

ECONOMIC ASSISTANCE STRATEGY FOR CENTRAL AMERICA 1991 to 2000

"Now it falls to us to strive towards a developed Central America, one capable of meeting by itself the basic needs of each of our citizens. We see integration as the means for achieving this development, and aspire to see Central America linked to the world in a mutually productive and respectful interdependence..."

Declaration of Antigua, June 1990



January 1991

Agency for International Development

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ECONOMIC ASSISTANCE STRATEGY FOR CENTRAL AMERICA 1991-2000

Dramatic political and economic changes in Central America, and in the world, demand a new U.S. economic assistance policy for the region in the 1990s. For the first time in history, all Central American countries have democratically elected governments. The region's presidents have renewed their commitment to peace and mutual interdependence. Also underway in the region is an economic transformation that has the potential to be as profound as the political transition of the 1980s. There is an unprecedented opportunity over the next decade to achieve the political stability, economic prosperity, and social justice that have for so long eluded the people of Central America.

The United States has widened the scope for cooperation with Central America through the Enterprise for the Americas Initiative (EAI) and has called for broad multilateral support for the region through a Partnership for Democracy and Development (PDD). At the same time, U.S. foreign assistance levels for Central America are declining from the historic amounts that were provided during the conflicts and economic crises of the last decade. The challenge for the 1990's is to sustain the positive but still very fragile trends toward political and economic freedom, utilizing diminished resources in a manner that will have the maximum impact.

The new strategy for U.S. economic assistance for Central America in the 1990s will support the broad objectives identified by the Central American Presidents in the Declaration of Antigua, adopted in June 1990, as well as the commitments they made in the Declaration of Puntarenas in December 1990:

- the development of stable, democratic societies;
- the achievement of broad-based, sustainable economic growth; and
- the attainment of effective regional cooperation.

The Agency for International Development will pursue these objectives through its own bilateral and regional programs, and through heightened collaboration with other U.S. Government agencies, multilateral development institutions, and other bilateral donors. As macroeconomic environments improve, A.I.D.'s implementation strategy will emphasize greater concentration of resources on the solution of specific sectoral problems.

To enhance democracy, A.I.D. will increase support for democratic institutions, especially to broaden and deepen participation in democratic processes. Local governments need to be strengthened in order to better deliver services and to broaden citizen participation in government. Judicial, legislative, and electoral systems need to be independent, professional, and effective to consolidate democratic gains. Public finances must be managed with the competence and integrity necessary to merit public confidence. Democratic values need to be promoted to develop stronger, more effective citizen participation.

To stimulate economic growth, A.I.D. will help Central Americans eliminate obstacles to private investment, trade, and employment generation. A.I.D. will encourage the adoption of policies, incentives, regulatory frameworks, and management practices that protect the natural resource base as well as facilitate greater participation in the economy by the disadvantaged. A.I.D. will also assist governments and the private sector to improve the effectiveness, efficiency, financing, and local control of basic social services.

To foster regional cooperation, A.I.D. will place greater emphasis on implementing initiatives identified by the Central Americans within a regional framework. A.I.D. will encourage policy, legal, and other reforms to further liberalize trade within Central America. A.I.D. will also support key regional institutions while at the same time helping them to achieve greater self sufficiency and reduce their dependence on A.I.D. resources.

Between now and the year 2000, the strategy emphasizes the following goals:

- free and open national and local elections will be the norm; administrative and financial authority of local governments will be strengthened; legislatures will function effectively and cooperate more through a Central American Parliament; judiciaries will increase respect for the rule of law and human rights; the military's role in the political processes will be reduced; civic participation in democratic processes will increase; the press and other media will be freer, more responsible;
- per capita GDP will grow between 2.5% and 3.0% per year; private investment as a percentage of GDP will increase substantially; nontraditional exports will maintain their brisk growth rates; unfettered intraregional trade and capital movements will be the norm; public investment will increase significantly, and will be concentrated in basic infrastructure for economic growth, the development of human resources, and the conservation of the natural resource base.
- infant mortality, malnutrition in children under five, and population growth rates will continue to decline substantially; vaccination coverage and primary school enrollments will increase;
- the annual rate of deforestation will slow substantially.

The new strategy will have implications on management. Increased staff requirements for democracy and environmental programs will be more than offset by staff reductions elsewhere. A.I.D. will need to coordinate its programs more closely with other U.S. Government agencies. Cross-cutting Congressional earmarks and functional accounts that do not reflect the requirements of the new strategy will need to be minimized.

United States foreign assistance resource requirements should decline during the 1990s, as increased trade and investment in Central America are expected to generate more foreign exchange from exports of nontraditional products. Other donor assistance and the return of Central American capital will be equally important. So long as external support is not precipitously withdrawn before the region's own resources can sustain robust growth with broad participation, U.S. objectives in the region can be met with an orderly decline in A.I.D. assistance.

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I. INTRODUCTION: A NEW CENTRAL AMERICA AND A NEW CHALLENGE

A. A NEW POLITICAL AND ECONOMIC ENVIRONMENT

Democratically Elected Governments

For the first time in history all the countries of the Central American isthmus, from Guatemala to Panama¹, are led by democratically elected governments committed to market-based economic policies. The realignment of East-West relations and the discrediting of statist and import-substitution economic policies provide a new generation of leaders a unique opportunity to solidify democracy and set a course of dynamic and equitable growth.

Progress toward Peace

The Central Americans are justifiably proud of progress toward peace under the Esquipulas Accords. The democratic transfer of power in Nicaragua, the peace negotiations in El Salvador, and the end to despotic government in Panama provide a basis for renewed regional cooperation and a better environment for all of the peoples of Central America to build a more secure and hopeful future.

A Renewed Commitment to Mutual Interdependence

Central American leaders, building on the success of the Esquipulas peace process begun in 1987, have renewed their efforts to rebuild their economies and integrate Central America into the world economy. In the Declaration of Antigua (June 1990), and reaffirmed in the Declaration of Puntarenas (December 1990), these leaders committed their countries to mutually supportive interdependence and set forth their own vision of Central American cooperation.

B. A SHARED VISION

Peace, Democracy, and Development

Today U.S. and Central American leaders share a common belief, expressed eloquently in the report of the International Commission for Central American Recovery and Development (the Sanford Commission), that "lasting peace, genuine democracy, and equitable development are inextricable. These three objectives are mutually reinforcing. None is sufficient by itself; all are necessary." That report, prepared by a diverse group of Central Americans and individuals from other nations in the Americas and elsewhere, is representative of the growing dialogue between Central Americans and those from outside the region who share a concern for its future.

Supporting the Vision

President Bush, in introducing his Enterprise for the Americas Initiative (EAI), underscored U.S. support for Central American efforts to deepen democracy, foster trade and investment, and promote sustained, broad-based economic growth. "The future of Latin America," the President said, "lies with free governments and free markets." The United States supports the Central Americans' expressed desire for greater political and economic interdependence which we believe will discourage instability and accelerate economic, social, and political progress.

¹Belize is dealt with by A.I.D. primarily in the context of the Caribbean region. It will be formally involved in the Central American Strategy as the opportunity arises, e.g. its observer role in the Partnership for Democracy and Development.

The EAI is designed to bolster the democratic and market-oriented transition throughout Latin America by focusing on trade, investment, and debt reduction. A companion initiative, the Partnership for Democracy and Development in Central America (PDD), will encourage broad support from the international community for regional democratization and development. The PDD will provide a forum for fostering international support for regional economic policies and integration efforts, strengthened democratic institutions, and a coordinated approach to bilateral and multilateral assistance to the region.

Increased private investment in productive areas is the key to the success of the EAI. Foreign investment is important -- and substantial amounts of it are already flowing. Some of the flight capital that left the region in the early 1980s has begun to return, and continued good policies will result in additional repatriation. Further financial reforms are also needed to increase the level of domestic savings which are critical for greater investment in the region.

With its field missions, the Agency for International Development (A.I.D.) can play a role in achieving the goals of the EAI. A.I.D. support for institutional and policy reforms in the trade and investment area, in addition to macroeconomic policy reform, will lay a basis for sustained growth in investment. In addition, support for increased linkages between the U.S. business community and Central American entrepreneurs will speed up the process of investment and trade. A.I.D. can continue to help Central American countries address their debt problems and take advantage of opportunities under the EAI to reduce debt. Consolidating democracies, addressing the social problems of the disadvantaged and ensuring better management of the environment will require the Central American countries to mobilize increased internal and external resources and use them more efficiently.

C. CENTRAL AMERICA: RECOVERING FROM THE CRISES OF THE 1980s

Crisis Management: The Early 1980s

In the early 1980s, Central American countries faced a profound economic and political crisis. The governments of Guatemala and El Salvador were under virtual siege by leftist insurgents and the extreme right; the Sandinistas were solidifying their power in Nicaragua and menacing El Salvador; Panama was under the increasingly brutal control of General Noriega; Honduras was preparing to end a long period of military rule in the face of a faltering economy. Only Costa Rica had a democratically elected government at the beginning of the decade.

The economies of the region were reeling under the impact of the oil crisis and subsequent recession. It is estimated that at least \$1.5 billion in capital left between 1980 and 1982; public and private debt skyrocketed to over \$10 billion; and private investment, both domestic and foreign, plummeted. Sharp declines in income (12% region-wide and as much as 20% in El Salvador) exacerbated the political crises. Even stable Costa Rica experienced sharply reduced incomes, high inflation, and rising unemployment. Governments everywhere were losing the capacity to face the economic challenges and to deliver basic social services.

Adopting an Outward Economic Orientation

The crisis of the 1980s made clear to the Central American countries that their economies were ill-equipped for the rapidly changing international economic environment. A regional consensus has emerged that a more outward-oriented economic strategy is essential to sustained, broad-based development. Private sector leaders who once lobbied for the revival of a protected regional market are now turning their energies to exporting new products to new markets outside the region. Governments are lowering tariffs, eliminating restrictions on foreign investment, and taking other important measures to liberalize their economies.

Progress under the Central America Initiative

The Central American Initiative, launched in 1984, was a comprehensive effort by the U.S. Government to help the Central Americans restore long-term political and economic progress. Much has been achieved (Chart I). Democratically elected governments are now in power throughout the region, headed by presidents who achieved national preeminence as political, rather than military, leaders. They are men and women of vision, committed to the democratic process and to improving the well-being of their citizens through sustainable, economic growth.

The economic hemorrhage of the early 1980s has been stemmed and positive economic growth restored. Excluding Panama and Nicaragua, the region has achieved positive real annual per capita growth each year since 1987. Outward-looking economic policies are now in place that promise sustainable growth. The region's entrepreneurs have responded by developing new export products for the United States and Europe. This export growth has created significant new employment and generated growing demand for imports, particularly from the United States.

With substantial aid from the United States and other donors, most countries have been able to improve social indicators. Over 1.8 million more people now have access to potable water. Infant mortality rates have fallen and immunizations and the use of oral rehydration therapy have expanded. An additional 400,000 children are attending primary schools, producing modest gains in primary school coverage and completion rates, despite high birth rates (Chart I).

CHART I: Indicators of Progress During 1984-1990

INDICATOR	1984	1990
Real Per Capita GDP Growth ¹	-0.5%	0.2%
Private Investment (% of GDP)	7%	13%
Nontraditional Exports (\$ Billion) to US	0.4	1
Democracy Rating for Political Rights and Civil/Political Liberties (Scale of 1 to 7) ²	3.6	2.7
Primary School Enrollment Ratio (Gross) ¹	89%	93%
Primary School Completion Rate (Gross) ¹	52%	60%
Infant Mortality (per 1000 births)	58	45
Water Supply Coverage ³	56%	60%
Sanitation Coverage ⁴	48%	59%
Vaccination Coverage ⁵	50%	66%
Children under 5 Malnourished ⁶	20.4%	17.8%
Annual Rate of Population Increase ⁷	2.71%	2.65%
Annual Deforestation Rate ⁸	N/A	3%-7%

¹Excludes Nicaragua.

²Freedom House is an independent non-profit organization that has conducted a comparative survey of freedom since 1972. Countries are ranked on a scale of 1 (fully free) to 7 (not free), on the basis of a 36-point checklist of political rights and civil liberties that measures such variables as elections, breadth of political participation, freedom of groups and the press from political terror or intimidation, and individual human rights.

³Percentage of Central Americans with access to water within 50 meters.

⁴Percentage of Central Americans with access at least to a latrine.

⁵An estimate of the percentage of living children between the ages of 12 through 23 months who have been vaccinated before their first birthday—three times in the cases of polio and DPT and once for both measles and BCG.

⁶Percentage of children under 5 years of age below 2.0 standard deviations of the WHO/NCHS reference population.

⁷Excludes Nicaragua, El Salvador (due to war).

⁸Under the Regional Environmental Project (RENARM), A.I.D. is developing improved environmental indicators to measure performance and progress in this priority program area.

II. A.I.D.'S STRATEGY AND TARGETS FOR THE 1990s

A. THE FRAGILITY OF PROGRESS TO DATE

Much has been accomplished to achieve peace, democracy, and economic recovery in Central America, but much remains to be done. The foundation for progress must be made permanent. More than anything else, what is needed now is the continued nurturing of the institutions of economic and political freedom to deepen their roots.

Serious challenges remain. Continuing internal strife in El Salvador and Nicaragua is evidence of the fragility of democratic principles. While elections have been held, many democratic institutions are weak, particularly at the local level. Although most countries are managing their economies better, they still need assistance to sustain their adjustment programs. Moreover, continued poor world markets for Central American products, an unresolved external debt problem, high population growth rates, and environmental degradation will complicate the economic management problems of the region's leaders. The majority of Central Americans still live in poverty, many in extreme poverty, and lack the means to alter their situation in the foreseeable future unless national policies and programs reduce the barriers to their participation in democratic political systems, growing economies, and fundamental social services.

B. KEY PREMISES

A.I.D. will build on past successes by consolidating and focusing its programs in the areas of participatory democracy and broadly-based growth. The World Bank's World Development Report for 1990 makes clear that market-based economic growth is essential for rapid and sustained progress in reducing poverty. "Getting prices right" not only provides farmers and urban residents more incentives to increase production; it also removes exchange-rate, credit, fiscal, and other distortions that have made capital arbitrarily cheap. This means that employers will place a higher value on labor, thus creating more jobs and providing the poor more income with which to improve their standards of living. Rapid and sustained economic growth also provides governments more revenue with which to expand primary education, primary health and nutrition programs, family planning programs, and other basic services that constitute the second major element of a successful strategy for reducing poverty. This kind of broad-based, sustainable model of economic growth offers Central American countries the best prospects for strengthening the democratic gains made during the 1980s.

A.I.D.'s strategy for supporting a deepening of democratic processes and the achievement of rapid broad-based, and sustainable economic growth is based on the following key premises:

There is a Shared Vision of the Region's Future

Central Americans have a vision of their future, and one aspect of that vision is that increased regional interdependence can promote common good for the region.

The Central Americans will use the consultative group and PDD mechanisms to mobilize additional external cooperation, trade, investment, debt relief, and democratic development.

Trade, Investment, and Aid are Linked

Over the longer term, increased trade and investment are key to the economic development of Central America, and aid can help lay the basis for this private sector-led growth. A.I.D. will place increased emphasis on trade and investment within its programs and explicitly link them to business outreach activities with and in the United States.

Expansion of trade and investment must be based on comparative advantage, which will require increased productivity, specialization, and aggressive marketing.

Significant policy and regulatory changes encouraging increased private investment and open trade are required to stimulate significant growth.

A reduction of political strife and an improved regional macroeconomic and sector policy environment will encourage substantial renewed private capital flows into the region.

Accelerated economic growth in Central America will create larger markets for U.S. exports, greater opportunities for U.S. investors, and more trade opportunities for Central American countries within the region, with the United States, and in the world economy.

Public and Private Sector Responsibilities Must be Realigned

Centralized government bureaucracies need to be reduced, with productive activities transferred to the private sector and essential government services provided with greater efficiency. The roles of municipalities, the private sector, and non-governmental organizations in development should be increased.

The multilateral banks and the private sector will take the lead in financing the construction and rehabilitation of productive infrastructure in the region.

A.I.D. will maintain and foster sound and focused safety net programs in the context of continued support for the Central Americans' macroeconomic policies and programs.

The U.S. Role and Objectives Will Change

The need for U.S. assistance to Central America will decline as recovery proceeds, as trade and investment flows to the region expand, and as other sources of multilateral and bilateral assistance increase.

In order to obtain the most productive use of more limited resources, Congress will need to agree to eliminate functional accounts and minimize earmarks of U.S. assistance to Central America.

A.I.D. will also streamline the programming process, including new sector assistance approaches.

C. TEN PRINCIPLES OF A.I.D.'S STRATEGY IN THE 1990s

With these premises serving as a framework, ten major principles will guide A.I.D.'s development assistance strategy in Central America during the 1990s:

1. A.I.D. will help Central Americans eliminate impediments to private sector-led trade, investment, and employment generation. The foregoing will require low inflation, macroeconomic stability and the further liberalization of international trade. To the degree that these efforts are successful, A.I.D. will gradually shift its focus from addressing macroeconomic constraints to helping to reduce barriers to growth in specific economic sectors, i.e. industry, agriculture, tourism, energy, and services such as finance.
2. Greater emphasis will go to supporting the development of democratic institutions and particularly to deepening and broadening participation in democratic processes.
3. To consolidate the democratic process, A.I.D. will emphasize programs to strengthen the judicial, legislative, and electoral systems through increased professionalism, heightened accountability, and civilian oversight.
4. Programs will be expanded to promote informed civic participation in public policy issues as a stimulus for open and responsive government.
5. The Central Americans, with A.I.D. assistance, will strengthen democratically-elected local governments through decentralization of real authority and resources.
6. Greater emphasis will be given to encouraging Central Americans to adopt economic policies, incentives, regulatory frameworks, and management practices which promote the protection and sustainable use of the natural resource base.
7. To help assure that a majority of Central Americans share in the benefits of a growing economy, A.I.D. will encourage governments to adopt policies and regulatory frameworks that will facilitate greater participation in the economy by the disadvantaged. A.I.D. will focus especially on policies designed to promote increased employment at the lower end of the economic spectrum where Central America has comparative advantages in labor costs.
8. A.I.D. will help Central American governments and the private sector improve the effectiveness, efficiency, financing, and local control of basic social services, thus increasing access to them and assuring their sustainability. Further improvements in the social service sectors will require increased national financing of public sector programs (in contrast to donor-funded service delivery) and broadening of private sector financing of quality health and other social service delivery wherever feasible.
9. Within the EAI and PDD frameworks, A.I.D. will more closely collaborate with other U.S. Government agencies, multilateral development institutions, and bilateral donors in helping Central Americans meet their political and economic development goals.
10. To reinforce the benefits of increased cooperation among the Central Americans, A.I.D. will support regional initiatives through regional and bilateral efforts to encourage regional dialogue and networking. Working with the Central Americans, A.I.D. will support initiatives such as promoting and strengthening intra-regional dialogue and interchange among Central American legislative representatives, including the possible emergence of a Central American Parliament; promoting liberalization of trade in goods and services within the region; facilitating the free flow of capital both intraregionally and between the region and the rest of the world, and supporting initiatives of special significance to the U.S. Government, e.g. counter-narcotics issues.

D. TARGETS FOR THE YEAR 2000

With adequate international support, Central America by the year 2000 can be a democratic, vibrant, and increasingly prosperous region. Specifically, the following targets appear attainable:

Democracy

- Free and open national and local elections will be the norm.
- Administrative and financial authority of local governments, including the power to generate revenues, will be increased, while that of central bureaucracies will decrease.
- Strengthened judiciaries will increase respect for the rule of law and human rights, and better protect the security of person and property.
- Legislatures will function effectively, and intraregional cooperation will increase through a Central American Parliament.
- The autonomy of the military in political and economic processes will be reduced.
- Civic participation in the democratic process will increase.
- The press and other communications media will be freer and more responsible.

Broad-Based, Sustainable Economic Growth

Central America will be a full participant in the world economy, with market-oriented economic policies that make possible steady increases in employment and productivity based on the region's comparative advantages. Government policies will reinforce a broadening of the economic base by improved access to quality basic education and health care in response to the democratically-expressed will of the people, by market-based policies that nurture entrepreneurs, small businesses, and agricultural producers, and by a legal framework that protects property.

Feasible indicators for measuring progress are shown in Chart I. Specific quantitative goals will be reflected in regional and country strategies and annual action plans, and adjusted as may be necessary in light of evolving circumstances. In this manner, it is feasible to account for and measure progress in each country. This is particularly important due to the diversity that exists in the region in the quality of life, conditions and prospects for economic growth, and the stability and development of democratic institutions.

While it is difficult to project goals ten years in advance, it is estimated that regional economic growth by the end of the decade should increase to 5% per year. Private investment as a percentage of Gross Domestic Product should increase from 13% to 19% region-wide, while nontraditional exports to countries outside the region are expected to increase from a baseline of \$1.46 billion in 1990 to over \$4.7 billion by the end of the decade. Infant mortality (per 1,000 births) should decrease from a 1990 baseline of 45 to about 37 region-wide. Communicable diseases susceptible to immunization control should be virtually eliminated by the end of the decade. The regional primary school completion rate is expected to rise from a 1990 baseline of 60% to over 70% in the year 2000.

III. STRATEGY OBJECTIVE NUMBER ONE: THE DEVELOPMENT OF STABLE DEMOCRATIC SOCIETIES

Support for and development of stable democratic societies in the countries of Central America constitutes the leading edge of A.I.D.'s strategy for the region. The strategy envisions a significantly expanded role in this area for field missions, including the Regional Office for Central American Programs (ROCAP). Working within the context of the USG country team, A.I.D. will work closely with other USG agencies to support nonpartisan efforts to deepen and consolidate indigenous democratic institutions. A.I.D. will focus on technical assistance and training, investing in human resources and the strengthening of local institutions, and will include democratic initiatives in its policy agenda.

Under the proposed strategy, A.I.D. will increase its financial resources for various democratic initiatives. These resources, particularly for strengthening local government, will need to be complemented by additional flows from other members of the donor community. However, support for democracy is not resource intensive. While external assistance is important, additional resources do not assure greater or more rapid progress. Success ultimately depends upon the political will and popular expectations of Central American societies.²

A. CONSTRAINTS

The following are the more salient constraints in varying degrees that restrain the growth of democratic values and institutions:

- Authoritarian history and political structure with tradition of military control and/or influence over government.
- Overly centralized public sector power with weak municipalities as well as weak traditions of support for human and civil rights.
- Lack of support for legislative, judicial, electoral, and political processes.
- Inefficient government institutions and widespread corruption.
- Lack of social, political, and economic pluralism and local participation; weak and unprofessional media.
- Government policies that reinforce the powerful and discriminate against disadvantaged groups.

B. PROGRAM STRATEGY

To address these constraints A.I.D. proposes a ten-point program under two broad areas of focus:

1. Strengthening government institutions to be more responsive to citizens and more democratic in operation.
2. Promoting democratic values among citizens through greater participation and influence of non-governmental and educational institutions and a free and professional media.

²See "Strengthening Democracy in Latin America and the Caribbean: U.S.A.I.D.'s Experience to Date and Plans for the Future", a presentation to the Development Assistance Committee of the Organization for Economic Cooperation and Development (OECD), Agency for International Development, Bureau for Latin America and the Caribbean, November 1990.

The first area focuses on the need for open, responsible and effective government, at both the national and local levels, to assure full application of the rule of law, the protection of individual rights, the holding of free and fair elections, the effectiveness of the legislative process, and the diminution of inefficiency and corruption.

The second area highlights the need to go beyond public institutions and formal processes to help stimulate pluralism and the growth of democratic values and traditions among the citizens at large. These efforts would build upon A.I.D.'s already extensive working contacts with non-governmental organizations, educational institutions, labor unions, the press, and community organizations to help develop stronger, more effective citizen participation.

1. *Improve the administration of justice through increasing the independence, professionalism, and effectiveness of the judiciary and police.*

Working through field missions and regional institutions, A.I.D. will support Central American efforts to:

- Upgrade judicial personnel, including judges, prosecutors, public defenders, clerks, and court administrators, through promotion of higher selection standards and the establishment of effective in-service training and continuing education programs for these key legal and management personnel;
- Establish and expand effective public defender systems;
- Modernize court and case management through professionalization of administrators and use of automated case management techniques;
- Establish and expand information systems on legislation in effect, past court decisions, and scholarly writing, including improved law libraries and documentation centers;
- Continue legal education for the private bar, with a particular focus on more active bar association involvement in justice system improvement.

2. *Promote the exercise and protection of civil and human rights.*

A.I.D. will support the work of the Inter-American Institute of Human Rights (IIHR), in human rights education in schools; rights of women, indigenous peoples, refugees and displaced persons; and training for human rights lawyers and activists. The civic education projects will include components that sensitize students or trainees to the obligations and duties of their governments in this fundamental area of applied democracy. A.I.D. missions will be sensitive to country human rights records when considering development portfolio composition and expansion.

3. *Strengthen electoral processes and institutions.*

The objective is to support and strengthen national electoral management bodies to assure that they are independent and professional. In the 1990s, A.I.D. will continue to help foster free and open elections through support for Center for Electoral Assistance and Promotion (CAPEL). CAPEL conducts research, widely distributes information about the electoral process, and provides networking activities and technical assistance to electoral courts and other institutions. Missions will seek to assist national electoral management bodies (electoral boards and tribunals). Policy dialogue will focus on the status of each national electoral process and its fair and non-partisan management.

4. *Strengthen legislative processes and institutions.*

The aim of this program is to foster an open and accessible legislative process, assisted by a trained professional staff. Such elements as specialized standing committees and access to appropriate legal, economic, and technical expertise in the legislative process are to be stressed.

The initial focus will be on strengthening institutional capabilities to draft legislation, improving the analytical and management capacity through training, promoting research, and sustaining dialogue on major policy roles for national and local parliaments. Support will also be provided to activities that increase contact and cooperation among legislators in the region, as well as with their counterparts in the United States and Western Europe. Since an independent, professional legislative auditor general is important to ensuring that legislators can actively monitor government programs, A.I.D. will help train and strengthen the offices of the Comptrollers General in a number of Central American countries.

Finally, regional activities such as the Regional Federation of Central American Legislative Clerks and the proposed Central American Parliament will further establish and reinforce relationships among Central American legislative leaders and with their counterparts in the United States and Western Europe. A.I.D. will expand its support for additional efforts in these areas.

5. *Strengthen elected local and municipal governments through decentralization of authority and control over financial and human resources.*

Most Central American leaders now realize that centralized national bureaucracies limit the ability to deliver services. There is also a growing recognition that centralized bureaucratic power is often anti-democratic since it limits citizen participation in the development process and encourages paternalism. Central American countries are working to create more responsive locally-elected governments which provide greater opportunities for citizens to participate in and more directly influence the development process.

The program will foster the empowerment of local governments through support for:

- revenue-sharing legislation;
- reform of the electoral processes;
- development of sound, equitable local tax bases and other local revenue sources;
- strengthening local government capacity to respond to local priorities and to deliver basic services; and
- other forms of municipal management training and technical assistance.

A.I.D. will also explore ways to help Central Americans:

- strengthen local government decision-making processes;
- encourage financial and administrative decentralization;
- strengthen local service delivery and maintenance capabilities; and
- enhance local revenue generation and cost recovery capabilities.

In developing these programs, A.I.D. will foster complementary and/or co-financing proposals with the Inter-American Development Bank (IDB) and the World Bank (IBRD) to provide the required capital financing, with A.I.D. financing technical assistance and training.

6. *Promote honesty and efficiency in government through transparency of decision-making processes and heightened accountability of civil service structures.*

This program will assist cooperating governments to assess their anti-corruption practices and procedures and support the design and implementation of financial management systems which improve the quality, reliability, timeliness, and credibility of financial information in the decision-making process. Working with other donors, A.I.D. will also undertake broader sectoral administrative and policy interventions to help improve host government development administration.

7. *Support for civilian control of the police and the military and for demilitarization through encouragement of dialogue between civilian and military leaders, and promotion of civilian oversight of government.*

Both the police and the military in most Central American countries have demonstrated a lack of civilian control and professionalism. This lack of civilian control has led to civil strife and human rights abuses. The U.S. country program will help promote greater judiciary-police cooperation through its legal assistance projects and coordinate with international organizations to facilitate multilateral assistance in this area.

Working with representatives of U.S. armed forces in U.S. Embassies in Central America, A.I.D. has a role to play in helping to further the dialogue between military and civilian leaders. A.I.D. will utilize both policy dialogue and project assistance for:

- integration of former military and police force members as productive civilians in the society;
- civilian scholars and policy specialists to acquire credible expertise in military affairs;
- legislatures to develop the institutional capacity to monitor military systems effectively and routinely; and
- civilian leaders to implement strategies to decrease military involvement in conflict resolution and build effective procedures for civilian control of military organizations.

8. *Strengthen political parties and the party system.*

Working through organizations such as the National Democratic and Republican Institutes and the National Endowment for Democracy (NED), A.I.D. will continue to support the strengthening of local political parties. NED is a private, non-profit organization established and funded by the U.S. Congress to promote democratic values and practices around the world, working with non-government organizations. When appropriate, A.I.D. will provide direct grants to NED for electoral and political party development, while carefully avoiding any involvement in or association with electoral campaigns or other partisan activity.

9. *Promote and strengthen pluralism and civic participation through non-governmental organizations and leadership training.*

The United States has a long tradition of supporting non-governmental organizations (NGOs) in the region. Support has been provided to technical NGOs working in specific sectors, humanitarian organizations, research institutes, labor unions and employee associations, community and municipal associations, business groups, cooperative organizations, and other groups. The continued sponsorship of a broad range of NGO activities will remain an important area for A.I.D. financing during the 1990s.

Of special note is the need to give attention to those civic groups and institutions working to assure citizen access to electoral, legislative, and judicial systems and helping people to acquire the knowledge, skills, and confidence needed for full participation in the democratic process. Special consideration will be given to financing NGOs active in civic and voter education programs and programs to strengthen judicial systems. The NGO programs will also focus on civic education curricula in the primary schools in order to teach basic citizen participation skills in a democratic context.

In 1985 A.I.D. launched the Caribbean and Latin American Scholarship Program (CLASP) to provide training in the United States to over 12,200 individuals from Central America as well as others from the Caribbean and South America. Most of this training is focused on the disadvantaged who are present or prospective leaders. The support to the CLASP program will continue through 1998. A.I.D. will also offer additional training opportunities for other individuals and leaders not covered by CLASP.

10. *Promote alternative information sources, including a free and responsible press, other media, and social/economic research organizations.*

In FY 1988 A.I.D. initiated a program to strengthen journalistic professionalism and improve mass media education and research capacities in Central America. This program will be expanded in the 1990s and will focus on training, creation of regional associations of media professionals and owners, strengthened and more appropriate university journalism education programs, and establishment of self-sustaining centers for mass media training in Central and South America, similar to some mass media training activities and programs already under way in A.I.D. population and child survival programs.

The program will continue to finance journalism education, with adaptation of U.S. textbooks to the Central American environment and long-term training in the United States in specially adapted journalism courses.

Through the Regional Technical Activities Center in Mexico, A.I.D. will continue to finance the translation into Spanish, and the sale to university students and the general public, of inexpensive U.S. textbooks in a variety of academic and technical subjects that would otherwise be unavailable. Political science and economics texts will be added to the available subjects.

IV. STRATEGY OBJECTIVE NUMBER TWO: THE ACHIEVEMENT OF BROAD-BASED, SUSTAINABLE ECONOMIC GROWTH

A. RECOGNIZING THE FLAWS IN THE OLD MODEL

The sharp decline in Central America's per capita GDP in the late 1970s and early 1980s was due to a combination of unfavorable external economic events, civil war, and insurgency in several countries, and economic policies that inhibited the ability of market forces to respond to opportunities offered by the world economy. Gradually, the Central American countries have come to realize that the old economic model—a hybrid based on traditional agricultural exports and regional import substitution within the framework of the Central American Common Market—was not sustainable.

The import-substitution model exacerbated already significant income inequalities by rewarding inefficient industries that did little to provide opportunity for growing labor forces. The differential protection of industry also diminished incentives for agricultural production and investment and limited both food production and exports. This fed the political unrest that erupted violently in Nicaragua, El Salvador, and Guatemala. The unrest, combined with poor economic policies, led to substantial capital flight and dramatic declines in private investment. Likewise, the model aggravated the deterioration of the region's natural resource base that was already underway because of population growth and lack of attention to environmental concerns.

B. PROMOTING THE NEW MODEL

There is now a widespread recognition throughout Central America, and in developing countries generally, that small countries especially must adopt more market-oriented, market-directed economic policies if they are to achieve rapid, sustainable economic growth. There is also a greater awareness that accelerated economic growth is essential to poverty alleviation. Economic growth does not guarantee rapid poverty alleviation, nor does it automatically take care of environmental problems. But it makes both of these tasks easier, especially if it places greater reliance on market forces by eliminating subsidies and controls that have benefitted primarily the wealthy, and when policies are adjusted to overcome "market failures" that produce environmental deterioration and thus threaten long-term economic growth.

A more broad-based, sustainable model for economic growth is essential to strengthen the democratic gains made in Central America during the 1980s. Reform of the policy environment, while critical to achieving vigorous private sector-led growth, is not sufficient. Non-policy constraints are also a major hindrance to growth and include: lack of infrastructure, poor market information and linkages, insufficient technology development and transfer, and undeveloped financial markets. During the 1990s, the Central American public and private sectors must improve the efficiency of free market activities and social service delivery systems, create more sustainable and less donor-dependent social programs, and develop domestic funding sources to support and further expand investment, public services and economic infrastructure.

The adoption of economic policies designed to stabilize and diversify the exports of Central American economies provides an opportunity for A.I.D. to build upon previously successful efforts to accelerate private sector-led growth focusing on agriculture, small business, and export industries and improve the delivery of social services that economic growth makes possible. In doing so, A.I.D. will increasingly work with other U.S. Government agencies involved in other aspects of the trade and investment programs under the Enterprise for the Americas Initiative.

C. CONSTRAINTS

Though progress has been made over the past six years, the constraints to economic growth and the widespread benefits that emanate from growth (in some cases excluding Costa Rica) are:

- Tax, foreign trade and credit policies that continue to discourage investment and labor intensive production.
- Macroeconomic policies that result in debilitating inflation and devaluation.
- Policy, legal, regulatory, administrative, and technical barriers to the free flow of goods, services, and investment capital within countries, among the Central American countries themselves, and between the region and the rest of the world.
- Lack of adequate transportation, communications, power, and other infrastructure in support of trade and investment.
- Despite progress in privatization, the continued existence of inefficient state enterprises dependent on government subsidies for survival and large, costly and overly centralized national bureaucracies in charge of social and other public service delivery.
- Poorly functioning financial markets, inefficient state financial institutions, and inadequate levels of long-term financing for private sector investment.
- Legal and regulatory obstacles to the establishment of small enterprises and protection of property and asset rights of low income groups.
- Rapid population growth.
- Continuing low levels of productivity of land and labor and inadequate and inappropriate technology development and transfer..
- Inequities in access to the factors of production by the agricultural sector as a whole vis a vis the industrial sector as well as within the agricultural sector.
- Poor quality of instruction and lack of textbooks and educational materials and supplies leading to educational inefficiencies.
- Inadequate and inefficient resource mobilization and allocation for social services and infrastructure.
- Lack of appropriate or adequately enforced environmental protection and management policies, laws, and regulations, and lack of awareness of environmental problems and potential solutions.

D. PROGRAM STRATEGY

To address the constraints identified above, A.I.D. proposes a ten-point program under three broad areas of focus:

1. Stimulate private sector trade and investment through regional and bilateral policy reforms efforts and programs.
2. Encourage greater opportunities for increased participation in the economy by the disadvantaged.
3. Encourage policies, incentives, regulatory frameworks and management practices which promote the preservation and sustainable use of the natural resource base.

These three areas of focus underscore the interrelationship of macroeconomic policies, trade and investment initiatives, promotion of access to jobs and social services for the disadvantaged, and conservation and proper management of the environment.

1. *Further liberalize external and intraregional trade in goods and services.*

Central American countries have already reduced maximum import tariffs from the 80-200% range to the 20-40% range. The evident success of these reductions in stimulating trade and employment, and President Bush's encouragement of free trade in the region, should make further progress feasible. A.I.D.'s approach will involve several elements:

- policy dialogue at both the country and regional level, linking U.S. assistance to continued progress;
- support for regional organizations, both private and public, that will further this goal;
- continued macroeconomic and sectoral policy improvement at the country level, particularly for stable market-determined exchange rates and open access to foreign exchange to facilitate movement of capital within Central America; and
- continued effort, through sector- and project-level interventions, to address procedural and regulatory impediments to the free flow of goods, services and capital.

A.I.D. efforts to support improved investment policies will enable host countries to gain access to investment and debt relief benefits under the EAI. A.I.D. will complement these efforts by working with the Office of the U.S. Trade Representative (USTR) to help liberalize treatment of products of special interest to Central America.

2. *Strengthen private-sector organizations promoting trade and investment and cooperate with other U.S. Government trade and investment promotion efforts.*

Central American export and investment promotion organizations which A.I.D. has supported have proven to be important both in helping to generate additional foreign investment and exports and in influencing governments to eliminate obstacles to growth in trade and investment. It is anticipated that A.I.D. support for some of the activities of these organizations will continue to be required while they attempt to become as self-sufficient as possible. A.I.D. will continue to provide support for those national export and investment promotion organizations it has helped create within the region and will encourage more host government, other donor and private financing for existing and future institutions.

Both in countries where A.I.D. has traditionally supported national export and investment promotion organizations, and in other countries - especially those where A.I.D. will be initiating new trade and investment programs - A.I.D. will seek opportunities to support local associations, chambers of commerce and other private organizations which represent and serve the interests of local businesses in various sectors of activity (agribusiness, commerce, industry, etc.). Support for specific trade and investment activities of these organizations will help them serve as bridges between their private business membership and U.S. and other foreign businesses interested in trade and investment. Two-way trade and transfer of technology can be facilitated by such organizations when U.S. business representatives, on trips organized by the Departments of Commerce and Agriculture, use these to make contact with local businesses. A.I.D. will also assist such organizations to access market information sources in the U.S. and other markets and to provide other services to their members. A.I.D. cooperation with such organizations for specific activities will also help strengthen their capabilities to promote government policies that improve the business climate.

A.I.D. and local private sector organizations it supports will intensify cooperative efforts with the Department of Commerce, the Overseas Private Investment Corporation (OPIC), the Export-Import Bank (EXIM), and the Department of Agriculture (USDA) to attract U.S. business to the Central America region. These efforts will be complemented by business outreach programs in the United States. The Latin America and Caribbean Business Development Center, created by the Department of Commerce and A.I.D., will be the focal point for these outreach programs.

3. *Reform fiscal systems by improving tax structures and administration, improving efficiency of government service delivery, and privatizing state-owned productive enterprises.*

The public sector must continue to play a key role in development, but structural improvements are needed. Excessive fiscal deficits constitute the major source of inflationary pressure and prevent private sector access to credit. In addition, these deficits contribute to the non-competitive financial markets and related capital flight.

A.I.D.'s strategy is to:

- use technical assistance and policy dialogue (together with the International Financial Institutions (IFIs)) to reduce distortionary tax systems, simplify tax administration, and improve enforcement.
- encourage implementation of tax programs which do not rely on tariffs to fund government budgets.
- use sectoral assistance to help reduce the cost and improve the quality of social services;
- promote reductions in public-sector payrolls through policy dialogue and technical assistance, and where appropriate, support for severance pay.
- continue efforts to privatize government enterprises through policy dialogue and technical assistance, and encourage capital support from the IFIs.

4. *Strengthen the ability of the financial sector to mobilize domestic resources and channel them efficiently to the most productive sectors of the economy, and continue to promote access to outside sources of long-term investment capital.*

Financial sector reform requires greater reliance on market forces in allocating resources, and greater pressure on financial institutions to mobilize domestic savings. In the past A.I.D. has sometimes dealt with these problems through temporary expedients -- directed lines of credit, central bank rediscounting, loans for specific activities, subsidized sources of financing -- that do not resolve the underlying problems.

A.I.D. will concentrate on strengthening domestic financial incentives for attracting and efficiently allocating financial resources. This will require support for privatization of financial intermediaries, decontrol of interest rates, support for establishment of cross-border financial institutions in the region, and promotion of capital markets.

A.I.D. will assist potential investors to gain access to external sources of long-term investment funds, including the IDB Investment Fund to be established under the EAI, Section 936 funds, OPIC financing and guarantees, and A.I.D. guarantees.

5. *Stimulate agricultural production and trade through removal of macroeconomic and sectoral policy constraints; promoting technology improvements; reducing tenure insecurity; and promoting agribusiness development and trade linkages with US and neighboring markets.*

Misguided macroeconomic policies have a disproportionate effect on incentives for investment in agriculture. These macroeconomic policy constraints are exacerbated by the sectoral policy distortions of pricing and market controls. A major focus of A.I.D.'s policy dialogue and support for policy reform will be to correct these negative policies. These policy reforms will increase demand for improved production and post-harvest technology, increased agribusiness inputs, and a more rational allocation of credit to farmers to acquire these inputs.

This strategy will also support institutional reforms encouraging private sector driven technology generation, adaptation, and transfer, private sector provision of inputs, and reform of the financial sector. It will also focus on upgrading productive market information and linkages between traditional and non-traditional small producers with modern agribusiness processors, exporters, and marketers.

To address tenure insecurity A.I.D. will support both legal reforms and simplification of procedural aspects of land registration.

6. *Increase investment in infrastructure, market information systems and networks, education and training, and technology development and dissemination.*

As economic recovery proceeds and nontraditional exports expand, bottlenecks in infrastructure, skills and technology will emerge. To deal with these issues A.I.D. will link skills training to requirements by promoting close ties between training institutions and private employers.

Under this strategy, A.I.D. will also seek institutional improvements that better utilize existing infrastructure, such as:

- increasing competition among ports in Central America by easing the difficulties of moving goods intended for trade among countries;
- increasing competition in transport by deregulating trucking and increasing access by additional carriers to airports through "open skies";
- reducing paperwork and procedural requirements for movement of goods and services;
- encouraging demand-driven technology development and dissemination; and
- stimulating sustainable public and private support for improving energy policy, planning, and conservation.

Where appropriate, technical assistance will be provided in the development of viable infrastructure initiatives while seeking capital support from the private sector and the IFIs.

7. *Increase participation in income-generating opportunities by segments of the society previously isolated from the economic system.*

Substantial opportunities for poorer segments of society should result from improved trade and investment policies. The growth in demand for labor resulting from increased use of comparative advantage should particularly favor unskilled workers, gradually eliminating the supply of underemployed workers. Nevertheless, more direct efforts will be undertaken to speed this process. These include:

- support for small and microenterprises through innovative credit and technical assistance activities in both urban and rural areas;
- policy dialogue on impediments to the integration of the informal sector in the economy, with technical assistance from experts in the region; and
- support for diversification by small scale agricultural producers through innovative credit and technical assistance activities.

8. *Increase access to basic education and improve the efficiency of the education system.*

A.I.D. will:

- help countries address education sector constraints through support for review and reform of fiscal and financial allocation policies affecting spending on basic education in both the public and private sectors.
- encourage decentralization, curriculum reform, and other policy and institutional reforms designed to improve both educational content and administrative efficiency.
- encourage increased investment in basic education as a percentage of total government expenditures.
- provide assistance to review legal changes needed to sustain private school systems and to encourage greater private sector support for basic education.
- increase, dramatically, its support for sustainable vocational and management education programs geared to productive employment.

9. *Increase access to basic primary health care, family planning, and nutrition services by the poor and improve the efficiency of those delivery systems.*

A.I.D. will:

- support policy and institutional reforms to help governments and NGOs reduce costs and expand access to basic preventive health and family planning services by improving management and administration and by shifting priority for public financing to cost-effective primary and preventive care.
- help governments, working with the IFIs and other donors, explore ways to mobilize alternative sources of financing through cost recovery, cost sharing, privatization, insurance schemes, and, where appropriate, targeted tax schemes.
- help explore the use of debt swap arrangements to support sustainable provision of family planning services through NGOs.
- look for ways to help remove constraints on resource mobilization and investment by the private sector in commercial provision of health and family planning services.

- continue to support development of private-sector service delivery and education mechanisms such as social marketing, use of the media, HMO models, innovative insurance and group health schemes.
- help governments, working closely with the IDB, encourage increased investments designed to expand water and sanitation coverage.
- emphasize creative sector policy and program approaches to consolidate many of the gains that have been made in the region and to assist governments to develop sustainable, decentralized social service delivery systems. Promote increased use of low cost paramedical personnel to provide basic health services.
- gradually reduce its support for commodity and other resource transfers for direct delivery and focus more on policy and systemic reforms, leading to long term sustainable delivery mechanisms.

10. *Promotion of sound environmental laws and regulations which are effectively enforced and rational management of natural resources by the public and private sectors to ensure long-term sustainability and high economic return.*

A.I.D. will:

- intensify its efforts to engage indigenous NGOs to work on environmental concerns.
- encourage creative programs such as debt-for-nature swaps to increase the role of the private sector in protecting and maintaining the natural resource base and limit the role of public agencies to policy-making, regulatory functions and support for investments in critical infrastructure and research.
- concentrate its investment in the following technical areas of environmental concern:

a. Sustainable agriculture

A.I.D. will:

- help NGOs and governments develop policies, laws, and programs; particularly those affecting land use, and those required to encourage sustainable agricultural practices including soil and water conservation and adoption of farm based tree crops.
- work with regional- and local-level institutions to develop, disseminate, and encourage the use of conservation technologies and minimize pesticide contamination.
- strengthen public and private institutions working in integrated crop protection methods and pesticide regulation and management, through regional initiatives.

b. Sound forestry management

A.I.D. assistance will:

- focus on policies and mechanisms for control of tropical and pine forest management plans and other policies, e.g., sale and pricing of standing timber.
- assist Central American institutions in the management of selected areas of existing natural forest with high production potential, and in the sustainable production of forest products, water conservation, and other environmental benefits.

c. Management of wildlands and protection of biological diversity

A.I.D. will:

- support and strengthen programs to consolidate and manage, on a sustainable basis, legally declared national parks and reserves.
- assist public and private agencies to prepare practical plans for the management of priority wildlands and will help develop facilities and services needed to control visitors' access to wildlands.
- strengthen institutional capacity to plan and manage coastal development.

d. Management of critical watersheds

A.I.D. will:

- encourage policy measures that call for users to pay for the costs associated with the management and conservation of water supplies.
- assist landowners, farmers, and community groups to carry out needed conservation practices in priority watersheds, including water storage/distribution structures, land purchase, fencing, and monitoring of water quality and runoff.
- support environmental education to increase public awareness of coastal resources.

e. Control of urban pollution

A.I.D. will:

- promote greater private-sector responsibility for resolving problems of solid waste management and water and air pollution through analysis of policy and regulatory reforms, technical assistance, and feasibility studies.
- look to the U.S. private sector to provide technical assistance and training in industrial pollution control and occupational health and safety.
- collaborate and develop pilot projects, working with the World Bank, the Environmental Protection Agency (EPA), and the IDB, to demonstrate cost effective approaches to reduce air and water pollution in urban areas.

V. STRATEGY OBJECTIVE NUMBER THREE: THE ATTAINMENT OF EFFECTIVE REGIONAL COOPERATION

A. REGIONALISM AND MULTILATERALISM

Consistent with the EAI approach and PDD framework, the A.I.D. strategy is a regional one that supports the political and economic interdependence of the Central American countries. A regional strategy implies not only working with regional groups, but also focusing on regional issues and concerns in our bilateral relations to further the shared regional objectives of democracy and growth. Coordination with other donors—Canada, the European Community, Japan, and Latin American countries such as Venezuela and Mexico—will be strengthened through the PDD framework.

The Central American Common Market (CACM) and its associated regional institutions made important contributions to Central American economic growth and development during the 1960s. Over the past two decades, however, the weaknesses of the import substitution model upon which the CACM was based became evident, with lower growth and fewer efficient investment possibilities. Moreover, regional institutions played a progressively less influential role, and regional cooperation likewise became progressively weaker until Central American efforts to achieve a peaceful solution to the region's conflicts reversed this trend toward the end of the 1980s.

The election of a market-oriented government in Nicaragua has led to renewed interest in common solutions to regional economic problems. There is growing interest in accelerating the recent revival of intraregional trade, not as a substitute for exporting to markets outside the region, but as a complement to it. Recent exchange rate and tariff reforms in the individual countries have reduced the obstacles to intraregional trade. In June 1990, at Antigua, Guatemala, the Presidents of the Central American countries—including Panama as an observer—adopted a Central American Economic Action Plan for strengthening intraregional integration and cooperation. This trend was given further impetus by the adoption of a specific work plan and calendar in the December 1990 Declaration of the Central American Presidents following their summit meeting at Puntarenas, Costa Rica.

B. CONSTRAINTS

Despite a revived spirit of intraregional cooperation, and the reversal of a long, sharp decline in intraregional trade, there remain significant constraints to effective regional cooperation:

- Key institutions—notably SIECA (the Common Market Secretariat) and CABEI (the Central American Bank for Economic Integration)—are financially weak because of individual countries' failures to meet their designated financial contributions to these institutions and, in the case of CABEI, member governments' arrears in repaying loans.
- Regional institutions are excessively dependent on external resources, especially from A.I.D., whose levels cannot, and should not, be sustained.
- Managerial and technical capabilities of some regional institutions are weak, partly but not entirely because of their financial problems.
- Honduras and Nicaragua have long felt that the benefits of regional economic integration during its heyday were distributed unequally, and will want to be reassured that any new integration efforts provide for a more equal distribution of benefits. Panamanian participation in selected regional initiatives may also prove problematical.
- Although exchange rate realignments have largely removed a major obstacle to increased intraregional trade, quantitative restrictions remain in the form of customs procedures, transport regulations, and other controls preventing goods and services from moving freely between countries. In addition, some intraregional trade continues to be subject to tariffs.

C. PROGRAM STRATEGY

1. *Forum for Central American regional dialogue.*

The overall theme of this strategy is to support the broad objectives of the Declarations of Antigua and Pantarenas through:

1. development of democratic societies,
2. achievement of broad based economic growth, and
3. the attainment of regional cooperation.

A priority for achieving this third objective is the expansion of regional cooperation relating directly to the first two objectives. A.I.D. will support a series of programs to:

- provide fora for discussion of specific regional cooperation initiatives,
- share information,
- exchange experiences, and
- foster a convergence of policies in the region.

Examples of appropriate themes include:

- the exchange of legislative information among country legislators and other elected representatives,
- municipal development and the deepening of local democratic institutions, and
- mobilization of domestic investment and intraregional financial flows.

2. *Strengthening regional institutions and reducing their dependence on A.I.D. resources.*

A.I.D. recognizes the important role of some regional institutions in addressing a range of regional concerns. Nevertheless, over the period of the strategy, regional institutions will assume greater responsibility for their own core budgets. A.I.D. will assist these institutions to pursue other means of financing including other donor, endowment, and self-financing mechanisms. The strategy anticipates that regional institutions will become independent of U.S. aid.

While reducing its financing of core costs, A.I.D. will work with regional institutions where possible on specific tasks consistent with the Central Americans' development agenda. ROCAP will take the lead in implementing A.I.D.'s strategy to promote sustainable regional institutions that will no longer depend predominantly on A.I.D.'s resources.

3. *Studies and policy dialogue supporting trade liberalization.*

A.I.D., in cooperation with the international financial institutions and other bilateral donors, will encourage additional policy, legal, and other reforms to further liberalize trade within Central America. ROCAP will undertake more economic analyses including trade, market, and financial analyses to assist the countries to increase intraregional trade and financial flows. ROCAP will work with the missions and countries to stimulate the convergence of sound economic policies and promote a future regional free trade zone.

4. *Sectoral programs.*

Sectors in which A.I.D. will seek to strengthen or initiate regional programs include the following:

a. **Trade infrastructure**

A.I.D. will support joint private and public-sector efforts to identify key infrastructure bottlenecks inhibiting investment and trade. Specific needs include improvements in port handling/processing facilities and modernization of key channels leading to ports. While A.I.D. financial and technical resources preclude much in the way of financial support for construction activities, A.I.D. can play an important role by supporting studies, technical assistance, training, and policy dialogue.

b. **Energy**

This is another sector in which resources are appropriately concentrated on efforts other than the financing of physical infrastructure. Issues that will be addressed through other types of assistance include strengthening of regional grid operations; movement toward a common rate structure; privatization; co-generation; expanded use of geothermal and small hydroelectric plants; and expansion of rural coverage.

With rapid economic growth, energy production and distribution will be a significant constraint to further expansion. Working through regional mechanisms, A.I.D. will help the countries through technical assistance, training, intraregional dialogue and information exchange to improve energy policies, planning and conservation, and encourage appropriate intraregional energy sharing and access.

c. **Social sectors**

A.I.D. will also take advantage of opportunities provided by the Central American governments to implement programs in the social sectors within a regional framework. One such opportunity is provided by a new regional initiative, "Health and Peace for Development and Democracy," adopted in 1990 by the Ministers of Health of the Central American countries. A.I.D. will support this regional initiative, thus helping to consolidate progress made during the 1980s in expanding access to basic maternal-child health and nutrition services and child survival interventions. The emphasis will be on mechanisms to assure the sustainability of these programs.

d. **Environment and natural resources**

A.I.D. is now supporting regional cooperation in addressing Central America's environmental and natural resource problems under the RENARM project. The new spirit of cooperation in the region, and growing awareness of the importance and interdependent nature of environmental and natural resource problems, will provide additional opportunities for A.I.D. to support regional programs in this area.

VI. MANAGEMENT AND RESOURCES

A. ORGANIZATIONAL RELATIONSHIPS

1. U.S. Government Coordination and Implementation Framework

The A.I.D. strategy is consistent with stated U.S. policy and Central American initiatives. In order for the strategy to work, close coordination with other U.S. Government agencies is required. For example, with respect to the EAI, A.I.D. will work closely with USTR, USDA, and Commerce on trade opportunities (e.g., the Latin American and Caribbean Business Development Center), with Treasury and the IDB on investment and debt reduction, and with State and EPA on programming local currency for environmental activities.

Within the PDD framework, A.I.D. will provide staff support for the consultative process. Close coordination will be maintained with the Peace Corps, USDA, USTR, the Department of Justice, the Department of Defense, the Department of Health and Human Services, and other agencies with which A.I.D. has already established relations in the region.

2. Regional Coordination within A.I.D.

To enhance coordination and more effectively integrate bilateral and regional programming, a new management oversight structure will be established for A.I.D.'s Central American programs. The Assistant Administrator will chair a steering committee to be comprised of the directors of A.I.D. missions, ROCAP, and the office of Central American Affairs, with ROCAP serving as the Executive Secretariat. The Committee will convene semi-annually to review overall priorities, address region-wide issues, and prepare inputs for the PDD and regional Consultative Group processes.

3. Regional Approaches

With its field presence and long experience in the region, ROCAP is in a unique position to assist in fostering regional cooperation in areas of concern to the Central Americans and the United States. ROCAP can provide a regional forum for information dissemination, technical support and program assistance to stimulate a harmonization of policies with respect to major issues such as trade, investment, energy and municipal development.

While ROCAP is only tangentially involved with the present portfolio of democracy strengthening initiatives, under the new strategy it will be assigned three important responsibilities. First, ROCAP--in consultation with bilateral missions and the A.I.D. Latin America and Caribbean Democratic Initiatives Office--will develop terms of reference and retain specialized "requirements" contractors similar to ROCAP's existing contract in the export sector. Where appropriate, technical assistance would be provided for "common theme" programs, such as judicial and legislative reform and development. Such an approach to the provision of technical assistance and information sharing would reduce administrative workload requirements for participating missions. Specialized contractors would be in an excellent position to facilitate communication and networking among country counterpart institutions, and through this process foster the development of shared values and approaches among Central Americans.

Second, ROCAP will be charged with managing a range of "common theme" training programs within the region, in the United States and other countries. ROCAP will contract with firms or institutions specialized in training which would be responsible for curriculum development and participant administration. Missions would use these contracts to access required expertise or training programs according to country priorities. This aspect is important since most Missions will be short on staff to handle the administrative workload implicit in the Democratic Initiatives program.

Finally, ROCAP will coordinate with Central American A.I.D. missions in helping to implement the PDD. This role will be particularly important as donor dialogue intensifies and opportunities for joint or parallel donor activities emerge at the regional or country level.

B. MANAGEMENT CONSIDERATIONS

1. Managing Shifts in Workload

In order to accommodate anticipated declines in funding and staff levels, and in recognition of the expanded role of other donor financing in the region, A.I.D. plans to change its mode of implementing projects and concentrate its programs both in terms of sectors and number of initiatives it manages. While the strategy calls for increased use of non-project assistance in support of economic growth activities, expansion of the democracy and environment programs will partially offset staff savings from a sector approach. Reductions in both technical and administrative functions will be sought through increased use of regional implementation mechanisms.

The strategy's greater emphasis on strengthening democracy will require increased coordination with other U.S. government agencies and some change in the technical orientation of A.I.D. staff. A.I.D. will work closely with the State and Justice Departments in the implementation of the democracy portfolio and will take the initiative, where appropriate, for policy, operational, and accountability functions associated with the program. A.I.D. will intensify and deepen in municipal development under the DI program.

2. Need for Congressional Restraint

More effective program concentration will require greater funding flexibility to respond to the region's expressed needs and more program accountability to demonstrate the impact of the program on these needs. This requires relief from cross-cutting earmarks and functional accounts that do not easily reflect the growth and democracy foci of this strategy. A.I.D. proposes relief from the rigidities of traditional functional accounts to permit the increased allocation of resources based on the objectives of this strategy and the performance of the recipient towards these objectives. With increased programming flexibility, A.I.D. will be better positioned to engage other donors in increasing their financing for complementary programs in the region.

C. RESOURCES

During the 1984-90 period, the Central American countries were heavily dependent upon U.S. economic assistance to pay for imports and to finance investment. The capacity of the Central American countries to meet their own development needs and to obtain external resources from non-U.S. Government sources has increased significantly since 1984, however, and this dependence should continue to decline during the 1990s. In addition, the return of peace to the region should increase the productivity of investment, particularly by eliminating the substantial requirements for replacement of guerrilla-damaged infrastructure. The principal sources of foreign exchange are export earnings, private capital flows and official assistance.

Export Earnings

Though traditional exports from the region continue to stagnate because of low world prices, the rapid growth of nontraditional exports is increasingly providing the foreign exchange needed to meet resource requirements. Nontraditional exports rose from \$423 million in 1983 to \$1.3 billion in 1990, and have the potential to rise to \$4 billion by 1996, if outward-oriented economic policies continue to be implemented. This will reflect a fundamental economic transformation. In 1984, nontraditional products accounted for only 12% of total exports outside Central America. By 1996, they could represent nearly half. This export diversification should improve the stability of export earnings and increase productive employment, as well as provide the basis for greater economic dynamism and production of exports with more favorable world market prospects.

Private Capital

Private capital flows are also likely to be substantially more positive during the 1990s than during the 1980s. The gradual decline in the military conflict in El Salvador, the establishment of democratic governments in Nicaragua and Panama, and the generally improved economic policy frameworks throughout the region can be expected to stimulate larger private capital inflows, both from foreign investment and from return of flight capital from the 1980-84 period.

After substantial net outflows during 1980-84, private capital began flowing into the region in 1985-89, averaging about \$300 million per year. Continued sound economic policies could raise this average perhaps to \$500 million per year by 1996.

Other Donor Assistance

Other donor assistance to Central America, particularly from the multilateral agencies, is expected to be substantially larger during the 1990s than during the 1980s. Net disbursements during 1984-90 from the IMF were negative \$400 million, and from the IBRD were only about \$200 million. For 1991-96, net flows with the IMF should be about zero, for the region has substantially reduced its indebtedness to the Fund. With continued good policies, gross disbursements of funds from the World Bank and the Inter-American Development Bank should more than double during 1991-96 from the past six years. A modest increase in other bilateral donor flows can also be expected during the 1990s.

U.S. Assistance

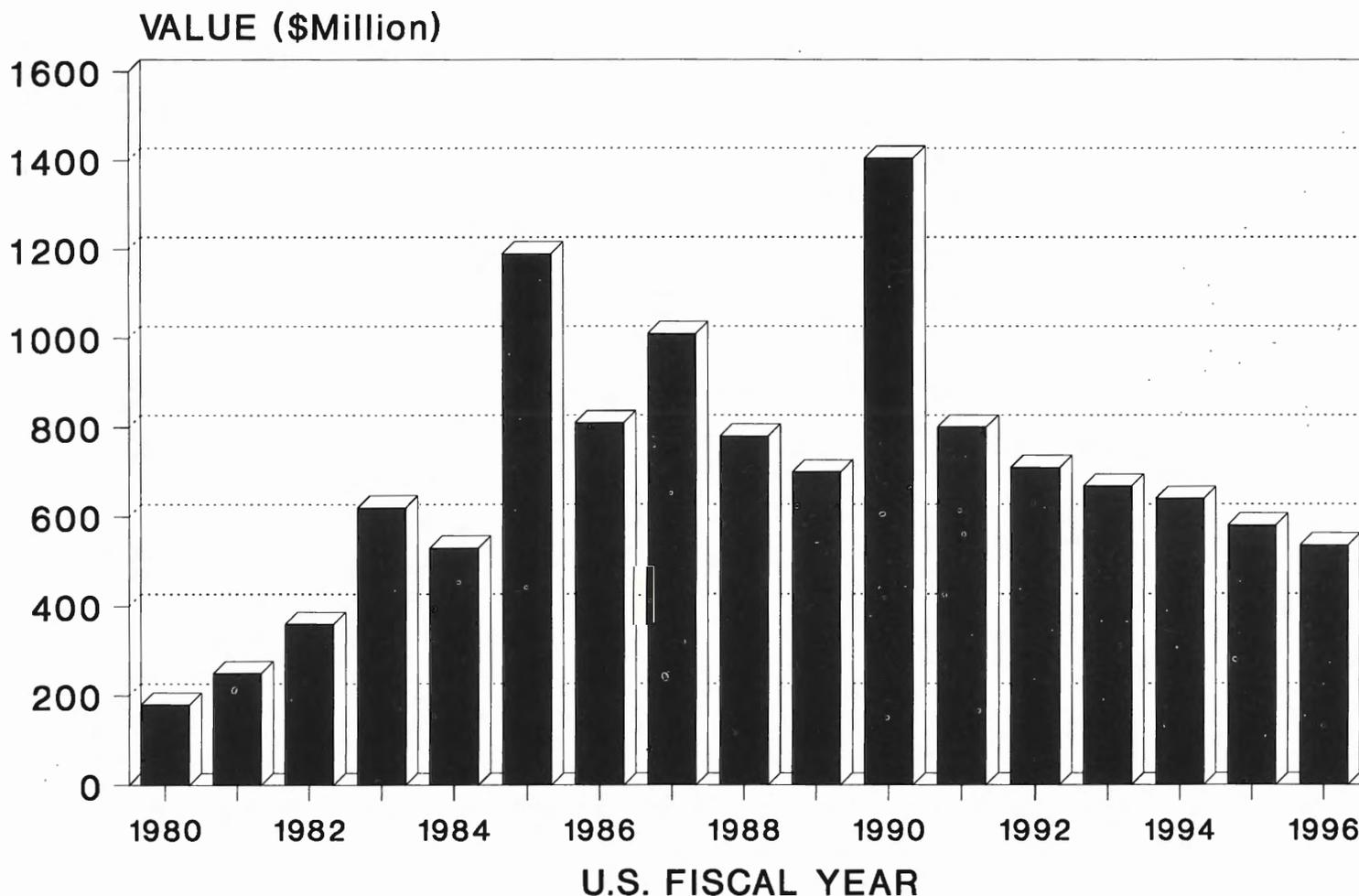
The developments discussed above should permit a gradual decline of U.S. assistance to the region, consistent with the goals of rapid economic growth and democracy deepening outlined above. Chart II provides a notional trend for A.I.D. flows over the 1991-1996 period, consistent with continued progress in these areas and expected flows from other sources. A.I.D. assistance would decline from \$810 million in 1990 (excluding \$420 million in extraordinary assistance to Panama) to \$430 million by 1996, for a total of \$3.2 billion in 1991-96. This would be a decline from \$6.2 billion in 1984-90. Over \$1

billion of the this assistance during 1991-96 would be expected to flow to Nicaragua, which was excluded from U.S. assistance during 1984-1989. For the four countries included in the Central American Initiative during 1984-89, the decline would be from \$6 billion in 1984-90 to \$2 billion during 1991-96.

The projected A.I.D. flows of \$3.2 billion, complemented by other projected resource flows, should lead to a growth rate of slightly above 5% by 1996. Because of the numerous assumptions and projections required for such modelling, the results can only be notional. Numerous factors--world coffee prices, trends in the overall world economy, productivity of investment, and economic policy generally--could substantially change the projected resource requirements. With the projected flows to Central America from other sources, the A.I.D. share of total resource availabilities would be expected to steadily decline during the 1990s. From a level of 44% of the total availabilities in 1984, the A.I.D. share would fall to 16% in 1996.

A.I.D. ASSISTANCE TO CENTRAL AMERICA

1980-90 Actual, 1991-96 Projected



Note: A.I.D. assistance was not provided to Panama from 1987 to 1989. A.I.D. assistance was not provided to Nicaragua from 1981 to 1989. These two countries accounted for about one-half of A.I.D. assistance to Central America in 1990 and Nicaragua is expected to be the largest single recipient in 1991 and future years.

