoría externa que no menciona el problema del Banco con USAID, es decir, que el Banco no muestra el pasivo valuado al tipo de cambio real que necesitaría para adquirir los dólares para el pago de su deuda. Tomando en cuenta esta subvaluación de su pasivo, COMIDESA se puede considerar como una institución en bancarrota por cuanto su patrimonio no representa ni el 20% de su pasivo al 31 de diciembre de 1988.

31

Cotizaciones del US Dolar al fin de cada mes
 Mercado libre fluctuante

APPENDIX 6

DOLLAR/GUARANI QUOTES 1982-1988

Meses	1982	1983	1984	1985	1986	1987	1988
Enero	160	252	330	402	850	715	900
Feb	158	244	335	423	825	710	882
Mar	157	240	355	455	785	725	886
Abr	165	245	333	502	745	790	888
May	172	280	336	577	730	790	886
Jun	184	310	411	624	680	799	900
Jul	188	337	414	735	675	803	915
Ago	250	422	443	830	625	820	938
Sep	268	416	414	780	625	865	958
Oct	273	384	402	710	590	915	985
Nov	244	334	396	655	645	885	1019
Dic	239	328	388	660	690	880	1025

Coordinación tipo cambio

- 16 $\frac{1}{2}$ 82

160

183

1/2 28

- 25 $\frac{1}{2}$ 84

240

330

1/2 76

- 10 $\frac{1}{2}$ 86

690

9

APPENDIX 7.

AMERICAN EMBASSY
UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT
Asunción, Paraguay

MEMORANDUM

DATE: December 20, 1988

TO: Julio C. Basualdo, PA

FROM: Peter R. Orr, AID Representative

SUBJECT: COMDESA Loan Rescheduling

For Oscar Estigarribia

On 12/20/88 I met with Dr. Carlos Knapps, the Central Bank Director designated as the responsible Central Bank authority on the COMDESA debt rescheduling negotiations. I informed him of the planned January 15, 1989 arrival of Don Davis of ISTI. Knapps said he would be on vacation in Europe until January 27 or January 28, but that this wasn't a problem. Dr. Oscar Estigarribia, Superintendent of Banks would be the one who would work with our consultant and that Knapps would be available for the final wrap up. Knapps expressed a strong desire to come up with a solution. He also promised to review the situation with Estigarribia to provide the necessary "board-level" guidance before he departs on vacation.

I then went to see Estigarribia who confirmed that he would be available during this time frame and that he was fully informed on COMDESA's situation. He also said that he had proposed long ago that the Central Bank assume the loan and negotiate a separate Guarani loan with COMDESA, but that no action had been taken on his department's recommendation. This incidentally is exactly what COMDESA wants.

Following this meeting, I met jointly with Knapps and Jean-Marc Fisher of COMDESA. The meeting was extremely cordial and both agreed that the problem should have been resolved a lot earlier, before it had become "catastrophic". Fisher reiterated his view that the solution cannot entail a loss greater than COMDESA's capital and that future payments cannot be at an undetermined rate in Guarani. He also pointed out that COMDESA is unable to push foreign exchange risk off on its clients.

Knapps responded that what COMDESA gets is probably going to hurt more than what it wants to get. He remarked that the resurrection follows the crucifixion.

Fisher then asked whether there was anything special he should prepare in advance of Davis' arrival. I told him that he should get together with Estigarribia to make sure that Estigarribia gets any information he needs before Davis' arrival. He promised to do so.

All parties understand that A.I.D.'s contribution to a solution is limited to rescheduling. I have already agreed with the President of the Central Bank that we are prepared to reschedule the entire amount, including the amount overdue. This was a Central Bank imposed condition

21

Memo to J. Basualdo
December 20, 1988
Page 2

if they were to enter into negotiations, given the present foreign exchange crisis.

I don't believe a grace period is necessary and it should not be raised without consultation with me. Also I'd say that the practical limit on the rescheduling is fifteen years, although we should aim for ten or less.

Given the above, it should be clear that the A.I.D. position is not the significant variable. Rather the task is primarily to intermediate or broker a deal between COMDESA and the Central Bank. As I view the situation, A.I.D.'s interest is in getting the loan repaid. We do not have developmental interests in the continued survival of COMDESA (other institutions are providing the same services) other than wishing to avert the potentially destabilizing effects of a messy bank failure. The Central Bank itself, however, is even more acutely interested in avoiding such an outcome. If the Central Bank does agree to assume the debt, then the long term viability of COMDESA is not nearly as important to A.I.D. than if we are left with an unguaranteed COMDESA debt that is being subsidized by the Central Bank. Consequently, any opportunity to have the option analysis narrowed down to Central Bank assumption of the debt or Central Bank guarantee of the debt should be exploited.

This memo along with the participation of John Davison, Regional Controller, both at the beginning and the end of Don Davis' visit should serve as adequate guidance for the process. Assuming a satisfactory meeting of minds is reached within the abovementioned parameters, John Davison is authorized to advise the parties that I will seek AID/W approval of the proposal.

cc. Mr. J. Mack, DCM
Mr. Hugo Llorens, ECON/COM
Mr. John Davison, USAID/Bolivia
Ms. Maria Mamlouk, LAC/SAM
Mr. Terry Brown, LAC/DK
Mr. Jim Suma, LAC/DR/PS (Pass to ISTI ASAP)

10

DRAFT OF OPTIONS FOR USAID

- I. Determine liquidity policy of bank. Liquidity represents closeness to cash. Banks typically have five ways of managing liquidity. We can seek solutions through any one method or a combination of several. A description of them is as follows:
- A. Self-liquidating approach. This approach to liquidity looks to be repayment of funds to the bank as a source of liquidity. These funds are repaid to the bank in accordance to loan agreements or the maturity of securities held in portfolio of the bank. This approach is particularly well suited to a merchant bank in a mercantilist economy. Ideally these transactions would be secured by commodities such as cotton or grain. Banco de Desarrollo may fall into this general category of medium term lender, with a significant portion of its portfolio in self-liquidating short term loans. The quality of the loan portfolio will suggest if this approach will be useful. The bank's liquidity reserves of government or other short term securities also represents an available resource.
- B. Asset saleability approach. The ability of a bank to sell its assets represents another approach. This is sometimes called the shiftability approach because it refers to the ability of the bank to sell its loans and securities to other banks and to the open market. This approach looks at the current market value of total assets, and as long as the book value, of the bank's assets are reasonably close to the immediate market value of the assets, it represents a form of liquidity available to USAID. If the bank owns its premises, and if they can be sold and leased back to the bank, this should represent some cash available to USAID. Also, if the bank has any past-due loans secured by mortgages, perhaps a foreclosure can be done in order to convert the assets to cash.
- C. New funds approach. Historically, most liquidity practice has focused on closeness to cash. In the late 1960's banks, which were regulated as to the amount they could pay on savings accounts, faced stiff competition from savings and loan institutions and therefore sought additional sources of funds from the sale of a new issue of common or preferred stock, or bonds. This approach rests on the reputation of the bank, or perhaps some honest market advantage such as the legal ability to readjust loan terms with respect to currency devaluations. This could be of interest to an aggressive and competently managed bank interested in a merger with Banco de Desarrollo.
- D. Borrower's earnings flow. The earnings flow approach to liquidity suggests that the bank's loans are not inherently self-liquidating, but will be paid off from future earnings of the bank's customers. It is also called the doctrine of anticipated income and looks to the financial health of bank's customers. As long as these borrowers are profitable enough to cover the interest cost and possibly the sinking fund requirements of their bank loans, as well as their other obligations, they may provide some liquidity consideration for a bank.

- E. Central Bank discount window. The discount window of the Federal Reserve Bank in the US, as well as the central banks in many other countries, is another source of liquidity. It is an extremely efficient way to monetize assets. In the real world, however, access to the window is a function of the liquidity of the central bank itself, as well as the central bank's opinion as to whether the member deserves any assistance.

II. INITIAL OPTIONS WITHOUT BENEFITS OF FACTS AND INTERVIEWS

- A. Persuade the Central bank to bring interest up to date and guarantee the loan, and then restructure it in dollars.
- B. Foreclose on all of the real properties of the bank, convert to cash, buy zero accrual US Treasury strips, which would create a sinking fund to collateralize the restructuring of the loan. The sinking fund could be managed by an investment management company in the US for no more than 1% p.a. with additional bonds purchased in the future, as more funds become available.
- C. Persuade COMDESA to sell their bank building, lease it back for a period of 25 years, and create a pledged sinking fund as in (B) above.
- D. Persuade the Central Bank to make a capital investment in COMDESA, with the marginal investment funds made available to USAID, as in (B)
- E. Because under the law establishing COMDESA, it enjoys a possibly significant competitive advantage not generally available to other banks in that it can write loans with a currency readjustment clause, try to sell or merge it with a very strong bank.
- F. Try to sell the bank to Japan Inc., or Bank of Tokyo, or a Korean or Taiwanese development bank, or a local oriental bank.
- G. If the portfolio of COMDESA really does have some significant problems, relative to saleable properties, foreclose and trade shares of the foreclosed properties for the USAID notes.
- H. Determine absolute maximum amount of cash which can be converted from COMDESA's assets for X percentage of the loan and buy zero accruals as a sinking fund.
- I. Take whatever guarantees are available and buy a sovereign risk note or other acceptable governmental entity of Venezuela, which currently is being offered in the secondary market in New York at an extremely attractive price, and use the note to establish a sinking fund to extinguish the COMDESA obligation.

42

- J. Negotiate the sale of the COMDESA dollar notes to the Central Bank at a rate of, say, G 2,000 to US\$ 1, and then sell the guaranties to an investor for dollars, which would be used to buy another deep discount dollar official obligation of an acceptable sovereign risk.
- K. Sell the COMDESA dollar note on the secondary market and swap for a better risk.
- L. Find a European or Japanese bank that has written down its loan to a developing country to zero and open negotiations.
- M. Swap COMDESA guarantee paper to a bank that has a particular interest in Paraguay, for whatever reason, for dollar notes in its portfolio, which it may be willing to part with for various reasons.
- N. Write a fixed payment variable maturities note, if Davis can obtain usage of the software in Chile.
- O. Try to persuade a strong local company like CONEMPA, to make a large capital investment in COMDESA.

43

APPENDIX 9

MEMORANDUM

To: Mr. Julio C. Basualdo
From: Donn Davis
Date: 01-22-89
Re: Banco de Desarrollo (COMDESA) Assessment

This is a progress report for the first week.

Following discussions with the Management of Banco de Desarrollo, with the Superintendent of Banks, and after studying two distinct sets of five year financial statements with different rates of exchange, it is clear that the bank has serious problems. Given a continuation of the bank's present capital structure, and assuming that no special rescue facility will be forthcoming from the Central Bank because it then would be assisting a private bank, it is my opinion COMDESA cannot generate sufficient income ever to repay the outstanding dollar debt to USAID.

The quality of the bank's loans appears to be reasonably good, with a fairly low provision for bad debts. The superintendent's office agrees with the provision. They do not, however, agree with the exchange rates used in some of the loan accounts in their balance sheet. The bank still is accounting for their USAID loans, for example, at a rate of Gs. 240 to US\$ 1. The bank argues that Gs. 240 was the originally contracted rate and that they are grandfathered from the subsequent exchange law promulgated by the Central Bank in 1986 saying that all private external debt is to be repaid at free market rates. The Central Bank has asked COMDESA to correct their financial information to reflect the higher free market rates and, because COMDESA has refused to comply, the Superintendent's office has not approved the balance sheet and profit and loss for the past two years. I feel certain that they also will ask that similar changes be made for the 1988 statements.

The effect of the accounting changes requested by Central Bank and Superintendent's office suggests, or would cause to show, that in 1986 COMDESA had a loss of Gs.311,234,051, instead of a reported profit of Gs.20,224,980. In 1987, if the higher free market rates are used, as requested, the loss would be Gs.402,032,062, instead of a reported small profit of Gs.32,634,062. Accumulated losses for these two years, along with a yet to be determined corrected figure for 1988, probably will cause the bank to have a negative net worth.

Traditional liquidity management will not provide enough cashflow to service the USAID loans, in my opinion, especially if the same 19% average inflation for the past five years should continue well into the

44

future. It is difficult to show that the Paraguayan government is doing enough to significantly reduce the inflation. Without a fairly massive new capital investment, there is insufficient income to seriously consider refinancing the loans in dollars. To do so, would be merely to postpone the agony.

These rather negative opinions are offered even though I have not yet seen the requested 5 year cashflow projections. If some type of substantial rescue facility is a part of future cashflow, perhaps refinancing could again be considered. I don't believe that a guarantee is enough to justify refinancing the loan in dollars, particularly when the primary candidate for such a guarantee also is in default on some of its own obligations. The key issue anyway, with or without a guarantee, is to be able to see how COMDESA could repay the loan. An additional thought is that USAID may wish to reconsider including an accurate and detailed written analysis available to people in government, of the condition of the bank in terms of existing Paraguayan banking regulations because it would not inspire depositor confidence.

This is a very serious situation which I believe requires immediate attention, while there still is some capital left in the bank. If the objective is to recover principal plus accrued interest, I think it can be done, over time, by means of a debt swap approach rather than refinancing the debt. The options in order of preference, which I recommend immediately trying to implement are listed below:

1. Persuade COMDESA to repay immediately in guaranties the principal of about \$2.8 million at face value plus accrued interest of about \$300,000, at a rate of Gs.550. This would total Gs.1.54 billion. USAID then would buy dollars on the free market, at a rate of about Gs.1,100. This should not be shocking since it is provided for by law and the Central Bank itself is an active participant in this market every day. USAID then would have \$1.4 million and could purchase zero accrual U.S. Treasury Bond strips with maturities of about 9 years, in order to recover the full principal and interest amount of about \$3.1 million. This, is more attractive than refinancing the debt where it is difficult to see any capacity to repay. If there exists any policy restraints on buying U.S. Treasury instruments, and a preference exists for leaving any collected loan funds in Latin America, USAID could purchase sovereign risk debt of, say, Venezuela or Brazil (37.5-38.5), or Chile (58-59) on the secondary market in New York. It also could buy government risk dollar notes of Paraguay. The U.S. Treasury strips are most attractive for guaranteed compounding reasons and were selling at a yield of about 9-9.5% two weeks ago.
2. Sell our dollar notes plus interest of COMDESA to the Central Bank for 35 cents on the dollar (\$1.09 million), simultaneously

116

negotiating the sale of the dollars to the Central Bank at a rate of Gs.1500 per dollar, (Gs.1.63 billion) and then buy dollars on the free market at a rate of Gs.1100 (\$1.48 million). Then buy zero accrual Treasury Strips with 9 year maturities at about 9.25 average yield. The inflationary impact of this on the money supply would be less than one-half per cent. The Central Bank would then make a loan to COMDESA to recover its Gs.1.63 billion.

3. If the Central Bank resists the idea of buying the dollar notes at a secondary market rate, we could sell them at face value and use a guarani conversion rate of 550, in which case the guarani amount including interest would total Gs.1.71 billion and the face amount plus interest would be recovered in 8 years.
4. In the above option, if the conversion rate was the official external rate of 400; the net present value of the dollars would be \$1,127,272 and recovery of the \$3.1 million principal and interest would take about 12 years.
5. If the Central Bank absolutely resists any form of assistance to a private sector bank, even though it would have to consider protecting an official source of funds for the future, namely USAID, and still can't accept one of the swap options, the notes could be offered for sale to some substantial local investors who may have US dollar resources such as señores Rodriguez, Bó, Saba, Ugarte Centurion, Pappalardo, at the market rate of 35 cents. These gentlemen then could offer the notes to Central Bank at 40 or 45 cents and find a reasonable short term profit opportunity.
6. The US dollar notes also could be offered for sale at market rates to strong local institutional investors such as a large financiera, or the Heisecke/Franco group or any other institution with active business interes in Paraguay
7. Sell the COMDESA dollar notes on the secondary market and swap for a better risk, either U.S. zero accruals, or more acceptable sovereign risk debt. Perhaps recovery in about 15 years.
8. Persuade COMDESA to sell their bank building, lease it back for a period of 25 years, and create a pledged sinking fund to collateralize the loan. If Gs.600 million were generated, USAID would recover in 20 years via US zero accruals.
9. Foreclose on all of the real properties of the bank, convert to cash, buy zero accrual US Treasury strips, which would create a sinking funds to collateralize the restructuring of the loan. The sinking fund could be managed by an investment management company in the US for no more than 1% p.a. with additional bonds purchased in the future, as more funds become available.

10. Because under the law establishing COMDESA, it enjoys a possibly significant competitive advantage not generally available to other banks in that it can write loans with a currency readjustment clause, try to sell or merge it with a very strong bank. Try to sell the bank to Japan Inc., or Bank of Tokyo, or a Korean or Taiwanese development bank, or a local oriental bank, and refinance the loan for 10 years.
11. Write a fixed payment variable maturities note, if Davis can obtain usage of the software in Chile, (after converting assets and creating a dollar pledged sinking fund).
12. If the Central Bank refuses the sale of dollars to COMDESA at any rate other than the free market rate, we should try to persuade them to treat COMDESA in a similar manner to that of Banco de Trabajadores (government-owned) in that substantial rediscount facilities are offered at 8% and loans permitted at about 28-32%. Enough cashflow probably would be generated to permit COMDESA to service their debt at free market rates, after USAID takes a mortgage on the building and establishes a dollar denominated sinking fund.
13. Swap COMDESA guaranties paper to a bank that has a particular interest in Paraguay for whatever reason (perhaps Brazilian or Japanese) for dollar notes in its portfolio, which it may be willing to part with for various reasons.
14. Persuade the Central bank to bring interest up to date and guarantee the loan, and then restructure it in dollars, after converting assets and establishing a sinking fund.
15. Persuade the Central Bank to make a capital investment in COMDESA, with the marginal investment funds made available to USAID and converted to dollars to create the pledged sinking fund investment.
16. If the Central Bank refuses to guarantee the COMDESA restructured loans, USAID should convert all available assets to cash and purchase Government of Paraguay or Central Bank notes in the secondary market to use as collateral for the loans to COMDESA.

AMERICAN EMBASSY
 UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT
 Asunción, Paraguay

MEMORANDUM

Date: January 26, 1989
 From: *Basualdo*
 Julio C. Basualdo, Program Assistant, USAID/P
 Donn Davis, Financial Analyst, USAID
 To: Dr. Carlos Knapps, Director Banco Central del Paraguay
 Re: Banco de Desarrollo del Paraguay S.A. (COMDESA)

This is further to our conversation of yesterday discussing various options which might be considered in seeking a solution to the past due dollar loans from USAID to Banco de Desarrollo (COMDESA). It is clearly understood that the options mentioned below do not represent any commitment on the part of the Banco Central del Paraguay, nor USAID; rather they are points for further discussion. We wish to emphasize, however, that since this matter has continued unresolved for over two years, and that the exchange markets are active, it is essential that we take action as soon as possible.

Following an intensive review of the financial statements of COMDESA for the past five years, a review of the comments on these statements by the Central Bank and the Superintendent of Banks, and after looking at projections of the bank for the next five years along with an estimate of inflation for the same period, it seems clear to us that COMDESA will not be able to repay their two loans to AID, totalling approximately \$2.8 million in principal plus about \$300 thousand in interest. At the same time, we wish to add that the loan portfolio of the bank appears to be in good condition and that it has good banking systems in place. The fact remains, however, that the dollar debt of COMDESA overwhelms all other considerations of the bank. If COMDESA were to account for all relevant transactions since 1986 at the free market rate, the net worth would be negative.

Since USAID prefers to avoid, if possible, causing the demise of COMDESA, but still expects to be repaid in full, some non-traditional options may be considered, along with the traditional solutions arising from liquidity management. The options for consideration, in very brief form, are listed below:

1. COMDESA buys dollars from the Central Bank at an exchange rate of Gs.240 and repays the entire debt to USAID (Gs.240 x \$3,100,000 = Gs.744,000,000)
2. COMDESA buys dollars from the Central Bank at an exchange rate of 550 and pays the entire debt to USAID (Gs.550 x \$3,100,000 = Gs.1,705,000,000)

3. COMDESA delivers Gs.1,240,000,000 to the Central Bank in payment of the debts to USAID at an exchange rate of Gs.400 and the Central Bank assumes the loan refinancing obligation, that is, it will reschedule the loan from USAID for 10 years, with equal semi-annual payments at a fixed interest rate acceptable to USAID.
4. COMDESA delivers Gs.1,705,000,000 to the Central Bank in payment of the debt to USAID at a rate of Gs.550 and the Central Bank assumes the loan refinancing, that is, it reschedules the loan from AID for 10 years, with equal semi-annual payments at a fixed interest rate acceptable to USAID.
5. The Central Bank gives the same refinancing facilities to COMDESA that they provided to the Banco Nacional de Trabajadores, that is, a substantial line of credit for discounting notes and the Central Bank assumes the refinancing obligation of COMDESA to USAID in dollars for 10 years. Simultaneous to this, the Central Bank permits COMDESA to pay them Gs.1,705,000,000 (based on a fixed rate of Gs.550) over 10 years at an interest rate acceptable to both parties.
6. COMDESA enters the secondary market in New York in order to buy past due official debts of the Government of Paraguay (at an indicated rate of \$0.35 per dollar), using dollars obtained from the free market ($Gs.550 \times \$3,100,000 = Gs.1,705,000,000 / Gs.1,100 = \$1,550,000$) and delivers the past-due official obligations to the Central Bank in consideration of their assuming as obligor the refinancing of the USAID debt, in the form of a rescheduled 10 year loan. COMDESA will seek the purchase of official debt totalling, more or less, about \$4,000,000 in secondary market discounted loans, which other banks have refused to refinance, for about \$1,550,000 and, the Central Bank will have in the end a 10 year rescheduled loan at a fixed rate.
7. COMDESA delivers Gs.1,705,000,000 ($Gs.550 \times \$3,100,000$) to the Central Bank and the Central Bank will enter the secondary market in order to purchase past-due official debt of the Government of Paraguay, to retire it permanently, and simultaneously assumes the refinanced debt of COMDESA to USAID by means of a 10 year rescheduled loan at a fixed rate of interest. The Central Bank would look specifically for official past-due obligation from banks which are refusing to refinance them. This option would solve all three problems.
8. The Central Bank makes a significant investment in COMDESA, by purchasing common stock of the bank and, at the same time, assumes the refinanced loan from USAID for a period of 10 years at a fixed interest rate. COMDESA then would continue as a mixed company.

AMERICAN EMBASSY
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 Asunción, Paraguay

MEMORANDUM

Fecha: 26 de Enero de 1989

A: Dr. Carlos Knapps, Miembro del Directorio del BCP

De: ~~Julio C. Basualdo~~, Jefe de Programas de AID
 Donn Davis, Asesor Financiero de AID

Tema: Banco de Desarrollo del Paraguay S.A. (COMDESA)
 Opciones para solución del problema de pago de préstamos de A.I.D.

El objeto de este memorandum es ampliar los puntos discutidos en nuestra conversación de ayer con referencia a diferentes opciones que podrían ser consideradas para buscar la solución a los pagos atrasados de cuotas de préstamos de A.I.D. al Banco de Desarrollo del Paraguay. Se deja constancia de que queda claramente entendido que las opciones mencionadas más abajo no representan ningún compromiso ni de parte del Banco Central del Paraguay, ni de parte de A.I.D. Deseamos dar énfasis, sin embargo, que en vista de que este asunto ha estado sin resolverse por más de dos años, y considerando que los mercados de cambio están activos, que es esencial que tomemos alguna acción para resolverlo tan pronto como sea posible.

Después de una revisión intensiva de los estados financieros de COMDESA de los últimos cinco años y de una revisión de los comentarios de la superintendencia de Bancos del BCP, y después de analizar las proyecciones del Banco de Desarrollo del Paraguay de los próximos cinco años, juntamente con una estimación de la inflación para el mismo período, nos parece claro que COMDESA no podrá reembolsar los montos pendientes de pago de los dos préstamos a la A.I.D., que totalizan aproximadamente US\$ 2.8 millones en saldo del principal más aproximadamente US\$300.000 de intereses vencidos. Desearíamos agregar que la cartera de préstamos del Banco parece estar en buenas condiciones y que el mismo funciona en base a un buen sistema administrativo-bancario. Todo esto no elimina, sin embargo, el hecho de que el peso de la deuda en dólares del Banco es una carga realmente abrumadora para el mismo. Si COMDESA contabilizara todas las transacciones pertinentes desde 1986 al cambio libre de mercado, su patrimonio sería negativo.

Teniendo en cuenta que la A.I.D. prefiere evitar, si es posible, causar la liquidación de COMDESA, pero sin dejar de recibir el total del saldo de los préstamos, más los intereses vencidos, se podrían considerar algunas opciones no tradicionales, juntamente con las soluciones tradicionales resultantes de la administración de los fondos. Las opciones que podrían ser consideradas, en breve forma, son las que se indican a continuación:

1. COMDESA obtiene dólares del Banco Central a un tipo de cambio de 240 y paga la deuda a AID enteramente en dólares. (\$ 3.100.000 incluyendo principal e intereses x Gs. 240 = Gs.744.000.000).

2. COMDESA compra dólares del Banco Central a un tipo de cambio de 550 y paga la deuda a AID en dolares (Gs. $550 \times \$3.100.000 = \text{Gs. } 1.705.000.000$)
3. COMDESA entrega Gs. 1.240.000.000 al Banco Central en pago de la deuda a AID a un tipo de cambio de Gs.400 y el Banco Central asume la refinanciación, como si se tratara de un préstamo nuevo de AID al Banco Central por el término de 10 años con pagos iguales, semi-anales y a intereses fijos.
4. COMDESA entrega Gs.1.705.000.000 al Banco Central en pago de la deuda a AID a un tipo de cambio de Gs.550 y el Banco Central asume la refinanciación, como si se tratara de un préstamo nuevo de AID al Banco Central por el término de 10 años con pagos iguales, semi-anales y a intereses fijos.
5. El Banco Central otorga a COMDESA las mismas facilidades que da al Banco Nacional de Trabajadores, o sea, una línea sustancial de descuento, y el Banco Central asume la deuda a AID en dólares por 10 años, y al mismo tiempo, permite a COMDESA pagar al Banco Central el principal Gs.1.705.000.000 (en base a una tasa fija de Gs.550) en un plazo de 10 años a una tasa de interés a ser negociada.
6. COMDESA entra en el mercado secundario en Nueva York para comprar obligaciones vencidas del Gobierno Paraguay (a una tasa que podría ser, por ejemplo, de \$0.35 por dolar) usando dólares del mercado libre. (Gs. $550 \times \$3.100.000 = \text{Gs. } 1.705.000.000 / \text{Gs. } 1.100 = \$1.550.000$) y entrega las obligaciones oficiales del Gobierno Paraguay al Banco Central, con la condición de que el Banco Central asuma la deuda a AID, como si se tratara de un nuevo préstamo por 10 años. COMDESA puede buscar la compra de obligaciones oficiales del Gobierno Paraguay con un valor aproximado a \$14.000.000, descontado en el mercado secundario, por \$1.550.000, y que otros bancos extranjeros rehusan refinanciar. El resultado final de esta opción sería que el Banco Central asumiría el pago de los préstamos de AID por \$3.100.000 por 10 años, con una tasa de interés fija.
7. COMDESA entrega Gs.1.705.000.000 (Gs. $550 \times \$3.100.000$) al Banco Central y el Banco Central lleva este monto al mercado secundario para comprar obligaciones oficiales vencidas del Gobierno del Paraguay, para retirarlas permanentemente, y simultáneamente, asume la deuda de COMDESA a AID como si se tratara de un préstamo nuevo por 10 años, con intereses fijos. El Banco Central podría buscar específicamente deuda oficial con vencimientos impagos de bancos extranjeros rehusan refinanciar dichas obligaciones vencidas. Esta opción podría solucionar tres problemas al mismo tiempo.
8. El Banco Central hace una inversión significativa en COMDESA, comprando acciones nuevas de COMDESA, y asume al mismo tiempo el préstamo refinanciado de AID por 10 años a una tasa fija de interés. COMDESA continuaría entonces sus operaciones como una entidad mixta.

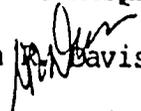
11

AMERICAN EMBASSY
 UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT
 Asunción, Paraguay

MEMORANDUM

Fecha: Enero 26, 1989

A: Dr. Crispiniano Sandoval, Departamento de Estudios Económicos
 Banco Central del Paraguay

De: Donn  Davis, Consultor de A.I.D.

Tema: Reconversión de Deuda (Debt Equity swaps)

De acuerdo a lo prometido en nuestra conversación de ayer, aquí esta un resumen breve de la conversión de deuda en otros dos países.

En Honduras, a Noviembre 1988, el Banco Central ha hecho, o participado, en nueve transacciones de la reconversión de deuda. Mientras el Congreso alla ha aprobado todas las transacciones, el mismo Congreso está ahora en el proceso de pasar una nueva ley donde se establecen las normas o condiciones para las reconversiones de la deuda. Estan haciendo eso para facilitar el proceso con el fin de alcanzar dos objetivos, que son reducir la deuda oficial total y al mismo tiempo, traer nueva inversión al país. Es verdad que en el proceso se produce alguna inflación, pero en la opinion de ellos, es mínima y los otros dos objetivos tienen mas importancia para el país.

Específicamente, un inversionista, que podría estar fuera o dentro del país, compra una obligación del Estado en el mercado secundario de un banco con prestamos internacionales, con un descuento. En el caso de Honduras, recientemente la cotización era \$0.26 por dolar valor nominal. Pero antes de concretar la compra, el inversionista consultaría sobre su proyecto, o sea la razon de la inversión, con el Banco Central. Si el Banco Central acepta la inversión, autoriza al inversionista el cambio de las obligaciones del Estado por bonos del Estado de Honduras, en lempiras, que vencen anualmente sobre un período de 10 años. El tipo de cambio es el valor nominal de las obligaciones del Estado compradas multiplicado por dos lempiras, que es el tipo de cambio oficial. El inversionista puede obtener un préstamo de un banco de plaza, dando los bonos en lempiras como garantía.

En Chile, el inversionista tambien compra la obligación vencida de un banco internacional por un tipo de cambio del mercado secundario para deuda oficial externa. En el caso de Chile, ahora es \$0.585 - \$0.595. El inversionista entonces puede usar una de las diferentes cotizaciones en dolares (pues existen varios mercados) para monetizar la obligación oficial y recibir pesos para su inversión. Hay variaciones sobre los mecanismos de este proceso, pero la diferencia mayor entre Honduras y Chile es que Chile usa para la liquidación final, el mercado mas cercano al libre, en vez del mercado oficial.

En el proximo mes, cuando esté en Costa Rica, y si hay algo interesante alla sobre el tema de reconversion de deuda, le mandaré una nota a usted. Yo se que se hacen esas cosas en Costa Rica, pero no sé los detalles, todavía.

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 SANTIAGO

Reuters PAGE : M L L A

Argentina	21-21.5	Venezuela	37.5-38.5
Brazil	37.5-38.5	Yugoslavia	44-46
Chile	58-59		
Colombia	58-60		
Bolivia	11-13		
Costa Rica	12-14		
Ecuador	13-15		
MEXICO	39.5-40.5		
Philippine	49-51		
Peru	5-7		
PANAMA'	20-22		
MOROCCO	47-49		
ROMANIA	93-95		
Poland	33.5-35		

 PARAGUAY - THIN MARKET
 INDICATION RATE ONLY: 35-40

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10-Jan-1989

10. Statement of Work for this TSO:

The Banco De Desarrollo (COMDESA) was established as a private development bank in Paraguay in the 1970's. It received two AID loans (526-L019 and 526-L-025) which were not guaranteed by the government. Due a precipitous devaluation of the Paraguayan local currency in the 1980's, COMDESA began to have difficulties servicing the A.I.D. loans. In 1986, the situation was aggravated when the Central Bank halted COMDESA's access to U.S. Dollars at a subsidized rate in order to pay the official debt. As of November 1988, COMDESA has ceased all payments and the unpaid balance on the loan amounts is US\$2,803,293.04, of which US\$1,187,030.50 is past due.

The consultant will go to Paraguay and assess the feasibility of rescheduling the loans that are outstanding. In addition, the consultant shall meet with senior management of both COMDESA and the Banco Central to establish a mutually agreeable exchange rate to facilitate the repayment of the loans. Specifically, he/she will:

- 1) Analyze COMDESA's financial statements for the last five years, its present portfolio, terms of lending and capital structure. Review appropriate regulatory policies, particularly as they bear on feasible debt repayment options;
- 2) Review with Central Bank officials the salient factors in the above analysis and determine whether additional factors need to be considered in developing a negotiable plan;
- 3) Develop several options for repayment of the A.I.D. debt. Each option will be accompanied by cash flow analyses with sensitivity analyses for critical factors, such as future movement of the free market exchange rate;
- 4) Provide an oral presentation of the above analyses to a joint AID/COMDESA/Central Bank meeting.

PLEASE NOTE: ATTACHED CABLE IS AN INTEGRAL PART OF THE SCOPE OF WORK.

11. Consultant Team Composition: Donn Davis

12. Deliverables: Prior to the consultant's departure from Paraguay, he/she shall present a draft written report and conduct an oral presentation with senior management. Both the draft and oral presentation must be in sufficient detail and depth to allow USAID/Paraguay to respond and make, as appropriate, recommendations for incorporation into the final draft.

The final report, incorporating Mission comments, shall be submitted to USAID/Paraguay within fifteen days of departure from Paraguay.

The final report shall be in English and ten copies shall be submitted to USAID/Paraguay.

14

PERONI - SOSA & ALTAMIRANO
ABOGADOS

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 GUILLERMO F. PERONI
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 MARIA BERTHA PERONI
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PATENTES Y MARCAS
 OLADYS B. DE MODICA

January 31, 1989

To: Julio C. Basualdo, Program Assistant, USAID/P
 Dean Davis, Financial Analyst, USAID

Re: Banco de Desarrollo del Paraguay S.A. (COMDESA)

I refer to our conversations on the subject and your Memorandum dated January 26, 1989 to Dr. Carlos Knapps, Director Banco Central del Paraguay.

I have reviewed the options proposed as settlement of the COMDESA past due dollar loans to USAID. In my opinion, the following considerations should be made:

- 1) The loans were originally made in 1970 and 1973 to COMDESA, which later became Banco de Desarrollo del Paraguay SA (BD). Has BD specifically assumed the obligations under the COMDESA loans?
- 2) We have no information regarding Central Bank commitment to COMDESA/BD for the supply of foreign exchange to pay the loans. Were the loans registered with Central Bank under article 16 of Law 216/70 or article 16 of law 550/75?
- 3) In 1982 (Circular 65/82) Central Bank ruled that foreign loans by banks and private sector borrowers destined to the "production of goods" would be paid at the rate of Gs.160. The applicable rate was changed to Gs.240 in 1984 (Circular 28/84). Central Bank supplied the foreign exchange.
- 4) In 1986 (Circular 59/86) Central Bank abruptly renounced its commitments to supply foreign exchange to the private sector. Henceforth, service of the foreign debt of the entire private sector would be at the Free Market Rates. Circular 59/86 maintained preferential repayment rates for the public debt at Gs.240 (until June 1987) and Gs.320 (as of July 1, 1987). Presently, public debt is being serviced at the rate of Gs.400 (Resolution 11, dated July 5, 1988).

59

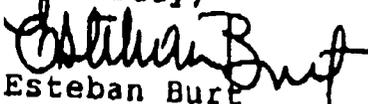
PERONI - SOBA & ALTAMIRANO

Page 2

- 5) We are aware that Central Bank has, discretionally, provided foreign exchange at preferential rates to non-government parties, to pay private sector loans and other import obligations contracted prior to the abovementioned circulars and resolutions.
- 6) Central Bank has the authority to intervene on behalf of private institutions faced with impossibility of paying its foreign loans, such as the present case. This authority is given by articles 4(b) and 5(d) of its Charter, Decree Law 18/52, and may be exercised for Options N° 4 and N° 5 of your Memorandum. I believe a more feasible rate would be Gs.750 proposed by Central Bank to Consejo Nacional de Coordinación Económica last October. An example of Central Bank intervention is the solution given in the Banco Nacional de Trabajadores insolvency.
- 7) Options N° 6 and N° are also technically and legally possible, but will require authorization of the highest levels of Government (President of the Republic and Consejo Nacional de Coordinación Económica) because it would affect present policy regarding handling of the foreign debt in general.
- 8) An investment by Central Bank in BD shares is not possible under its Charter.

I have only reviewed the legality of the practical options set forth in your Memorandum. Should you require a more detailed opinion regarding USAID's legal position vis a vis Central Bank and COMDESA/BD we will need to access the historical documentation and correspondence between the parties. At that time we can also discuss the ramification of strict enforcement of the loan agreements against COMDESA/BD.

Sincerely,



Esteban Burt

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