PD-AAW-595

FINAL REPORT

INSTITUTIONAL ASSESSMENT OF CENTRAL AMERICAN BANK FOR ECONOMIC INTEGRATION (CABEI)

A STUDY FOR THE U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT REGIONAL OFFICE FOR CENTRAL AMERICA AND PANAMA (USAID/ROCAP)

DECEMBER 28, 1984

Price Waterhouse

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December 28, 1984

Mr. John Eyre
Regional Office for Central America
and Panama (ROCAP)
Agency for International
Development (AID)
Guatemala City, Guatemala

Dear Mr. Eyre:

Institutional Assessment of the Central American Bank for Economic Integration

Price Waterhouse is pleased to submit this Final Report on an "Institutional Assessment of the Central American Bank for Economic Integration" (CABEI). The major findings and recommendations are presented in the Executive Summary and described in detail in Sections I through VI of this Report.

We appreciate the cooperation and assistance we received from you, your staff, and officials in AID/Washington. Also, please express to the President of CABEI, Sr. Ramirez, our thanks for the excellent cooperation we received from members of his staff.

We trust that our analyses and recommendations will prove useful to the U.S. Government and AID in determining their future policy in respect to CABEI. We look forward to working with ROCAP again in the future.

Yours very truly,

Price Waterhouse

U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

CENTRAL AMERICAN BANK FOR
ECONOMIC INTEGRATION
(CABEI)

INSTITUTIONAL ASSESSMENT

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PREFACE

This report was prepared under contract to AID/ROCAP (Contract No. PDC-0001-I-00-3171-00, Work Order No. 7). The report was prepared by members of Price Waterhouse Office of Government Services, and benefitted from the findings and recommendations of the following team members:

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I. EXECUTIVE SUMMARY

This report presents the results of an institutional assessment of the Central American Bank for Economic Integration (CABEI). The study was conducted by Price Waterhouse for the Agency for International Development (AID), U.S. Department of State. The study was undertaken during a five week period from October 11 to November 15, 1984.

This section includes the following:

- Study objectives
- Scope of Work
- Approach
- Report Organization
- Summary of Findings and Recommendations
- Recommended U.S. Government Assistance Strategy Towards CABEI

A. Objectives and Scope of the Study

The overall objective of this study was to examine the medium- and long-term viability of CABEI and its role as a development institution in Central America. Specifically, the study was designed to:

- Examine the current financial condition of CABEI, including the reasonableness of its cash flow projections and the impact of more conservative assumptions on these recovery rates.
- Review the probable significance of recent CABEI administrative reforms in terms of improving its organizational structure.

- Analyze the nature of CABEI's development planning for the region especially as to whether CABEI's medium- and long-term regional priorities and objectives are consistent with those of the U.S. Government as perceived in the report of the National Bipartisan Commission on Central America (Kissinger Commission).

- Analyze whether the long-term financial prospects of CABEI are consistent with its strategic goals and plans, specifically whether the Bank will be able to meet its projected lending activity in the region.

- Assess the adequacy of current CABEI management, organizational structure and staffing with respect to its long-term planning and goals.

- Assess the advantages to CABEI of expanding its capital base by soliciting new equity participants.

- Identify other steps CABEI can take to increase financial flows to the region, particularly from private financial institutions and capital markets.

- Review the advantages and disadvantages for donors and private financial institutions of channeling resources through CABEI compared with other development banks and other national-level institutions.

- Review the contribution that CABEI has made to Central American development and assess its potential for the short, medium and long term.

B. Approach to the Study

The project team conducted the following major activities:

- Conducted fact-finding in Central America

  The project team collected and reviewed information on economic trends, trade patterns, and investment climate; and on the current state of the Central America integration movement.

- Collected information on CABEI

  The financial position of CABEI--including its portfolio management, loans outstanding and recovery prospects--was analyzed as part of the fact-finding mission. We

also examined CABEI's organizational structure and management policies and practices.

- Analyzed information and developed recommendations

  We analyzed the findings from our review and developed recommendations for CABEI and the U.S. Government.

C. Organization of the Report

- Section I provides an executive summary of the report.
- Section II describes recent trends in the Central American economy including the current state of regional integration, financing needs, and reviews U.S. government development strategy for the region.
- Section III discusses CABEI's strategic position in the Central American Common Market (CACM), its future role, and ability to implement medium and long-term strategies.
- Section IV reviews CABEI's current financial position, provides an assessment of steps to improve its capital base, and its potential for success.
- Section V reviews CABEI's organizational structure and management policies and practices.
- Section VI provides our recommendations for U.S. government assistance towards CABEI.

D. Conclusions and Recommendations

1. General

Our principal conclusion is that CABEI can, over time, become a dynamic and effective instrument for regional economic integration and development if the following conditions are reasonably satisfied:

- That CACM countries strive to define a coherent regional economic development strategy and the role they wish CABEI to play in implementing that strategy.

- That CACM countries demonstrate their support for CABEI by meeting their financial obligations to the institution.

- That there is an improvement in the economic and political environment in the region which could provide an adequate basis for successful implementation of the CACM regional strategy.

- That CABEI senior management accord high priority attention to resolving the Bank's current financial and organizational/management problems, which, while serious, are clearly surmountable over time.

- That the U.S. government define its policy toward regional economic integration and development in Central America and, specifically, its posture toward CABEI in close coordination with CACM governments.

- That U.S. assistance to CABEI, under the above conditions, could be crucial to its institutional recuperation and its long term viability. Such assistance could reinvigorate CABEI members' support for the institution, and help attract new-extra-regional members and external funding sources. It could also help advance a new regional integration/development concept with emphasis on private sector led, export-oriented productive growth.

2. Economic Background and Projections

Our review of the economic performance of the region, the prospects for regional integration, and the region's financing needs resulted in the following findings and conclusions:

- After a moderate decline in GNP over the past five years, the CACM economy remains weak. Per capita income levels have fallen dramatically, in some cases barely equalling 1960 levels. There is little expectation of significant economic recovery over the short term.

- The chief causes of the economic decline involve high oil prices, inflation, recession, weak demand and low prices for commodity exports, foreign debt, economic mismanagement, and political turbulence within and between countries.

- There has not been a systematic regional approach by all interested parties to the crisis. This partly reflects preferences of multilateral/bilateral creditors and the political and economic pressures which make individual governments primarily concerned with their short-term survival.

- Reflecting this pursuit of self-interest by individual governments, support for CABEI or other regional institutions by its members or external financing sources has been inadequate. With such support, however, CABEI could assist in a revitalized export-led growth strategy by using its financing capabilities to stimulate industrialization and infrastructure development and its apolitical role to guide economic policy formulation.

- Several estimates of the region's financing needs have been made. For example the Kissinger Commission estimated $21 billion in aggregate external financing would be needed to achieve 1980 per capita levels by 1990. CABEI has estimated regional external financial needs at $24 billion to $33 billion depending on growth in GNP and exports.

- The size of CABEI's role in financing future CACM economic activity will be determined by the strength of the integration movement, the availability of financial resources and CABEI's capacity to grow as the development needs of the region change.

- The U.S. government, as evidenced by AID assistance strategy in the region, emphasizes a bilateral rather than multilateral approach to development, with inadequate country involvement in the definition of the region's economic future.

3. CABEI's Stategic Position

We reviewed the medium and long-term stategy of CABEI and assessed its potential role in regional economic development.

The stagnation of Central American economic development has resulted from a combination of the external factors mentioned above and, more directly, civil disturbances and national tensions within the region. Some of the former are apparently becoming less severe and it is hoped that the regional antagonisms will progressively moderate. Assuming the restoration of an atmosphere reasonably conducive to economic development, our analysis suggests the following:

- o Central American economic integration remains a valid objective of economic policy, but the regional integration strategy should shift markedly from import substitution to a more open economy encouraging competitive exports to extra-regional markets.
- o CABEI can be an important and valuable instrument for implementing such a strategy through:
  - rehabilitation or improved maintenance of deteriorated regional infrastructure
  - financing industrial, agricultural and agri-industrial programs of regional scope
  - serving as a central regional development institution, utilizing a second tier of national intermediaries to channel financing and assistance to private sector enterprises
  - providing intraregional and/or export trade financing and insurance as well as other export promotion services
  - bringing relatively objective regional judgments to bear in solving difficult regional economic issues.
- o CABEI could be a more credible and reliable channel for external financing to Central American economic development than the separate national entities.
- o CABEI's financial viability will depend in substantial part on its attracting additional members/guarantors, of which the most important candidate is the U.S. CABEI's ability to attract new members depends significantly on the degree of U.S. support.

The U.S. attitude may therefore be crucial not only for CABEI as an institution but also for the prospects of channeling external funds efficiently into vital sectors of the Central American economy. The ideal solution, from CABEI's standpoint, would be for the U.S. to become a member.

If U.S membership is impossible for policy reasons, AID might accomplish a similar purpose by providing concessional assistance to CABEI on a quasi-equity basis. Such AID assistance might be segregated as a special reserve fund to be administered by CABEI which would guarantee bond emissions or borrowings from private banking sources. Under such a facility, AID could leverage three to four times the value of its contribution in generating external financing from other sources.

4. Financial Situation

Our analysis of the financial statements, changes in financial position, and cash flow projections leads to the conclusion that CABEI is by no means in unsurmountable trouble. But the symptoms of what could become problems affecting the viability of the bank are present. Liquidity is a deepening concern. The erosion of profitability is another. The large arrears in the portfolio, which so impact the cash position, require strong, immediate action to stem the deteriorating trend in the public sector portfolio and to reduce losses in the private sector portfolio. Capital sufficiency is questionable, the more so if new borrowings are to be realized. Also subject to review are those accounting procedures which tend to mask the real extent of the problems in the portfolio and their affect on CABEI's financial condition.

The liquidity concerns require that stronger efforts be made to reduce outlays and increase recuperations through more effective collections practices. The member states have to pay their arrearages. While not much can be expected from Nicaragua, arrangements should be made for an orderly, regular repayment, even if stretched out. The various plans for obtaining new resources should be pursued aggressively. Senior management must exercise strong leadership to see that the above initiatives are carried through.

Portfolio collection is the key to CABEI's viability. The private sector loans which are in difficulty or under judicial collection should be contracted out to professionals to manage their rehabilitation, collection or liquidation. This might first be tried on a pilot basis with a selection of loans, and in a separate package with guarantees executed in case of non-payment. Experience will determine how such a program might be best developed. Collection of the public sector portfolio should be a special concern of CABEI's senior management.

CABEI ought to seek additional external resources. The basis for attracting outside support must begin with member states supporting their own commitments to CABEI. High level representations should be made to the member governments to secure a $50 million callable capital contribution and to persuade them to treat payment of their debt to CABEI with the same priority as their debt to the World Bank, the Inter-American Development Bank and AID.

5. Organization and Management Issues

We reviewed organization and management issues in light of the recent reorganization and from the standpoint of assessing

CABEI's capabilities to support a reoriented and revitalized program. Our conclusions and recommendations are summarized below:

- Key problems identified were:
  - lack of management information system
  - need to improve its external image as an agile, efficient financial institution
  - inadequate staff capability in relating to the private sector
  - need for improved strategic, operational and administrative planning

  These problems are generally similar to those afflicting several other development finance institutions in the region to which AID assistance is being provided for management improvement.

- Bank senior management is fully aware of its organization and management problems and have taken constructive steps to address them through the 1984 reorganization process.

- Organization/management problems appear to be surmountable but they require high priority management attention and diligence in undertaking remedial action. With such action, the Bank should be fully capable of meeting institutional requirements for supporting strategic plans. The important cadre of experienced, highly professional Bank personnel should provide a basis for success of institutional improvement efforts.

- Priority should be given to organization/management problems since the Bank's external image will be judged by the quality of its management and operational efficiency. Its external image is a key factor in obtaining external financing.

- Present organizational structure and management practices can be improved by:
  - adjusting the structure of certain existing organizational units; relocating and/or combining units and functions as necessary to improve operations and management control

- clarifying certain functions and relationships in the financial area
- filling vacancies of key executive positions with qualified bank managers, and
- strengthening loan supervision and collection practices.

o Priority attention should be given to developing a management information system using short-term and medium-term approaches:

- the short-term approach involves urgent selection of banking software programs for general ledger, financial reporting and portfolio management needs
- the medium-term approach is to begin study of the conceptual design and implementation of an integrated management information system including financial management, portfolio management, and economic/ statistical data base sub-systems.

o Undertake studies to:

- design and implement a new personnel evaluation system
- prepare qualifications statements to accompany position descriptions
- assess medium- to long-term manpower needs
- assess training needs for senior and middle level managers
- analyze possibilities of reducing steps in operating procedures

6. Recommended U.S. Government Assistance Strategy Toward CABEI

It is the Project Team's recommendation that U.S. foreign policy interests in Central America will be well served by providing AID concessionary assistance to CABEI in FY 1985. We

consider such assistance to be crucial to CABEI's institutional recuperation and long term viability as well as its capacity to play a constructive role in advancing an updated strategy for regional integration and development, emphasizing private sector, export-oriented productive growth.

A demonstration of U.S. support to CABEI is important to reinvigorate its member's own support for the institution, particularly by meeting its financial commitments. It will also help attract new members and external funding sources.

In summary, we believe that CABEI has an important role to play in the region and that the U.S. government should support it. In particular, we recommend that:

- U.S. government support of CABEI should be conditioned on concrete evidence of support for the institution by member governments.
- U.S. government financial assistance to CABEI should be on a concessionary basis, represent a contribution to its capital structure, and be designed to leverage generation of additional external financing.
- U.S. assistance should be conditioned on these funds being used to further U.S. government development priorities (e.g., private sector, export-oriented productive activities).
- U.S. assistance to CABEI should be coordinated with other donors such as the World Bank and IDB.

II. ECONOMIC BACKGROUND AND PROJECTIONS

A. Introduction and Summary

This section presents recent trends in the economies of the Central American Common Market (CACM) countries.1/ These trends are analyzed with particular attention given to their impact on regional economic integration, future financing needs, and the role of CABEI.

Recent trends in the CACM countries show that:

- After a moderate decline in GNP over the past five years, the CACM economy remains weak. Per capita income levels have fallen dramatically, in some cases barely equalling 1960 levels. There is little expectation of significant economic recovery over the short-term.
- The chief causes of the economic decline involve high oil prices, inflation, recession, weak demand for commodity exports, foreign debt, economic mismanagement, and the deteriorating political situation.
- There has not been a systematic regional approach to the crisis. This partly reflects preferences of multilateral/bilateral creditors and partly the political and economic pressures which make individual governments concerned with their short-term survival.
- Reflecting this pursuit of self-interest by individual governments, there has been little support for CABEI or other regional institutions. However, CABEI could assist in a revitalized export-led growth strategy using its financing capabilities to stimulate industrialization and infrastructure development and its apolitical role to guide economic policy formulation.
- Several estimates of the region's financing needs have been made. For example, the Kissinger Commission

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1. Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua.

estimated $21 billion in aggregate external financing would be needed to achieve 1980 per capita levels by 1990. CABEI has estimated regional external financial needs at $24 billion to $33 billion depending on growth in GNP and exports.

- The size of CABEI's role in financing future CACM economic activity will be determined by the strength of the integration movement, the availability of financial resources and CABEI's capacity to grow as the development needs of the region change.

- The U.S. government's approach, as evidenced by USAID planning, tends to emphasize a unilateral approach to development rather than a multilateral approach with significant regional involvement in the definition of the region's economic future.

B. Recent Economic Trends

The economies of Central America remain weak in 1984 having declined an estimated 4 percent in real GNP terms during the period 1979-1983. Table II-1 shows growth rates for individual countries over this period. In per capita terms the decline has been even more pronounced with the increase in population exceeding GNP growth every year since 1978. In late 1983, the Economic Commission for Latin America (ECLA) reported that in Costa Rica, Guatemala and Honduras the absolute level of per capita income barely equalled that of 1976. For El Salvador and Nicaragua the comparison was even more dramatic, with 1983 per capita levels having regressed to early 1960's levels. The situation has since so deteriorated that the effects of more than two decades of economic growth have been eroded.

Table II-1

PERCENTAGE CHANGE IN REAL GNP
1979-1984

	1979	1980	1981	1982	1983[e]	1984[e]
Costa Rica	4.9	0.8	-4.6	-9.1	0.8	2.7
El Salvador	-1.7	-8.7	-8.3	-6.0	-2.3	-0.4
Guatemala	4.7	3.8	0.7	-3.7	-2.7	-1.0
Honduras	6.8	2.9	0.3	-1.8	-0.7	1.5
Nicaragua	-26.9	13.5	5.3	-1.2	2.0	-0.6
Weighted Average	0.4	2.3	-1.3	-4.5	-1.1	0

Sources 1. CABEI, Comportamiento de la Economia Centroamericana en 1983 y Perspectivas de Corto y Mediano Plazo, October 1984.

2. CEFSA, Sobre el Estado Actual de las Economias Centroamericanos y Sus Perspectivas Inmediatas, September 1984, and estimates

This economic downturn has had profound social consequences reflected in the deterioration of health, education, housing, nutrition and other indicators of human welfare. It has also become self-reinforcing. Private sector preferences and government policies have led to dramatic declines in real investment (see Table II-2), undercutting future growth potential. The economic adjustment has led to some improvement in the balance of payments. The region's current account deficit fell from $2.1 billion in 1981 to $1.4 billion in 1983. However, since this adjustment reflects both lower exports and imports, the lack of imported raw materials and spare parts has become a serious constraint on productive activity.

TABLE II-2

	REAL GROSS FIXED INVESTMENT* (% change)		
	1982	1983[e]	1984[e]
Costa Rica	-38.8	-7.2	-3.2
El Salvador	-10.6	-5.5	-2.6
Guatemala	-8.5	-28.7	-8.9
Honduras	-19.7	-1.8	-6.2
Nicaragua	-17.3	1.2	-3.0

Sources: As for Table II-1.

Although the emergence of positive economic growth in Honduras and Costa Rica this year may presage the end of the contraction, there is little expectation of significant economic recovery over the next few years. The Inter-American Development Bank (IDB) expects real growth in the region to average less than 2% through 1988. On a per capita basis, this would leave economic activity at the end of 1988 well below the level of ten years ago. The estimates of ECLA are even less optimistic.

The causes of the economic decline are well documented. The report of the National Bipartisan Commission on Central America (NBCCA or Kissinger Commission) cited several key factors including:

- High oil prices, world inflation, prolonged world recession, and weak demand and prices for commodity exports.
- Intra-regional tensions and political unrest.
- Economic mismanagement by the individual countries of the region which, together with the political/security situation, contributed to large-scale capital flights.
- Excessive foreign debt and concomitant high debt service burdens.

Some regional analysts--including the management of CABEI--place much of the blame for the economic collapse on the world recession and the abrupt cut-off of foreign commercial bank credit. Others point to the 35% contraction in the Nicaraguan economy during 1978-1979 and the resulting shock to the regional trade and payments system as prime causes of the prolonged region-wide economic decline.

The CACM countries are trying to cope with their economic problems through economic adjustment programs aimed at the national rather than the regional level. All of the countries, except Nicaragua, have adopted, and implemented with varying degrees of success, IMF-sanctioned stabilization programs. These programs typically include efforts to reduce and rationalize imports, liberalize exchange rate and tariff regimes, curtail money and credit growth and reduce public sector deficits through spending cuts and tax increases. These programs do not have regional components. In fact, economic conditionality as administered by the IMF, World Bank, and USAID has encouraged national initiatives outside a regional context, for example through exchange rate and tariff policies.

The major regional initiative has been an effort to establish a consultative group under the auspices of the IDB. An initial meeting of the five Central American countries and potential donors was held in Brussels in September 1983, but there has been little follow-through. Proposals to refinance regional commercial and financial institutions have received limited practical support, and intra-regional trade remains low. The value of exports from the five countries to each other has fallen by one-third since 1980. The Kissinger Commission encouraged efforts to revitalize regional trade as part of an emergency stabilization program and to provide financial assistance to

regional institutions, including CABEI. Recently, ministers from the European Community and the CACM countries met to discuss economic recovery and financial assistance on a regional basis. Nevertheless, there has not been a systematic regional approach to the crisis in Central America.

C. Regional Integration

The lack of regional economic recovery initiatives reflects the general malaise that has affected the regional institutions. Regional organizations still continue to meet regularly. CABEI, in particular, has sponsored numerous meetings bringing representatives of all five countries together in addition to holding sessions of its Board and General Assembly. However, the member states have repeatedly placed national interests above regional interests. For example, while Nicaragua has accumulated substantial arrears to CABEI, it has chosen to allocate scarce foreign exchange to other purposes. Nicaragua has only intermittently allowed private sector companies access to foreign exchange to service their debts to CABEI despite a negotiated agreement to do so. Similarly, CABEI members recently agreed to a $50 million capital call but several countries have resisted paying their subscriptions (in local currency), arguing that monetary ceilings prevented them. Again, the real issue is the willingness to allocate scarce resources to regional instead of national purposes. There is also speculation that several members have privately discouraged bilateral assistance to CABEI, worried that any assistance to regional organizations would come at the expense of their own aid allocation.

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CABEI's response to this criticism has been as follows:

- Member states have demonstrated their support for CABEI by encouraging economic assistance through regional institutions at the Brussels meeting of the consultative group and at the recent San Jose meeting with the European Community. Also, CABEI has received agreement from the five Central American countries to seek access to the oil facility extended to them by Mexico and Venezuela.

- Member states are unwilling and unable to allocate scarce resources to CABEI because the institution lacks the ability to lend back at least the amounts which countries are expected to repay. Thus, certain countries would be net payers to CABEI. Under current economic and political circumstances, no member will allow CABEI to reduce its exposure.

Nevertheless, there is little substantive evidence of support for CABEI or other regional institutions in the current crisis. This reflects the political and economic pressures which make governments concerned with their short-term survival, as well as the preferences of multilateral and bilateral creditors.

Future prospects for regional economic integration are uncertain. Many Central Americans worry that the evolving political/economic system in Nicaragua may be incompatible with the rest of the region's economies. At the same time the need for regional infrastructure (much of it already completed), realization of scale economies, and geographic realities are as important today as they were at the peak of the integration movement. Perhaps more significantly, many people in the region continue to profess a "Central American" cultural identity which seems to transcend passing political conflicts.

Nevertheless, the economic reality of integration as measured by commercial and financial interaction has been reduced. The economic interdependence of the five countries exists as a short-term liability, not an asset. Even if the immediate political and economic crisis were overcome, the nature of the economic integration model would need to be reappraised. The Central American Common Market was successful for at least three reasons: (1) it provided a protected market of sufficient size to encourage a significant degree of industrialization; (2) it encouraged, to a limited extent, the development of extraregional export industries; and (3) it developed the regional infrastructure essential to promoting growth.

In the mid-1980's, revitalization of a common market based primarily on import substitution in an area which needs foreign exchange both to service existing liabilities and to finance future growth makes little economic sense. However, increasing regional trade as an emergency spur to growth, while at the same time lowering the common external tariff and moving towards a common regional currency (which would also necessitate closely coordinated monetary and probably fiscal policies) could help to promote an export-led growth strategy.

CABEI could play a vital role in such a strategy. Its financing capabilities (for example, directed at completing or restructuring regional infrastructure and promoting internationally competitive industrialization) together with its ability to play a uniquely apolitical role in guiding economic policy formulation at both the macro and sectoral levels--such as export promotion--could be critical to forming a region-wide economic strategy that is more than the sum of its five parts. Individually, the countries face limited prospects. With an effective well-led regional strategy combining and rationalizing national

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stabilization programs the economic benefits of integration might again be realized.

D. Financing Needs

Various estimates of the region's overall external financing needs have been presented. The Kissinger Commission estimated that to achieve 1980 per capita income levels by 1990--a modest target for most countries--$21 billion in aggregate external financing (i.e., the sum of projected current accounts) would be needed by the five countries during 1984-90. While this estimate reflects specific assumptions about the international economic environment, the efficacy of economic adjustment programs, and regional political circumstances, other forecasters have reached similar conclusions. For example, the former governor of the Costa Rican Central Bank, Carlos Manuel Castillo, has estimated a $23 billion financing requirement. AID made a roughly similar estimate in presentations to the Kissinger Commission. The Inter-American Development Bank has forecasted far more modest current account deficits--about half of the NBCCA or Castillo estimates--associated with the low economic growth rates described above.

CABEI has made several estimates of the region's aggregate financing needs, which are generally higher than those prepared outside the region. In a working paper currently being prepared for the bank's revised medium-term strategy, the planning department has estimated that the external financing needs of the region would reach $16.4 billion during 1984-88 and $24.3 billion during 1984-90 in 1983 dollars. In CABEI's judgment, higher economic growth rates would be associated with even higher external financing needs. Table II-3 summarizes several alternative scenarios. These estimates seem high and presumably reflect

little underlying economic reform which is supposed to reduce the import intensity of growth and to encourage higher domestic savings.

TABLE II-3

AGGREGATE FINANCING NEEDS OF CENTRAL AMERICA
(MILLIONS OF 1983 $)

	Alternative I		Alternative II		Alternative III	
	Yearly	Cumulative[2]	Yearly	Cumulative[2]	Yearly	Cumulative[2]
1984	2.9	2.9	3.1	3.1	3.2	3.2
1985	3.1	6.0	3.4	6.5	3.7	6.9
1986	3.3	9.3	3.8	10.4	4.2	11.1
1987	3.5	12.8	4.2	14.6	4.7	15.8
1988	3.6	16.4	4.6	19.3	5.3	21.1
1989	3.8	20.2	5.1	24.3	5.9	27.0
1990	4.1	24.3	5.5	29.9	6.5	33.5

Alternative I Growth rates: GNP 2%, Exports 2%
Alternative II Growth rates: GNP 4%, Exports 4%
Alternative III Growth rates: GNP 4%, Exports 2%

Source: CABEI, "Diagnostics del Plan de Mediano Plazo: Situacion Economica de Centroamericana", preliminary working paper October, 1984.

The Bank uses these scenarios together with estimates of the region's investment needs to project, at least approximately, the role to be played by CABEI in the medium-term. A recent planning department analysis indicates that if the external resources required during 1984-88 are $16.4 billion and if CABEI

2. May not add up due to rounding.

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has historically accounted for almost 20% of the external financing flowing into the region 3/, then CABEI's "share" would be $655 million annually or a five year total of $3.3 billion. This exceeds the peak level of activity of the Bank and is not a realistic guide to either the likely demand for CABEI lending or its capacity.

A more realistic assessment, made by CABEI, is based on aggregate 1983-86 country investment plans (totalling $8.3 billion in 1982 dollars) and a rough estimate of $8.0 billion for private investment. Historically, the Bank finances about 5% of region-wide investment (about 13% of public sector investment), so the demand for CABEI would be approximately $204 million annually or $1 billion over 5 years in constant dollars.4/ CABEI management seems to believe that this represents a realistic estimate of not only the demand which resource availability will allow the institution to meet, but also its capacity.

The size of CABEI's role in financing future economic activity in the region will be defined by the strength of the integration movement, the availability of financial resources, and CABEI's capacity to grow as the development needs of the region change. Macro calculations can only be crude yardsticks of the potential size of CABEI. Indeed, there is no essential reason that CABEI should be limited by its historical share in financing regional development.

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3. CABEI, "Requerimientos Financieros de la Inversion en Centroamerica", May, 1979

4. CABEI, "Bases para el Plan de Mediano Plazo 1984-89," February, 1984

E. U.S. Government Policy

Largely due to its intense political interest in Central America over the last several years--due to the revolution in Nicaragua and the insurgency in El Salvador--the U.S. government has articulated a detailed economic program for the countries of Central America. The program, which has now been at least partially funded by Congress, represents a significant departure from the past, both in terms of size and of focus. Reflecting the report of the Kissinger Commission, it is conceived as a multi-billion dollar, multi-year economic and social reform effort; it is far more ambitious than any previous program, designed to promote substantial improvements in socio-economic conditions as well as to lay the basis for sustained, well distributed economic growth.

AID has identified four fundamental elements in its strategy for the region:5/

- Immediate economic stabilization, providing balance of payments assistance in conjunction with the International Monetary Fund or, if a Fund program is not feasible, AID-established macroeconomic performance criteria
- Creation of a basis for long-term growth, through policy reform, promotion of industry and agriculture, and funding of economic infrastructure--with a strong emphasis on labor intensive, export-oriented sectors
- Promotion of equity, particularly through programs in health, education and housing

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5. The following discussion draws on an AID Congressional presentation, entitled "The Economic Assistance Program for Central America," undated.

- Support for democratic institutions, principally by linking economic assistance to "specific" commitments regarding free elections, independence of the judiciary system, and respect for human rights.

AID, following the letter if not the spirit of the Kissinger Commission recommendations, has indicated some support for regional intiatives. It supported the creation of a consultative body of Central Americans and Americans to advise on development goals and targets and to evaluate the performance of Cental American governments toward these targets; this is a much reduced version of an NBCCA proposal for a Central American Development Organization (CADO). The Agency has also expressed interest in providing support to CABEI and, through efforts to finance regional trade arrears, the CACM; some $200 million of the $1,120 million economic assistance request (plus $610 million in guarantee authority) for FY 1985 was requested for regional programs.

Nevertheless--perhaps because of the U.S. antipathy toward Nicaragua and the uncertain commitment of the Central American countries to their regional institutions--the U.S. government's economic strategy basically emphasizes extra-regional initiatives. Detailed country strategies are blueprints for economic recovery and reform, one country at a time, rather than for the region as a whole. At best, the CACM seems to be viewed as a vehicle to promote short-term economic recovery. Moreover, the U.S. approach seems to be heavily unilateral in the sense that policy documents and interviews with U.S. government officials reflect the general attitude that the U.S. can define appropriate economic policies and goals, with minimal national participation. AID does not seem to be as prepared to commit U.S. economic assistance to support policy initiatives originating in the region as it is to define detailed economic strategies for the

countries--reflecting an underlying view that unilateral approaches are the most effective ways to achieve long-run political and economic goals.

In this sense the development program of the U.S. government departs sharply from the philosophy embodied in the Kissinger Commission Report. The Commission heavily emphasized multilateral, regional approaches with significant involvement of Central Americans in the definition of the economic (and political) future of the region. This vision is reflected in the current AID strategies more in form than substance.

What of CABEI? AID has explicitly recognized the possibility of supporting CABEI with additional funds (if not membership as recommended by the NBCCA); there are already indications that both increased housing guarantees and direct loans will be made available to CABEI in the current fiscal year. Nevertheless, this does not seem to represent a commitment to the primacy of a regional, multilateral economic approach or to an analytic framework that includes economic interaction at a region-wide level as key elements of the recovery and reconstruction strategy.

III. CABEI'S STRATEGIC POSITION

This section discusses CABEI's strategic position in regional integration and development as well as medium and longer term strategies.

This section is organized into the following parts:

A. Background of CABEI's purpose and current portfolio

B. An assessment of CABEI's recent performance

C. A description of CABEI's medium term strategy as envisaged by its staff

D. Potential longer term strategies for CABEI

E. An assessment of CABEI's role in the future

F. A discussion of CABEI's strengths and weaknesses

G. Financial mobilization efforts undertaken by CABEI

H. Other questions

I. Conclusions

A. Background

CABEI was established in May 1961 "to promote the economic integration and balanced economic development of the member countries". and to this end it was to concentrate mainly on the following investment sectors:

> "(a) Infrastructure projects for completion of existing regional systems or which compensate for disparities in basic sectors which hamper the balanced development of Central America...[excluding] projects of purely local or national scope...;

"(b) Long-term investment...in industries of a regional nature... which will contribute to the increment of goods available for Central American trade, or....the export sector...not... of an essentially local nature;

"(c) Coordinated projects of agricultural specialization...conducive to regional Central American supply;

"(d)...Expansion, modernization...or modifications in the...production [of enterprises] in order to improve their efficiency and competitive capacity within the common market so as to facilitate free Central American trade;

"(e)...Services essential in the operation of the common market;

"(f) Other productive projects which shall make the economies among the member countries more complementary and shall increment Central American trade."1/

Further, in conformity with its central objective of promoting regional integration, CABEI was debarred from making available loans or guarantees to any member state which had not previously ratified the four treaties that established the legal framework for industrial integration, for regional free trade and for equalization of tariffs.2/

During the ensuing twenty years, CABEI--benefitting from generous financial support from AID, IDB and other offical sources and ready access to shorter term bridging loans from foreign commercial banks--made substantial contributions to

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1. CABEI Constitutive Agreement, Article 2.

2. Ibid, Article 34.

furthering integration, especially to strengthening regional infrastructure. From CABEI's beginning until June 30, 1983, the year of the highest total of loans outstanding, CABEI had committed $1,748 million for 935 projects, as shown in Table III-1.

Table III-1

CABEI PORTFOLIO
Cumulative to June 30, 1983

Sector	No. of Loans	Amount (CA $ million)3/
Agriculture and fisheries	35	56
Mining	7	8
Manufacturing	318	183
Electricity & water	69	271
Infrastructure	187	643
Transportation, storage and communication	66	164
Tourism	81	78
Intermediary financing	62	43
Social Services	31	67
Housing	79	235
	935	1748

3. The Central American dollar, the unit of account used by CABEI and the common market, is valued at par with the U.S. dollar. In this section, for simplicity, the $ sign is hereafter used interchangeably without other designation, unless required by an explicit distinction between local money and foreign exchange.

While private sector projects (in agriculture, mining, manufacturing, some tourism and financial intermediation) were over 40 percent by number, they received only 16 percent of the total financing. The projects for highways, telecommunications and electric power, and for publicly-supported housing, were individually more than four times larger than those in the directly productive sectors.

B. Recent Performance of CABEI

From the late 1970s, CABEI was faced with serious and growing difficulties caused by both external and intraregional circumstances that have been described earlier in this report: on the one hand, the successive oil price shocks, rising global interest rates, deterioration in Central America's terms of trade and shortage of foreign exchange; on the other, the exacerbation of national and ideological antagonisms within the region, the mounting socio-political disturbances, and the decline in regional economic growth and trade consequent on all these factors. The annual growth rate of the Gross Domestic Product (GDP) for the region, which had been sustained at 5 to 6 percent through the 1960s and most of the 1970s, turned negative in 1979, most notably for Nicaragua, but by 1982 in all five countries; and the industrial, commerce and construction sectors were especially hard-hit. Intraregional trade declined, in real terms, by 48 percent from 1978 to 1983.

The consequences of these trends for CABEI were: (a) some slackening of demand for loans, mainly in the private sector; (b) more particularly, a sharp increase in the level of arrears, largely due to economic tribulations and foreign exchange stringency; (c) a liquidity crisis, the combined results of the

arrears and the growing concern of foreign commercial banks about the creditworthiness of the Central American countries and by extension of CABEI itself; and (d) inability, therefore, to fund a large volume of pending new loans (some $400 million as of October, 1984) which it had previously approved in principle.

All these trends are evident in the summary of CABEI's loans and recoveries since 1976 as shown in Table III-2.

TABLE III-2

SUMMARY OF CABEI LOANS, 1976-84
($ millions)

Financial Year (July-(June)	Net Commit-ments	Disburse-ments	Repay-ments	Year-End Port-folio	Arrears at Year-End
1976/77	134.2	121.3	35.4	431 1	8.0
1977/78	154.2	115.6	30.8	515.9	11.3
1978/79	136.5	119.7	35.9	599.7	19.3
1979/80	181.7	87.3	46.2	640.8	23.9
1980/81	201.0	98.3	44.9	694.2	49.7
1981/82	168.7	101.0	35.3	759.9	77.6
1982/83	53.0	92.0	55.3	796.7	92.7
1983/84	10.7	68.0	53.5	811.2	106.4

The rise in arrears is particularly disturbing, for several reasons. It reflects, of course, the deterioration of the Central American economy over the past several years, which makes the banks unwilling to continue financing CABEI. Until 1983, the arrears affected private sector loans which constitute a small proportion of CABEI's portfolio; but in 1983/84 the total of public sector arrears increased by 75 percent while those for private sector debts were actually reduced by nearly one-fifth. The public sector arrears (as of June 30, 1984) were very unevenly distributed--65 percent attributable to Nicaragua and

approximately 13 percent each to Costa Rica and Honduras. All of the delinquent governments blame foreign exchange scarcity for their failure to keep up payments--or in some cases to transfer payments made by the borrowing entity, public or private--and there can be no doubt that all of the countries in the region face severe payments problems. They have, however, continued service on their debt to the World Bank (WB) and IDB; and the failure of some to do likewise for CABEI, an institution in which they are still more intimately involved, could be construed as indicating an erosion of their commitment to its purposes and well-being--or merely that they rate its ability to reward or punish them as less significant than that of the Washington institutions. Whatever the reason, it seems clear that CABEI's institutional credibility, in the medium- to long-term, will depend in major part on its ability to enlist convincing support from its shareholder/clients, not least through recovery of payments due from them.

In assessing CABEI's capabilities and potential future role, it is relevant to consider whether and how CABEI might have anticipated and perhaps done more to avoid its current financial difficulties. They stem in major part from factors beyond its control: the deterioration of terms of trade due mainly to the oil price increases but also to recessionary trends in industrial nations' markets; the decline of intra-regional trade partly as a result of financial stringencies and partly of political hostilities; and the counter-productive effects of civil disturbances and capital flight. The extent and timing of the adverse international price movements were not accurately forecasted by financial authorities and institutions anywhere; and the intraregional problems, although foreshadowed to some extent, were not reliably predictable. As these difficulties grew increasingly severe, to be sure, CABEI might have cut back its loan commitments earlier

and thus preserved a somewhat greater liquidity margin, but this is questionable hindsight. More important was its tardiness in recognizing how serious were the problems of its private sector portfolio, and in taking action to deal with these problems. This would appear to be the gravest deficiency in CABEI's performance to date--one that should be remediable no doubt, but which will require the maximum of vigor, imagination and knowledge that CABEI can mobilize.

Moreover, the deterioration of the regional economy, the decline of intraregional trade and the evident political hostilities between governments--all call into question the strategy of regional cooperation and integration and hence CABEI's primary mission. Does the integration objective still have validity? As we have seen in Section II above, it is argued in some policy-making circles, both in Central America and in Washington, that an economic development strategy based mainly on import substitution for the regional common market is a dead-end strategy and that the individual countries should instead reduce protective tariff barriers, open their industrial sectors to the stimulus of competition, and devote their energies to promoting export manufactures to North American and European markets following the model of the East Asian super-stars--Korea, Taiwan, Hong Kong and Singapore. If this approach were widely preferred it would raise still another question: Would CABEI retain any unique role, any comparative advantage relative to other institutional mechanisms for promoting Central American economic development? Or would such development be equally or better served through support of national or private financial intermediaries in the region?

C. CABEI's Medium-Term Strategy

CABEI, of course, vigorously resists any suggestion that it might not be called upon to play a pivotal role in regional reconstruction and development. It points with pride to its past record in the definition, financing and implementation of regional highways, telecommunications and power networks. While it acknowledges that the most important infrastructure linkages are now in place, it notes that a number of gaps still remain; and it stresses the need for costly rehabilitation or heavy maintenance of some of the facilities that have suffered from civil strife and neglect during recent years.

CABEI also emphasizes the need for selective rehabilitation, balancing, reorientation and restimulation of existing industrial enterprises--to make efficient use of existing capacity to create additional employment, to contribute to intraregional trade and especially to increase exports overseas. It proposes to give priority attention to the following:

- Industries for export of non-traditional goods to markets outside the region
- Industries of strategic character--not otherwise defined but presumably including pharmaceuticals, agricultural chemicals, etc.
- Industries producing capital goods, intermediate products and selected consumer goods for the CACM.

CABEI cites the accomplishments of its agricultural and agribusiness programs, mostly still of relatively recent origins, and their potential continuing role in strengthening both the export and the domestic economies of its member countries and the effectiveness of agrarian reforms in some of them; and it envisages a Phase II program to carry them forward. It also

underlines the importance of the housing and other social development programs financed in recent years, which it wishes to continue and expand.

For all these sectors CABEI has studied, in varying depth and detail, the candidates for credit, and made some preliminary estimates of potential lending volume, under different assumptions ranging from $737 million to $1,230 million over the five-year period 1984/85 through 1988/89.4/ We were not asked and have not attempted to analyze the merits of the programs or projects underlying these projections. They do appear, however, to be based on serious reviews of the sectors in question. They also show a marked shift in the proportion of loan commitments, as compared with the past, from infrastructure toward the directly productive sectors and (to a somewhat lesser extent) toward social purposes; technological and preinvestment studies are also given much greater weight. In gross terms these are appropriate changes in emphasis, although we would not decry the contribution of certain infrastructure facilities to increasing production; the greater attention to technical studies is especially welcome.

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4. The prospective program published in February 1984 envisaged new operations of $1,000 million during this period. The more recent working papers reach the same total for their medium-term projections but with a different phasing, lower in the early years and higher later on.

However, these projections are still in flux, and CABEI is wary of publicizing their planning figures except in global terms since:

- The political/economic situation in the region, as it affects particular country or sector needs and potential, is not yet stable enough to permit reliable projections
- The allocation of resources will depend in some measure on the total amounts available (and no doubt on donor specifications or preferences)
- The recent estimates are the product of staff work and have not been approved or reviewed by the CABEI Board.

What emerges from the still tentative planning documents is a strong conviction that integration remains an essential means to Central American economic development and that CABEI can continue to make a valuable contribution to this and other development objectives. This is a natural, almost inevitable, institutional reaction. How valid is it? What are CABEI's special strengths and/or weaknesses as an instrument for these purposes?

One crucial element of current weakness is CABEI's financial resource position; and it is seeking, as a matter of urgency, to remedy the problem in several ways. The first priority is to prevent further deterioration of the Bank's frail liquidity position, and to restore it as soon as possible to a reasonable level. To this end CABEI has:

- Been limiting loan approvals to the amounts of assured resources
- Suspended disbursements to public sector borrowers which are in arrears by over 90 days (two countries in particular)

- Based on the foregoing, reestablishing ready access to commercial banking facilities for short term bridging requirements.

These various approaches are discussed in more detail in the sections that follow.

E. CABEI's Role in the Future

The CACM is in decline and disrepute: its domestic demand eroded by the economic deterioration; its exchanges impeded by national antagonisms, civil strife and currency restrictions; its external tariff lacking a clear policy direction or consensus; and its financing precarious. Hence, CABEI's primary mission is called into question, unless there is a resumption of progress toward regional integration and growth. Is this a likely prospect? And are there other useful contributions, apart from support to the CACM, which CABEI is especially suited to make? The following topics are discussed in further detail below:

- Regional integration
- Other development objectives
- Trade financing
- Rural and agricultural development

1. Regional Integration

The basic concept continues to command widespread loyalty in all five countries. As was noted by the Kissinger Commission,

> "...despite the political differences dividing the region, Nicaragua remains an essential part of the Central American economy, although the pronounced deterioration in that

country over the last several years has undermined some of the linkages with the rest of the region."5/

Still, the regional power and telecommunications networks function routinely with and through Nicaragua, along with intra-regional trade at levels much reduced from those before 1980. CABEI's member countries uniformly endorse its institutional purposes, and have expressed willingness to borrow or guarantee World Bank loans on its behalf, and to increase their paid-in capital (in Central American currencies).

Indeed it is hard to envision a solidly based, dynamic, self-sustaining process of economic development in Central America except in a regional context. The individual countries' economies are too small and poor to support industrialization of any depth or diversity. Separately, these economies would have to deperd very largely on agriculture which, in light of rapid population growth and scarcity of new land for cultivation (except perhaps in Nicaragua), offers limited scope for expanding employment and real incomes; on tourism, which may hold potential when political stability is restored but is a narrow and precarious economic foundation; and on a handful of industries--first-stage processing of farm or mine products, small producers of simple goods for a strictly local market, or exporters of garments, electric or electronic items and the like to North America or Western Europe.

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5. Report of the National Bipartisan Commission on Central America (January 1984), p. 42.

To be sure, all these possibilities could have some promise and should be actively pursued, especially the last. The emphasis on export promotion, often in association with industrial country enterprises on the basis of production-sharing, was pioneered by the East Asian "star performers"--Hong Kong, Singapore, South Korea and Taiwan--and in recent years has been prescribed by international development experts for almost every country with limited resources and market, and pressure of population, in Asia, Africa and the Caribbean Basin. It is not, however, a simple strategy nor a universal remedy. Hong Kong was a virtually open economy from the start, Singapore soon abandoned protectionism, but both Korea and Taiwan based their export drive on a strong, growing, protected domestic market, progressively orienting it toward international trade. To the extent that political conditions permit, the same strategy seems appropriate for Central America, with a total population roughly equal to that of Taiwan and substantially less than that of South Korea. The Hong Kong conditions are not replicable, nor could very many Hong Kongs be easily accommodated in the world economy.

In a reoriented, reinvigorated CABEI should continue to support a regionally integrated economy. However, it should insist on modification of the CACM's excessive concentration, as in the past, on import substitution, often with minimal import savings, and on administratively-agreed trade-offs of one integration industry for another--each monopoly of Industry X in exchange for my monopoly of Industry Y--which precludes real competition and often forfeits the promised development when the industry X monopolists, for any reason, decline to go ahead. It should seek to identify and support industries which, though originally conceived as import-substituting, are efficient enough to have real export potential, and encourage them to explore export

markets; the present underutilization of industrial capacity should make such markets attractive, even at deeply slashed prices.

Thus an increased emphasis by CABEI on promotion of industries for extraregional export, especially of non-traditional goods, should not be viewed as an alternative or substitute for its support of regional integration, but as an extension of that support. Indeed, it is clear that strengthening of the region's export capabilities would promote the end of integration as well--by easing the foreign exchange stringency that has hampered the functioning of the CACM; by permitting greater economies of scale for certain regionally-based industries; and by encouraging them to become more efficient, productive and economical in serving regional as well as overseas markets.

A high priority requirement, once a sufficient measure of civil tranquility has been restored in Central America, will be to rehabilitate important segments of the regional infrastructure that have suffered from the fighting or from lack of maintenance in recent years. CABEI is especially qualified to assess these needs and to administer their financing.

For the longer term future, it may be hoped that the development momentum of the 1960's - 1970's can be recovered, based on a resumption of the upward trend in regional production and trade and bolstered by powerful incentives and pressures toward export markets. A strong financial institution will be needed to provide the underpinning for such a recovery. CABEI is the obvious candidate; if it were allowed to die in the current tribulations it would have to be created anew later on--forfeiting a couple of years, at least, in the process. It would seem prudent to keep

CABEI in existence for the day when its integration role may again be entirely relevant.

What, however, should it do, and how should its operations and staff be oriented, in the meantime?

2. Other Development Objectives

A number of economic development programs/projects in Central America do not have explicit regional justification or focus--although they may well contribute indirectly to strengthing the regional economy and trade--but are motivated mainly by domestic political and economic concerns. Such are most of the nationally sponsored programs for industrial/agricultural development; and the assessment and funding of projects, and administration of loans, under them have generally been handled by national intermediaries, public or private or through direct recourse (by the more creditworthy enterprises) to foreign banks. In recent years these latter channels have virtually dried up, and the term lending programs funded from public sources, domestic or external, suffer from certain operational weaknesses.

An essential requisite is that there be some sort of central regional development institution: (i) to allocate funds, either directly to ultimate borrowers or to second-tier intermediaries which in turn would make the final loans; (ii) to set the criteria and enforce the rules governing eligibility, loan conditions, collateral security, etc.; and (iii) generally to attend to management of the program, whether it administers it directly or through other intermediaries. In several of the Central American countries this responsibility is entrusted to the Central Bank, principally because there is no other national financial institution with sufficient credibility or broad enough

powers to undertake it. But central banks, as a rule, are not very well suited to the role of such a development bank. Their primary mission of short-term monetary and credit adjustment calls for, and has usually evolved, quite different attitudes and staff qualifications. Indeed, the inculcation of development banking attitudes and skills in the central bank staff could tend to weaken or distract their attention from their principal functions.

It has been suggested by some foreign assistance donors that a more suitable alternative would be to use CABEI as an intermediary for the funds they provide for development. For this purpose it would act not as a direct lender but as a regional development finance institution, administering nationally designated funds through qualified national intermediaries for purposes agreed with the donor agency.

CABEI is now partly capable of fulfilling such a role, and has potential for full capability. It has an improving organizational/management capability, and is relatively insulated from the narrow domestic political pressures of any single country. On the other hand, it lacks adequate skills and experience in dealing with the directly productive sectors--notably industry and commercial agriculture--in project appraisals, negotiation, suspervision, the practical solutions to operating problems. But this is a deficiency that can be corrected; and CABEI's professional reputation, existing institutional capabilities, and above all its basic commitment to economic development, should give it an advantage over any national government agency in Central America in attracting the necessary talent.

We would reemphasize, however, the need for CABEI to strengthen its project appraisal and supervision staff in the productive (as distinct from infrastructure) sectors, especially in non-traditional industries having export potential. We would also stress the desirability of its making more extensive use of outside consulting services, based within the region or abroad, for many of these purposes.

Of special importance in the short run is CABEI's program for assisting the rehabilitation of the industrial economy of the region, especially of its clients who are in difficulty. As regards the latter, CABEI has recently established a special unit, under the Operations Directorate but also reporting directly to the Presidency, which would attempt to diagnose an ailing company's problems, arrange for needed consultancy services, give financial assistance (to replenish working capital or finance imported inputs) or reschedule loans as appropriate, help in identifying or adapting to extraregional markets, etc. Assistance from the World Bank to support this effort, is under active discussion. This is an area of activity where outside experience--of professional managers or management firms ("company doctors"), who could be employed as CABEI's agents to tend to a particular sick enterprise for as long as it takes to turn it around or, if its case is hopeless, to liquidate it on the best terms possible--will be specially valuable and necessary.

3. Rural and Agro-industrial Development

Much of the financing for development of agriculture and related activities will also flow through institutional channels of the several Central American countries--and should do so; they will generally be better able to establish the indispensable

linkages with local authorities and grassroots organizations. Yet for some aspects of such activity CABEI may be an expecially useful intermediary, as for example:

- For programs of regional scope, involving the introduction and export promotion of a new crop, the control of a potentially epidemic disease, etc.
- For large scale agro-industries (e.g., alcohol from sugar or cellulose from cotton linters), involving more than one country or requiring an investment beyond the capability of any single national institution.
- For certain politically sensitive agrarian programs where CABEI's combination of technical competence and relative insulation from national politics could help defuse tensions.
- Moreover, CABEI would be a suitable channel for the financing of commercial agricultural and agribusiness programs of the type discussed above--i.e., as the central regional development institution to channel resources and supervise operational standards and performance for a second-tier of national institutions.

4. Trade Financing and Promotion

CABEI has not engaged significantly in trade promotion activity in the past, but it is a potentially very promising field, with numerous aspects, that could contribute importantly to Central American economic development and to the enhancement of CABEI's own earnings. Several kinds of possibilities deserve exploration and study in detail.

The major inhibitions to trade, both intra- and extra-regional, are the high cost of credit and, even more, the shortage of foreign exchange. The latter has often restricted the importation of necessary raw materials and spare parts required for export production, or financing of capital equipment

needed for its modernization or quality improvement. It has also forced the Central American countries to limit the permissible level of trade deficits among them, holding down the intra-regional trade volume.

The U.S. has sought to mitigate this foreign exchange stringency by substantial balance of payments support to the individual countries. It has extended credit lines amounting to $16.6 million, as of end-1983, to the Banco Latinoamericano de Exportaciones (BLADEX), the principal purpose of which is to promote exports from Latin American countries. CABEI also opened an additional $50 million line of credit to BLADEX, specifically earmarked for promotion of CACM trade. Pursuant to a recommendation of the Kissinger Commission, AID has recently agreed with the EXIM Bank to establish a $300 million trade credit insurance facility, to be administered by EXIM, which will provide credit guarantees to U.S. banks for goods exported from the U.S. to Central American importers. In some cases these exports may be financed jointly by the participating U.S. banks and CABEI, as is done using export credits from Europe and Japan; the availability of similar facilities from the U.S. will further supplement CABEI's resouces and help lubricate the channels of trade.

The Central American Council of Ministers has recently proposed that CABEI engage more directly in financing intraregional trade, opening a new window for the purpose. Rather than financing inter-country transactions directly, CABEI could usefully provide guarantees for credits extended by local banks or financieras, charging a modest fee, thus helping to overcome the bankers' ingrained caution and to secure easier access and terms for credits to exporters.

A regional trade credit insurance facility could also help exporters obtain pre- and post shipment financing through local banks at lower interest and with reduced collateral than is normally required. Such a facility could improve the competitive position of Central American exporters. This facility could be important in facilitating extra-regional exports. It would be extremely valuable, for enabling the Central American economy to become more outward-looking. Often they involve an element of subsidy in the interest rate or other terms. CABEI would be better suited to undertake this task regionally than national entities in any of the five countries--by reason of its financial standing, its international contacts and its knowledge of the regional economy. However, management of an effective export finance or credit insurance program requires experience and skills quite different from those of CABEI's customary activities, and appropriate preparatory studies, policy definition and staffing will be essential.

Apart from the financing of exports, there is the function of promotion--or studying foreign markets and identifying targets of opportunity for Central American products, of informing exporters about such products and trade possibilities, of developing representation arrangements abroad, etc. Certainly this could be done more effectively under regional auspices than by five national agencies all promoting essentially the same products.

F. CABEI's Strengths and Weaknesses

CABEI's ability to fulfill these (or any other) roles will be determined by numerous factors, favorable and unfavorable. Despite its present financial problems, it offers several important advantages over alternative intermediary institutions for promoting economic development in Central America:

- It exists. There is no need to negotiate an agreement or create an organization from scratch; its developmental role is widely recognized and supported within the region and abroad; and the substitution of any other entity as a chosen instrument for focusing development efforts and aid would require a strong justification, which is not now evident.

- Its staff includes many experienced and competent professionals; it is certainly less subject than national entities to parochial pressures--of patronage, partisanship or privileged access--that often undermine the integrity of development financing. And CABEI's performance in the financing of regional infrastructure has received uniformly good ratings.

- Its regional scope and perspective enable it to appreciate and exploit opportunities for mutually reinforcing use of resources, and of comparative advantage, involving two or more Central American countries; to make use of economies of scale in production, in marketing and in the organization of investment (including external funding); to apply resources with more flexibility to promising areas and purposes. While CABEI is doubtless obliged to apportion its loans "equitably" among its member countries, its financing constitutes only a minor share of their total investment so that it can exercise substantial discretion or bargaining power in setting its priorities.

- CABEI's multi-national character may sometimes facilitate its achieving pragmatic solutions to problems posed by the divergent policies or ideologies of its members. For example, it recently persuaded the Nicaraguan Government to allow a private borrower to regain part ownership of an expropriated property, through a new company with 45 percent private, 45 percent government and 10 percent CABEI shareholdings, and management by the private partner.

- Its regional scope might be particularly advantageous for effective promotion of exports outside the region--both provision of export credits and organization of market studies and exploitation--with greater efficiency and impact than could the individual counties.

- CABEI also could be a more attractive and credible channel for external funding of Central American economic development than are the national intermediaries

CABEI also has, or is alleged to have, some weaknesses and disadvantages:

- The most obvious ones relate to its financial situation: the build-up of arrears (whose causes and proposed remedies are discussed in Section III-B, Recent Performance, above); the liquidity squeeze, which has been eased somewhat by the "Club Loan," but remains serious; and the continuing dearth of new resources, especially of foreign exchange. The efforts of CABEI to deal with its financial problems are discussed below (Section III-G, Financial Mobilization Efforts).

- In some influential circles, in the U.S. and elsewhere, CABEI is criticized as being too heavily oriented toward the public sector. In our view this is a legitimate comment but not a valid criticism. CABEI's mandate was essentially to finance public sector infrastructure, and it has fulfilled this mandate creditably. It now seems clear, however, that its operations should shift, not totally but in marked emphasis, toward the directly productive sectors and especially toward extraregional export industries. It needs to strengthen its staff capabilities, for preinvestment and project analysis, in the latter areas.

- The commitment of the member states to CABEI has been questioned because of the growing arrears on public sector projects in some countries, and restrictions on conversion to foreign exchange of payments by private debtors. If CABEI cannot count on unqualified support from its members, shareholders, and beneficiaries, does it deserve support from abroad? CABEI's response is only partly convincing. It is gearing up to improve the viability of private borrowers and the collectibility of their loans. It is actively negotiating with delinquent member governments to secure special treatment of local currency conversion for the debts due it; but it considers that, as a minimum, it ought to reinvest in each country at least as much foreign exchange as the latter is repaying (analagous to the "Club Loan" rescheduling). That is perhaps a reasonable objective, but in no way is it a proper condition for fulfillment of payment obligations; indeed CABEI's future foreign exchange lending capability may be determined in part by demonstration of its ability to secure <u>unconditional</u> payment of its loans. CABEI also notes the apparent readiness of its members to respond favorably to a call for additional

capital payment totalling CA $50 million, in local currencies, which is encouraging and helpful but not for easing the stringency of foreign exchange.

G. Financial Mobilization Efforts

During the halcyon period of rapid growth in the Central American region, CABEI obtained most of its external resources from USAID and IDB, with considerable short-term supplements from the foreign commercial banks. Both AID and IDB seem disposed to consider continuing support to CABEI, but AID is wary of the unsettled political/security situation in much of the region and anxious to see a clear-cut and agreed definition of CABEI's long-term role.

CABEI has sought for some 20 years to involve the World Bank (WB) in its financing of Central American development. Although sympathetic, the WB has been obstructed from the start by the requirement of its charter that all its loans be made to or guaranteed by a member government. CABEI was unwilling to seek such a guarantee from its members, for fear of creating a troublesome precedent for demands from other lenders. The WB sought to overcome the problem by offering loans to the several member countries, which would then buy CABEI bonds to finance projects agreed between CABEI and the WB; this was agreed in principle but the WB then concluded that Nicaragua and El Salvador were no longer creditworthy. It was suggested that CABEI might guarantee loans to its less creditworthy members, but if the latter are dubious risks, could CABEI itself qualify? So frustration ensued on both sides.

An approach to a solution that has been under discussion for several years is an expansion of the CABEI membership to include some countries interested in Central American development that

are stronger in the international economy than the present members. In 1983, the Board of Governors began actively seeking new members, and the WB undertook to canvass possibilities on their behalf. The present situation is as follows:

- Panama expressed interest early on. It is hardly an economic super-power but is a major regional financing center, uses the dollar as its currency and has access to foreign exchange. It was denied membership because it would not adhere to the CACM, but this is no longer a condition.

- Negotiations are under way with the European Community, subject to approval by the Council, to provide credit for small and medium-sized industries, the repayments to be recirculated or converted into a capital subscription.

- Mexico conceded a five-year credit at 8 percent interest to each Central American country for 20 percent of its annual oil bill, and if the country and Mexico could agree on development projects for that country, repayment of the loan was to be disbursed against those projects and repaid over a 20-year term at six percent; but so far no such projects have been identified, a reflection of bureaucratic rigidities in Mexico and in Central America. CABEI undertook to negotiate an alternative arrangement, and it was finally agreed that the oil-consuming countries will repay the 20 percent over five years while Mexico in turn will allow the proceeds to be used one-half to finance equipment and supplies imported from Mexico, 30 percent for local project costs and 20 percent to be sequestered and become eventually a Mexican subscription to CABEI capital--all to be administered by CABEI. The portions used for Mexican imports and local project costs will be lent for 15 years at 6 percent interest; the first tranche of this facility totals $70 million, $14 million attributable to an eventual capital payment.

- Parallel discussions have been proceeding with Venezuela, which had agreed to its Fondo de Inversion buying up to $40 million of CABEI bonds, half denominated in dollars, half in bolivares (but following devaluation of the bolivar the total was reduced to $24 million equivalent). It is now proposed that repayment on the bonds be earmarked for a Venezuelan membership

subscription to CABEI. Colombia and Argentina have also agreed to become members, the agreement to be formally confirmed by all three countries in the near future.

- The WB contacts have elicited encouraging responses from Canada and France, less clearly from some other European countries. Canada, in particular, has stressed that the U.S. should take the lead, in view of its much stronger economy, its leading Hemisphere role, and its declared vital interest in Central American development.

- The U.S. Government attitude on membership remains unclear. The Kissinger Commission, as part of its program of development support for the region, specifically urged that the U.S. join CABEI and

> "encourage other creditor countries to seek membership. The infusion of new resources would help invigorate the bank, which could channel much needed funds to small-scale entrepreneurs and farmers, provide working capital to existing private sector companies and encourage development of new industries. Again, U.S. membership in CABEI would benefit all members of the Common Market."6/

CABEI is also calling for payment by its existing members of a further tranche of their already subscribed capital, amounting to CA $50 million. This is expected to be forthcoming. It will help in some measure to improve the bank's liquidity position, but not to solve its major problem of foreign exchange stringency, since the payments will be in local currencies.

Aside from additional capital and membership gurantees, CABEI is seeking further long-term loans. It has two applications pending and scheduled for early action in the IDB, totalling about $100 million. The WB is willing to make a small pre

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6. Report of the NBCCA p. 50.

investment loan and would be favorably disposed toward a [illegible] larger funding if the guarantee creditworthiness problem see discussion above could be resolved. A number of potential projects are under consideration for [illegible] context and for housing urban development. The Germans are reportedly considering a small loan perhaps [illegible] awaiting CABEI's response to the Lazard Freres report and evidence of progress on its organizational reforms.

H. Other Questions

CABEI's financial troubles, reflecting in large part those of its member countries, are the most obvious signs of weakness. Even more fundamental of course is the problem of civil disorder in the region, which hampers every kind of economic development effort and deters both domestic initiatives and help from abroad for that purpose. It also gives rise to doubts as to the depth and consistency of some critical American government commitment to CABEI; there remains substantial evidence of such commitment, but because of their ample publicized disagreements on other matters, it needs to be demonstrated convincingly.

It is also widely accepted that CABEI's operational focus needs to change from that of the past--that it needs to shift in substantial measure from public sector infrastructure to promotion of private sector production, especially for extraregional export. Such a shift is called for by:

- The very high incidence of arrears on CABEI's present private sector loans
- The short-term necessity to get modern productive sectors functioning as quickly as possible where security conditions permit

[illegible]

[illegible]

[illegible] IADB [illegible] specialization [illegible] expertise [illegible] will especially be [illegible] with the problems of the private sector industrial [illegible] [illegible] staffed and the experience and expertise of the personnel that is in place also relates [illegible] IADB's capabilities [illegible] and dealing with the private [illegible] sector and the hard-headed appraisal and administration of private sector loans [illegible] substantially [illegible] This is possible [illegible] [illegible] the term stated.

In dealing [illegible] the private productive sectors both industry and agriculture [illegible] IADB should work in conjunction with selected national intermediaries, private or parastatal, in the several member countries. In some cases it might extend lines of credit to these institutions delegating to them attributes full responsibility for project appraisal and loan administration. In the classic pattern of IF lending, more often perhaps IADB would itself do most of the preparation and appraisal work for a lending program but finance it jointly with the local institution, leaving to the latter the major share of responsibility for supervision and [illegible] of individual loans. In this way IADB could economize on staff and field supervision, help choose wisely and continuously following and foster the local market development and vertical relations with IADB while using the

professional caliber and integrity of its staff to maximum advantage. It would also contribute, in the long run, to the regional integration objective.

I. Conclusions

The stagnation of Central American economic development has resulted from a combination of external factors (the oil shocks, mounting interest rates, declining investment, world trade and commodity prices, etc.) and, more directly, civil disturbances and national tensions within the region. Some of the former are apparently becoming less severe and it is hoped that the regional antagonisms will progressively moderate. Assuming the restoration of an atmosphere reasonably conducive to economic development, the foregoing discussion suggests the following conclusions:

- Central American integration remains a valid objective of economic policy, but the regional strategy should shift markedly from import substitution (especially through administrative fiat) to a more open economy encouraging competitive export production.

- CABEI can be an important and valuable instrument for implementing such a strategy through:

  - rehabilitation and reactivation of internationally competitive export-oriented industries

  - rehabilitation or heavy maintenance of deteriorated regional infrastructure

  - financing industrial projects or agricultural programs of regional scope

  - serving as a regional development finance institution, utilizing a second tier of national intermediaries to channel finance to private sector agriculture and industral development

  - intraregional and/or export trade credits

- other extraregional export promotion efforts
- bringing relatively balanced/pragmatic judgment and a certain acknowledged neutrality to help in the solving of sensitive economic/political issues.

o CABEI also could become a more credible and reliable channel for external financing to Central American economic development than the separate national entities, and hence could probably attract more such financing and apply it relatively efficiently.

o CABEI's financial viability will depend in substantial part on its attracting additional members/guarantors, of which the most important candidate is certainly the U.S. (If the U.S. joined there is little doubt that Canada and the EC, or some of its members, would follow).

The U.S. attitude may therefore be crucial, not only for CABEI as an institution but also for the prospects of channeling external funds efficiently into vital sectors of Central American economic development. Establishment of an effective alternative mechanism to do so, in the short term, is a doubtful possibility at best. The ideal solution, from CABEI's standpoint, would be for the U.S. to become a member, with all that implies.

If membership is impossible for broader U.S. policy reasons, a similar purpose might be accomplished, in substantial degree, by AID providing concessionary assistance to CABEI, on a quasi-equity basis such as a number of governments provided for their development banks in the 1950s and 1960s--subordinated to CABEI's other obligations. This would not entail participation in the guarantee of such obligations, like regular shareholders. However, it might be segregated as the nucleus of a special reserve fund to be administered by CABEI, which could serve as a guarantee for borrowings from private banking sources to expand that fund or for bond emissions; a leverage of 3 to 4 times the AID contribution might be envisaged. Access to loans from this

special fund might appropriately be restricted to countries which had concluded, and were fulfilling, satisfactory agreements to meet in full their obligations to CABEI.

IV. FINANCIAL ANALYSIS

A. Introduction

1. Objective

The objective was to analyze CABEI's current financial situation, identify key issues and assess the implications of the current situation in meeting the financial requirements of CABEI's strategic plans.

2. Scope of Work and Methodology

The scope of our work was to assess CABEI's present financial situation and prospects; assess its portfolio management situation and capabilities; specifically, analyze the problem loans situation and recovery prospects. In light of the results from the above: (a) assess the financial situation as a function of CABEI's medium and long term strategic posture, and (b) analyze and make recommendations on the means for strengthening CABEI's financial base for the medium and long run.

The methodology used was to review documentation, interview CABEI staff and others, and prepare a report.

3. Setting

The background of why CABEI is in difficulties is external and internal to the Central American region. World recession, regional political crisis, the breakdown of the Central American Common Market, the foreign debt crises of the CACM countries, and

the lack of dollar exchange in the region have contributed to a situation of liquidity crises and delinquencies.

Exacerbating the situation for CABEI was its inability to call up "callable" capital to cover unfunded loan commitments.

Into this situation came the Kissinger Commission Report recommending a stabilization program with massive economic assistance for Central America; and, in recognition of CABEI's important regional financial role. the participation of the U.S. and other outside nations in this institution. The implementing legislation resulting from these recommendations could be expected to have a very positive effect on the region's economies.

The current regional setting is one of incipient economic recovery being delayed by politics and debt service. There are bright spots in the decline of oil prices and interest rates. But the critical basis for the whole financial planning of CABEI is the political/economic environment. If the environment is conducive to peace and growth, then a program for the revitalization of CABEI makes sense.

B. Financial Analysis

A review of the Financial Statements indicates that liquid assets have declined absolutely and relatively over the years, continue to decline. and are barely adequate. Of the approximately $90 million in liquid assets, 20 percent are not available in cash. and less than half of the remainder, or $31 million, is available in hard currency for foreign debt services (Exhibits IV-1 and IV-2). CABEI's liquidity has declined from a two year

EXHIBIT IV-1

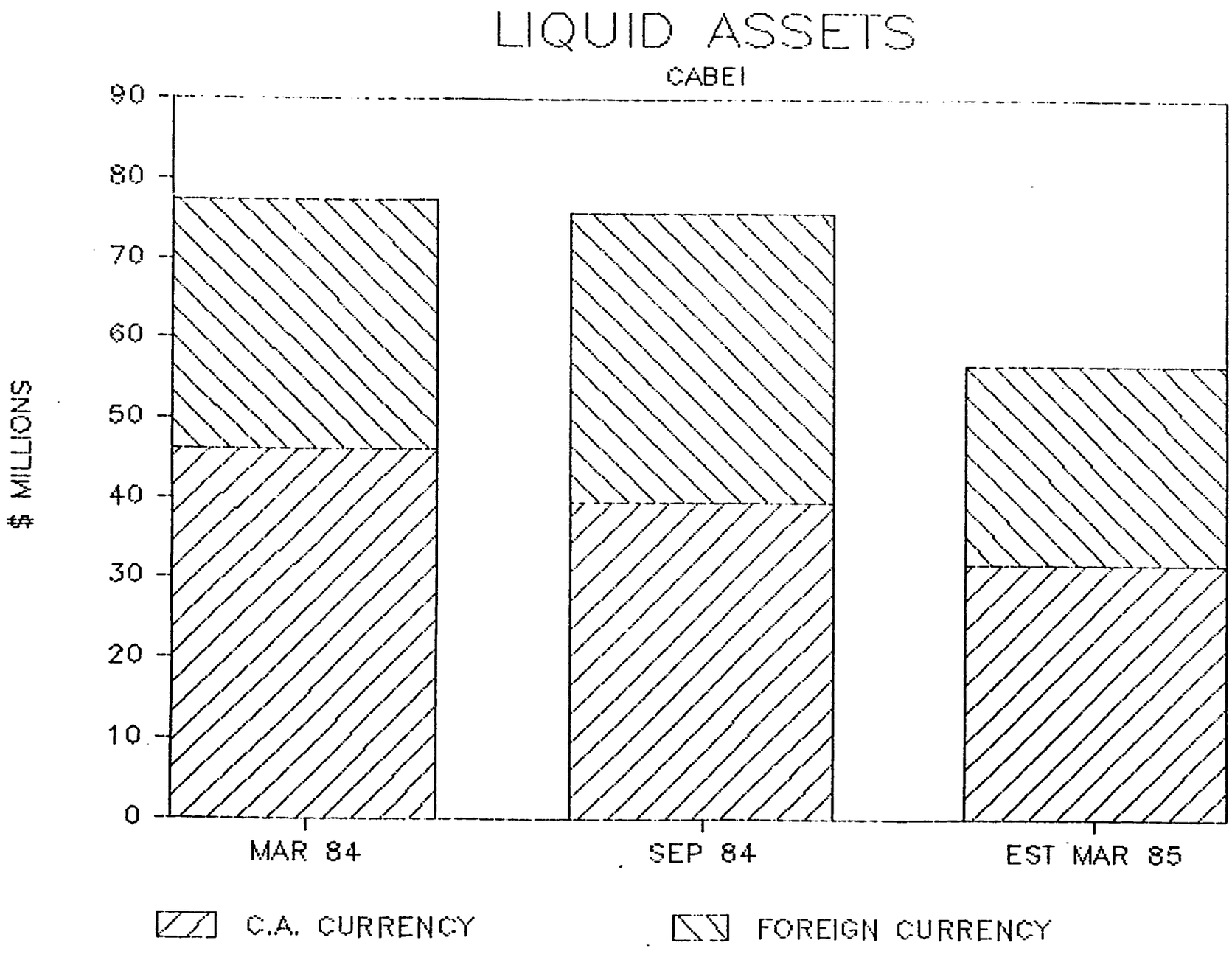
CABEI
LIQUID ASSETS

	MAR 84	SEP 84	EST. MAR 85
CASH (CA$ millions)	96.5	94.8	75.7
less: CENTRAL AMERICAN CURRENCIES	46.2	39.5	31.9
FOREIGN CURRENCIES	50.3	55.3	43.8
less: SPECIAL DEPOSITS	17.9	17.9	17.9
less: LONG TERM INVESTMENTS	1.2	1.2	1.2
NET LIQUID POSITION IN FOREIGN CURRENCY	31.2	36.2	24.7
TOTAL LIQUID ASSETS			
CENTRAL AMERICAN CURRENCY	46.2	39.5	31.9
FOREIGN (MAINLY U.S.) CURRENCY	31.2	36.2	24.7
	77.4	76.7	56.6

Sources: Lazard Freres. Diagnostic Report on CABEI's Financial Position, June 1984, pp. 10, 11.

CABEI, Internal Document: Profile for 1984, Oct. 15, 1984.

EXHIBIT IV-2



SOURCE Exhibit IV-1

coverage of debt service in 1980 to less than one year's coverage in 1984 (Exhibits IV-3 to IV-5); and projections show a further 20 percent deterioration from March 1984 to March 1985. If programmed disbursements are added, liquid assets cover only one-fifth of the total of undisbursed loans and debt payable. This is one half the coverage maintained by the IDB (Exhibits IV-6 and IV-7). Moreover, most regional banks tend to maintain liquid assets covering at least one half of total debt outstanding compared with CABEI's 15 percent coverage. The Bank's own goal of maintaining 30 percent of disbursements and debt repayment for the three subsequent years would require liquid assets of over $171 million, a figure that, even by its own projections, would not be reached until 1988.

All projections, whether by Lazard or CABEI, optimistic or pessimistic, show a net cash ouflow for the next year or two (Exhibits IV-8 and IV-9). These projections range from Lazard's pessimistic Scenario 2 of a $100 million net outflow in years 1985 and 1986 to CABEI's projection of a net outflow of $7 million for those years.

When only foreign currency flows are examined, the net outflows in the immediate years are less, due mainly on the Club Loan restructuring and to a lower proportion of disbursements in foreign currencies versus collections. But it is to be borne in mind that the Bank's funds are disbursed in foreign currencies to the member States which convert them to local currencies for investment generally in infrastructure not directly productive of foreign exchange. Thus, the ability of the States to generate foreign exchange from other activities governs their ability to satisfy the needs of CABEI for hard currency with which to repay its own borrowings.

EXHIBIT IV-3

LIQUID ASSETS, LOAN DISBURSEMENTS
AND
LONG TERM DEBT

(millions CA$)	LIQUID ASSETS AS OF 3/31/84	ANTICIPATED LOAN DISBURSEMENTS AS OF 6/30/84	ANTICIPATED LOAN REPAYMENTS TO 6/30/85	TOTAL LONG TERM DEBT OUTSTANDING AS OF 6/30/84
CENTRAL AMERICAN CURRENCY	46.2	63.5	10.0	27.8
FOREIGN CURRENCY	31.2	61.8	30.6	591.2
TOTAL LIQUID ASSETS	77.4	125.3	40.6	619.0

Source: Lazard Freres. Diagnostic Report on CABEI's Financial Position, June 1984. pg. 10

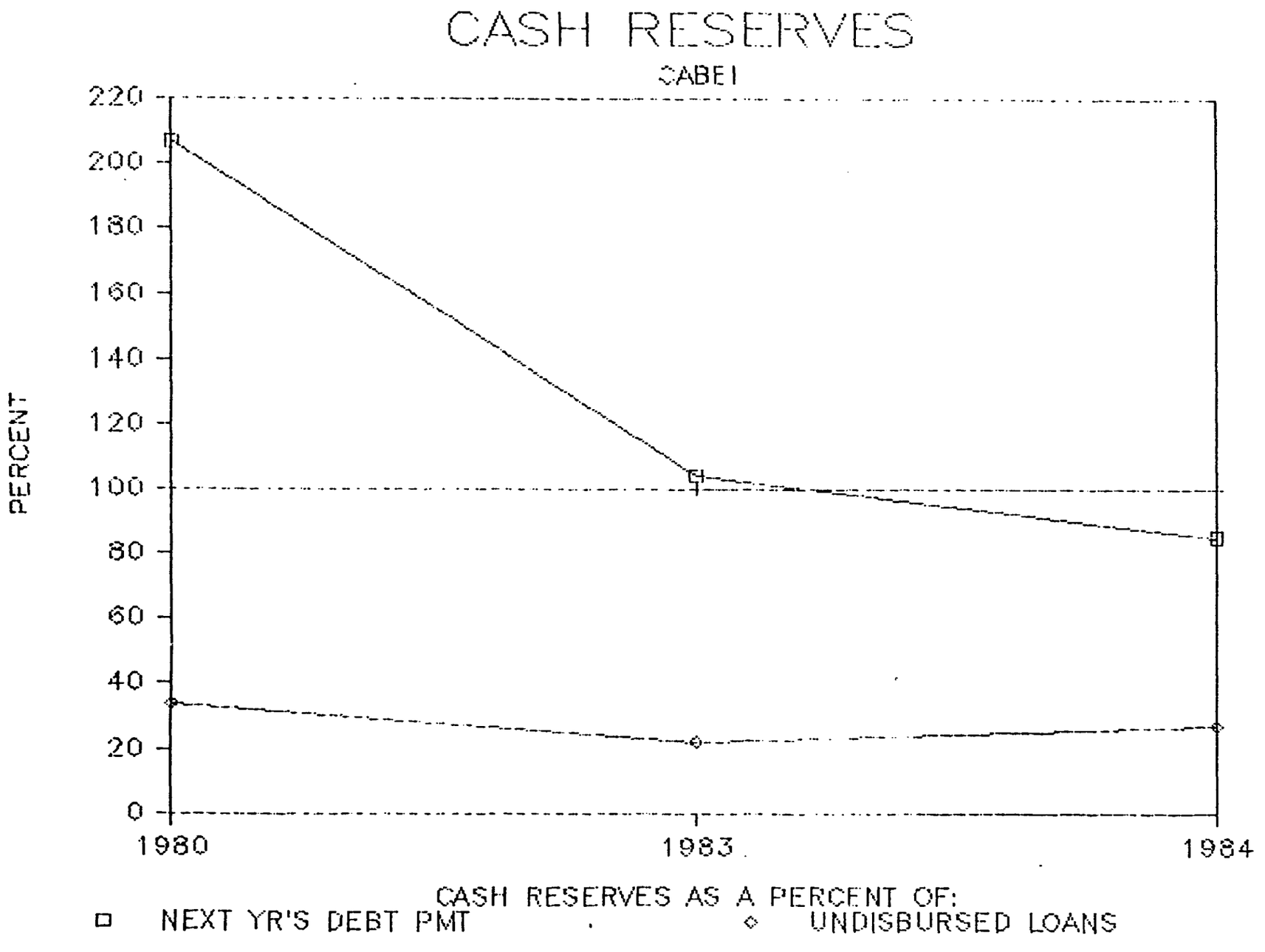
EXHIBIT IV-4

LIQUIDITY COVERAGE

LIQUIDITY AS A PERCENT OF:	1980	(YEAR END) 1983	1984
1. UNDISBURSED LOANS	34%	22%	27%
2. DEBT PAYABLE IN SUBSEQUENT YEAR	207%	104%	85%
3. UNDISBURSED LOANS AND DEBT PAYABLE (1.&2.)	29%	18%	21%
4. TOTAL LONG TERM DEBT	19%	15%	16%

Source: Lazard Freres, Diagnostic Report on CABEI's Financial Position, June 1984, p. 14.

EXHIBIT IV-5



SOURCE Exhibit IV-4

EXHIBIT IV-6

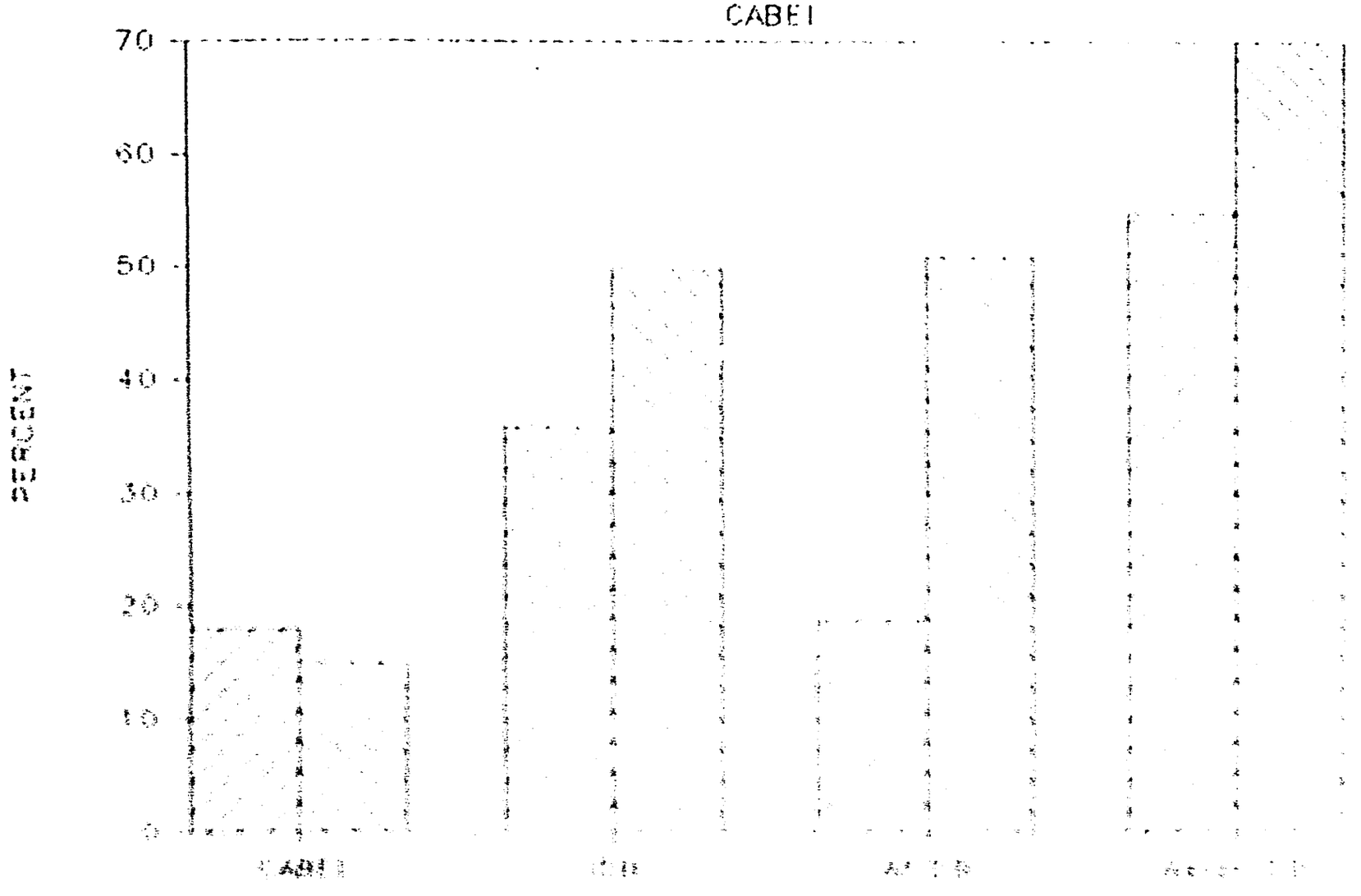
LIQUIDITY POSITION COMPARISONS

LIQUID ASSETS AS A PERCENT OF:	CABEI	IDB	AFRICAN DEV BANK	ASIAN DEV BANK
- UNDISBURSED LOANS & DEBT REPAYMENT	18	36	19	55
- TOTAL LONG TERM DEBT OUTSTANDING	15	50	51	70

Source: Lazard Freres, Diagnostic Report on CABEI's Financial Position, June 1984, p. 15.

EXHIBIT IV-7

LIQUIDITY COMPARISONS



SOURCE: [illegible]

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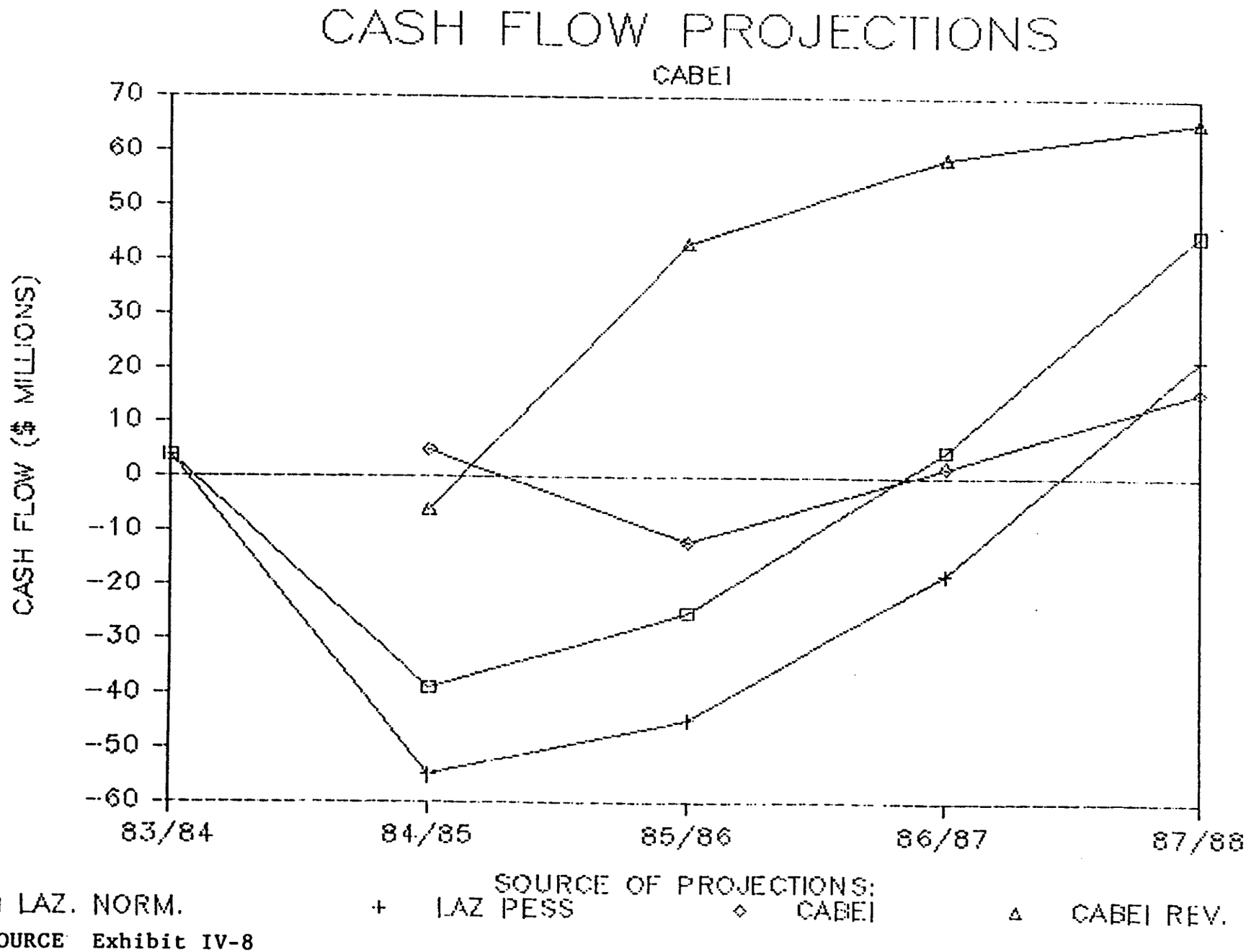
Source: Latard France [illegible] Report on Capital Financial Position, June [illegible] and Internal LABEL planning documents

EXHIBIT IV-9



SOURCE Exhibit IV-8

The projections agree, with minor variations, on the amount of collections expected from the portfolio. On the whole, the assumptions on portfolio collections are realistic; they assume little or nothing from Nicaragua in the early years, sharply scaled back receipts from the private sector portfolio, and a rescheduling of the amounts in arrears. Where they differ is in new financial resources and in disbursements. CABEI assumes that a $50 million capital call will be paid in 1985 and that $100 million in new financing will be obtained over the next two years; while Lazard omits the capital entirely and reduces new financing to $70 million. On the outflow side, CABEI assumes $75 million more in debt repayment in the next few years and $35 million less in loan disbursements.

Our own scenario would agree with the collection schedules but would spread the new capital receipts over three years and reduce even CABEI's more conservative loan disbursement schedule by $30 million over the next two years. Plugging these two assumptions into the Lazard and CABEI projections would show a net cash flow in 84/85 in the range of plus $8 million to minus $10 million; and for 85/86 a range from plus $2 million to plus $52 million.

In summary, under more optimistic scenarios, CABEI might see its liquidity further reduced but could continue operating at a slackened disbursement pace. But under more pessimistic assumptions, such as Scenario 2 of Lazard, even assuming that all of the liquid assets were fungible, they would be totally depleted over the next two years. And should another country, in addition to Nicaragua, become unable to service its debt, CABEI would be in a real cash bind.

But the Bank has some options: the first is to call for capital (in hard currency) from the member states. Second, it could simply cut off, reduce or postpone the $100 million to be disbursed over the next two years. Third, if absolutely necessary, it could request an extension on the maturity of a portion of its short term debt. But more likely, as events have been proving, it will be able to count on new financial resources of important magnitude, as will be discussed below (Section D.3).

Profit margins have been shrinking, with the 2 percent spread between interest rates paid and collected now only slightly higher than costs (1.83 percent), and return on investment is in steady decline. A charge to earnings to more realistically reflect recovery values of the private sector portfolio, as discussed further on, coupled with a stricter accounting treatment for accrued but uncollected interest could produce operating losses in the immediate term.

Delinquencies in the portfolio have more than doubled in three years to $109 million, or 13 percent of the portfolio. Of the arrears, 47 percent are private and 53 percent public. While the private sector is only 15 percent of the total portfolio, private sector arrears are almost half the private sector portfolio. Moreover, only 10 percent of the 80 private sector clients are said to be operating normally. The believed value and collectibility of the guarantees behind private sector loans may not be easily realized, as testified by the $21 million in "other assets" representing physical assets received through court action and still not disposed of. Nevertheless, private arrears seem to have peaked a few years ago, while public sector arrears continue to increase.

The capital base, while strong, at a relation of $1 for every $2 borrowed, due to the plowing back of earnings, nevertheless, has to be seen in relation to the asset portfolio, which is not throwing off dollars sufficient to meet debt service, and which may have to be adjusted downward as a charge to capital to cover uncollectible debt. The fact that callable capital does not represent the more or less automatic safety net which it does in other public institutions requires that a more sober view be taken of the strength of CABEI's capital base.

Regarding controls and procedures, the internal control and auditing system appears to be effective. A new and more responsive information system is in early stages of development which should provide when completed a useful mechanism for financial control and decision making. With regard to reserves, as the new asset rehabilitation unit comes to have a complete review and feel for each of the troubled private sector assets under its responsibility, it may wish to recommend additional loss reserves. A formula for both specific and general provisions against bad and doubtful loans should be defined. If the U.S. formula for commercial banks were used, 20 percent reserve for substandard loans and 50 percent for doubtful ones, the reserve figure might be $20-25 million vs. the current $10 million. It is noted that the Lazard report suggested much higher amounts. However, a spot check of some of the collateral and guarantees suggests that there are some real values behind the CABEI private sector loans. These are indeed troubled times for the region, but economic activity goes on and there are plenty of current examples of companies being rehabilitated and of assets changing hands for considerable sums.

Also with regard to the Lazard report, and with all due respect, we believe that the sovereign risks represented by the

member states, which incidentally each own a proportionate share of the value represented by the considerable net worth of CABEI, need not be reserved against. Unless and until a member state refuses to pay, this policy should be maintained. Finally, with regard to accounting policy and procedure, it may be more realistic to account for maintenance expenses, on assets seized for non-payment, by a charge to earnings rather than adding it to the value of the asset. Also, on the subject of accounting procedures, CABEI should consider putting items on non-accrual, after 90 days, rather than the 180 days which has been the policy heretofore.

C. Summary of Findings

CABEI is not in unsurmountable trouble. But the symptoms of what can become large problems affecting the very fate of the bank are present. Liquidity is a deepening concern. The erosion of profitability is another. The large arrears in the portfolio, which so impact the cash position, require strong, immediate action to stem the deteriorating trend in the public sector portfolio and to reduce loss in the private sector part. Capital sufficiency is questionable, particularly so if new borrowings are to be realized. Also to be reviewed are those accounting procedures which tend to mask the real extent of the problems in the portfolio and their effect on CABEI's financial condition.

D. Key Financial Issues

1. Liquidity

Maintaining liquidity is a key issue. The background of the mini-crisis in February, which resulted in the Club Loan of $128 million, arose mainly because foreign credit was cut off just

when it was needed to fill the gap caused by declining portfolio recuperations. But it also had its origin in the policy of approving loans (to save time and carrying costs) before nailing down the funding.

Given the conditions in Central America, it would seem that the Bank ought to err on the side of conservatism and maintain sufficient cash to cover at least two years of debt service and operating costs, or upwards of $200 million. Actually, taking into account "special deposits" and other blocked currencies of one sort or another, the Bank has been operating with less than $50 million. The risk in maintaining such a low cash position is that, as a result of outside forces, CABEI could be thrust into a position, momentarily, of being incapable of servicing its debt. Moreover, it would then have to practice crisis management which is a poor way to manage assets for optimum return. The fact that the Bank deals in so many currencies in addition to dollars, many of which fluctuate widely in relation to the dollar, greatly complicates the task.

What must be done, of course, is to continue to cut cash outflows, both in terms of loan disbursements and expenses, and increase revenues by boosting recuperations, improving cash management, and obtaining additional funding. A last resort would be to seek a rescheduling.

2. Portfolio Recuperation

Portfolio recuperation is also a key to CABEI's well-being. A series of good starts has been made: setting up a department to manage private sector loan rehabilitation, reporting directly to the Executive Vice President; classifying the borrowers into categories according to the degree of problem represented; and

negotiating a potentially very useful technical service arrangement with the World Bank to obtain help in debt collection. But much more is required. Stronger collection management of the public sector, with top level support, is necessary. While it may be argued that the member countries know their own bank, they also know they cannot get much more out of it, but can get more funds out of the other international agencies and therefore, give priority to their debt repayment. The fact is that the members' debts to CABEI represent only 5 percent of their total debt, hardly significant enough to stand in the way of meeting their commitments.

With regard to private sector debt, CABEI simply lacks the resources to engage in serious rehabilitation and or liquidation efforts. This is a work for experts with the experience and know-how to appraise business situations and set about making them well or disposing of them. Fortunately, there exist in Central America (and Mexico) people and organizations with experience in rehabilitating companies and recuperating investments.

3. Obtaining New Resources

While cutting disbursements and maximizing recuperations is one side of the coin, the other side is obtaining new resources. The proposal to call on the shareholders to pay in an additional amount of $50 million should be pushed forward. This is an absolute necessity not only to bolster capital but as a first step in obtaining resources from others inside and outside the region. Several promising initiatives are being pursued to obtain outside shareholders, among the most promising of which is with Mexico which has promised to make available to CABEI 20 percent of its Central American oil revenue bill and to leave a

portion for eventual participation in CABEI's capital. Additional promises are from Europe, Canada, Venezuela and Colombia. With additional callable capital as well as capital from outside the troubled region, CABEI would be in a position to negotiate additional borrowings from the international financial community.

An important key to securing these capital participations will be the presence of the United States. We understand that AID is considering providing new assistance to CABEI. If such assistance can be used to leverage other borrowings, it would be truly significant. If it proves unrealistic for this assistance to come in the form of equity (via membership) but it still comes in as quasi-equity (say as a long term loan at concessionary rates and subordinated to other debt), it might be used in some sort of sinking fund, possibly in conjunction with contributions from the member states, to serve as a guarantee for borrowings from commercial financial institutions or bond emissions. In this way, the AID funds might be leveraged, possibly as much as 3 or 4 to 1. On the other hand, it is doubtful that commercial banks would be pursuaded to increase their exposure in the region, especially through CABEI, without some sort of guarantee mechanism based on financial resources from outside the area.

Among other efforts being considered and/or pursued (See Exhibit IV-10) are those with the Inter-american Development Bank and finally with the World Bank. The kinds and amounts of loans sought from these agencies are interesting and encouraging. Also encouraging are initiatives to capture funds from Central Americans--flight capital and "under-the-mattress" money.

The sinking fund mechanism, noted above, might prove to be an attractive guarantee with the debt instruments in bearer form, denominated in U.S. dollars and carrying a "higher than Miami"

RECEIVED
24 OCT 1984
CONSULTATION

GESTIONES DE CONSECUCION DE RECURSOS

Inventario Preliminar

No.	Fuente	Programa	Monto (Millones $)	Estado Actual	Acciones Pendientes
1.	GESTIONES PARA CORTO PLAZO				
1.01	BID	Preinversión	15.0	Solicitud Presentada (F-82) Misión Análisis Realizada	Aprobación Préstamo por BID Seguimiento de Acciones
1.02	BID	Rehabilitación de Carreteras	80.0	Solicitud Presentada (A-84) Pendiente Misión Análisis	Completar Estudios Proyectos Promover Misión Análisis BID
1.03	CEE	Reactivación Industrial (PMI)	12.0	Negociaciones en Curso Misión Análisis Realizada	Aprobación Préstamo por CEE Seguimiento de Acciones
1.04	AID/ESF	Reactivación Industrial (PMI)	12.0	Negociaciones en Curso Pendiente Posición AID	Preparar Documento-Programa Seguimiento de Acciones
1.05	AID	Reactivación Industrial	15.0	Solicitud en Preparación Pendiente Posición AID	Completar Documento-Soporte Seguimiento de Acciones
1.06	AID	Agroempresas Rurales	20.0	Solicitud en Preparación Pendiente Posición AID	Completar Documento-Soporte Seguimiento de Acciones
1.07	MEXICO	Varios Proyectos	70.0	Negociaciones Completadas Pendiente Aprobación Méx.	Aprobación Préstamo México Identificación de Proyectos
1.08	ALEMANIA	Varios Proyectos	10.0	Gestiones Preliminares Próxima Misión Análisis	Continuación Negociaciones Identificación de Proyectos
1.09	JAPON	Telecomunicaciones	50.0	Negociaciones en Curso Falta Definir Proyectos	Definición Final Proyectos Seguimiento de Acciones
1.10	CIV's	Varios Proyectos	10.0	Gestiones con Bancos Centr. Preparación Plan Promoción	Concretar Negociaciones Colocación de los CIV's
2.	GESTIONES PARA MEDIANO PLAZO				
2.01	BID	Desarrollo Social	25.0	Solicitud Presentada (M-81) Pendiente Posición BID	Obtener Posición del BID Reformulación Programa
2.02	BID	Agroempresas Rurales	30.0	Solicitud Presentada (A-83) Pendiente Posición BID	Obtener Posición del BID Reformulación Programa
2.03	BID	Ampliación Red Vial C.A.	60.0	Indagatoria Preliminar Documento en Preparación	Completar Documento-Programa Iniciar Gestiones ante BID
2.04	AID	Vivienda/Desarrollo Urbano	40.0	Gestiones Preliminares Pendiente Documentación	Completar Documento-Programa Presentar Solicitud a AID
2.05	BIRF	Varios Programas	65.0	Negociaciones en Curso Pendiente Arreglo Jurídico	Resolver Problema Jurídico Continuar Negociaciones
2.06	VENEZUELA	Varios Programas	24.0	Contactos Preliminares Pendiente Inicio Gestiones	Preparación Plan de Acción Iniciar Gestiones Formales
2.07	CEE	Varios Programas	38.0	Gestiones Preliminares Pendiente Posición CEE	Preparación Plan de Acción Iniciar Gestiones Formales
2.08	PROVEEDORES	Varios Proyectos	20.0	Inventario de Proveedores Inventario de Proyectos	Definir Posibles Gestiones Iniciar Negociaciones
2.09	FRANCIA	Varios Proyectos	5.0	Gestiones Preliminares Pendiente Negociaciones	Preparación Plan de Acción Iniciar Negociaciones
2.10	BONOS/VALORES	Varios Proyectos	40.0	Realización Estudios Preparación Esquemas	Preparación Plan de Acción Iniciar Negociaciones Países
2.11	CAPITAL ESTE	Varios Programas	50.0	Preparación Plan de Acción Estudio de Requerimientos	Realizar Gestiones Políticas Realizar Llamamiento Capital
2.12	SOCIOS EXTRA-REGIONALES	Varios Programas	60.0	Preparación de Estudios Gestiones Preliminares	Completar Estudios y Esquemas Iniciar Negociaciones Formales

LPL
24-10-84

EXPECTATIVAS DE CAPTACION DE RECURSOS FINANCIEROS

Estimación Preliminar

No.	Fuente	Programa	Monto	1-85	2-85	3-85	4-85	1-86	2-86	3-86	4-86	1-87	2-87	3-87	4-87
1.01	BID	Preinversión	15.0	-	15	-	-	-	-	-	-	-	-	-	-
1.02	BID	Rehabilitación Vial	80.0	-	-	-	-	80	-	-	-	-	-	-	-
1.03	CEE	React.Industr.(PMI)	12.0	-	12	-	-	-	-	-	-	-	-	-	-
1.04	AID/ESF	React.Industr.(PMI)	12.0	-	12	-	-	-	-	-	-	-	-	-	-
1.05	AID	React.Industrial	15.0	-	-	-	15	-	-	-	-	-	-	-	-
1.06	AID	Agroempresas Rurales	20.0	-	-	-	20	-	-	-	-	-	-	-	-
1.07	MEXICO	Varios Proyectos	70.0	70	-	-	-	-	-	-	-	-	-	-	-
1.08	ALEMANIA	Varios Proyectos	10.0	-	10	-	-	-	-	-	-	-	-	-	-
1.09	JAPON	Telecomunicaciones	50.0	-	-	50	-	-	-	-	-	-	-	-	-
1.10	CIV's	Varios Proyectos	10.0	-	10	-	-	-	-	-	-	-	-	-	-
Sub-Total			294.0	70	49	50	45	80	-	-	-	-	-	-	-
2.01	BID	Desarrollo Social	25.0	-	-	-	-	-	-	-	-	25	-	-	-
2.02	BID	Agroempresas Rurales	30.0	-	-	-	-	-	-	-	-	30	-	-	-
2.03	BID	Ampl. Red Vial C.A.	60.0	-	-	-	-	-	-	-	-	-	60	-	-
2.04	AID	Vivienda/Des.Urnano	40.0	-	-	-	-	-	-	40	-	-	-	-	-
2.05	BIRF	Varios Programas	65.0	-	-	-	-	-	-	-	-	-	-	-	65
2.06	VENEZUELA	Varios Proyectos	24.0	-	-	-	-	-	-	24	-	-	-	-	-
2.07	CEE	Varios Programas	38.0	-	-	-	-	-	-	-	38	-	-	-	-
2.08	PROVEEDORES	Varios Proyectos	20.0	-	-	-	-	20	-	-	-	-	-	-	-
2.09	FRANCIA	Varios Proyectos	5.0	-	-	-	5	-	-	-	-	-	-	-	-
2.10	BONOS BCIE	Varios Proyectos	40.0	-	-	-	-	-	-	-	40	-	-	-	-
2.11	CAPITAL	Varios Proyectos	50.0	-	-	-	-	-	50	-	-	-	-	-	-
2.12	SOCIOS EXT.	Varios Proyectos	60.0	-	-	-	-	-	-	-	-	-	-	60	-
Sub-Total			457.0	-	-	-	5	20	50	64	78	55	60	60	65
TOTAL			751.0	70	49	50	50	100	50	64	78	55	60	60	65

interest rate. While the main thrust of activities should be for CABEI to continue to put its house in order and to make itself stronger from within, a sustained effort should be made at the same time to attract additional external resources, because there is considerable interest abroad in helping CABEI fulfill its role as the region's central development financing institution.

4. Nicaragua

Nicaragua represents a special situation. On the one hand it accounts for 65 percent of the public sector arrears, and while payment plans have been made on three different occasions, they have not been honored. On occasion, Nicaragua has blocked important regional projects (e.g., a submarine cable). Yet lacking financial resources, especially U.S. dollars, it really needs CABEI. For its part, CABEI needs to get its money back from Nicaragua and, due to its regional focus, has to include Nicaragua in many of its programs. Because Nicaragua needs CABEI and has to remain on friendly trading terms with at least some of the member states, there is a basis for believing that a deal can be reached between CABEI and Nicaragua. It will have to be a special deal which recognizes Nicaragua's inability to pay much in the immediate future, and be handled in such a way that it does not become a precedent for the other CACM countries.

With regard to U.S. financing, a U.S. stipulation that none of its financing benefit Nicaragua could impede CABEI's recovery. The U.S. financing package must be structured to deal with this situation.

5. Financial Planning and Management

Many people in Department of Planning and the Financial Gerencia are new in their posts and will be acclimating while the new organization is evolving. Nevertheless, there appears to be some very able people in key jobs who should be able to handle the responsibilities of obtaining and controlling new financial resources. An important task will be to try to maximize the utility and return on the various currencies which CABEI has on deposit in the region. The $16 million deposited in the Nicaraguan Central Bank is one example. In addition, the $18.9 million 30 year loan at 17 percent, whose first principal repayment is not until 1992, ought to be carefully reviewed as to its terms, in order to seek a basis for revision of the rate. Essential to the effectiveness of these efforts will be strong guidance from the top under well laid policies and plans which include a program and assignments for maximizing cash availabilities, and for regular debt collection and follow-up, not simply on loans in arrears, but to prevent laxity.

6. Summary

The liquidity concerns require that stronger efforts be made to reduce outlays, increase recuperations, and tighten collections. The member states have to be made to pay their bills. While not much can be expected from Nicaragua, arrangements should be made for an orderly, regular pay down, even if stretched out. The various plans for obtaining new resources should be pursued apace. Senior management must exercise strong leadership to see that the above initiatives are carried through.

E. Conclusions and Recommendations

CABEI has a unique role to play as the region's principal financial institution. It can and should overcome its liquidity squeeze. Given the current regional and internal situation, CABEI should concentrate on improving its financial stability before expanding its lending activities. Strong top management is essential to this task.

In developing strategies for the future, CABEI should consider directing the thrust of its financing towards export or export-supporting activities to generate dollars, thus improving the payback abilities of its clients. At the same time, it also ought to review, in general terms, how best to serve the private sector and should consider being more of a second tier lender, working through development financial institutions in the region or co-participating with them. It might even consider taking an equity position in investment or venture capital companies which are privately controlled and operated.

CABEI should also seek additional resources. The base for attracting outside support must be provided by the member states supporting their own commitments to CABEI. High level representations should be made in the member countries to secure the $50 million capital contribution and to persuade them to treat payment of their debt to CABEI with the same priority as their debt to the World Bank and the Interamerican Development Bank.

U.S. support is critical to attracting additional external resources to continue CABEI's regional development role. The U.S. participation should be quasi-equity, long term, at concessional rates, and subordinated to other debts. It could be used

In some sinking fund form to attract extraordinary support, thus leveraging these funds.

Top priority should be given to working out with Nicaragua a resumption of debt repayment.

Portfolio collection is the key to CAFTI's viability. The private sector loans which are in difficulty or under judicial collection should be contracted out to professionals who could manage their rehabilitation, collection or liquidation. This might first be tried on a pilot basis with a selection of loans, and in a separate package with properties executed for non-payment. Experience will determine how such a program might be best developed. Collection of the public sector portfolio, as mentioned above, should be a special concern of CAFTI's senior administration.

V. ORGANIZATION AND MANAGEMENT ANALYSIS

A. Introduction

1. Purpose

The purpose of this section is to carry out a general analysis of the organizational structure and management of the Bank in order to identify areas for improvement and to recommend adjustments to CABEI's senior management.

2. Scope of Analysis

a. Review and assess the current organizational structure and management situation; review the impact of the 1984 reorganization; relate this assessment to CABEI's operational requirements in carrying out its medium- and long-term strategies

b. Evaluate the Bank's management information system with emphasis on its financial management, reporting and control systems

c. Assess internal coordination/communications practices

d. Review loan application, appraisal authorization and supervision practices

e. Review personnel selection, staff utilization and training practices

B. Background

1. Principal Organization and Management Problems Identified in Previous Studies

In recent years, a number of special studies have reviewed various aspects of CABEI's organization, management, operations, finance and overall performance.

We have reviewed a number of these studies which have identified certain organizational and management problem areas. These include a:

- Need to strengthen planning and programming functions and give these increased status in the organizational hierarchy
- Need to reduce the number of executives reporting to President and Executive Vice President
- Need for expanded information flow and coordination throughout Bank
- Need for a modern management information system and subsystems covering requirements for all users
- Need for a modern, automated financial management, reporting and control system
- Need for improved personnel selection, staffing and training programs
- Need for organization and methods staff, associated with systems unit, to conduct continous evaluation of organization and procedures to rationalize operations
- Need for design/implementation of operational procedures to reduce paper work, speed up loan processing, approval and supervision
- Need to improve Bank's external image as an operationally efficient financial institution offering distinctive, competitive services to clients
- Need to clarify definition of functions between units; delegation of responsibilities and authorities
- Need to streamline internal action/decision-making process
- Need to establish specialized unit to assist rehabilitation of private sector portfolio

C. The 1984 Reorganization Process

1. Origins

The Bank maintained its original organizational structure, with only modest changes, until 1976 when a major reorganization was undertaken. (See Exhibit V-1 for organizational structure 1976-84.) Its basic objective was to adapt the organizational structure to serve better the requirements of its planned medium and long term strategies and to accomodate the growth in its operations.

Over the past year, both the World Bank and the Inter-American Development Bank have held discussions with the Bank concerning improvement in organization and management practices. Senior bank management has understood well the need for a comprehensive reorganization effort. Both these institutions offered to finance technical assistance services for the Bank for this purpose. These offers were left pending until the Bank could undertake its 1984 reorganization. At the same time, the increasingly serious financial problems of the Bank made it more urgent to take action to reduce its staff and trim its operating expenses.

From these origins emerged the decision of the Board of Directors in February 1984 to undertake a major reorganization.

2. Reorganization Objectives

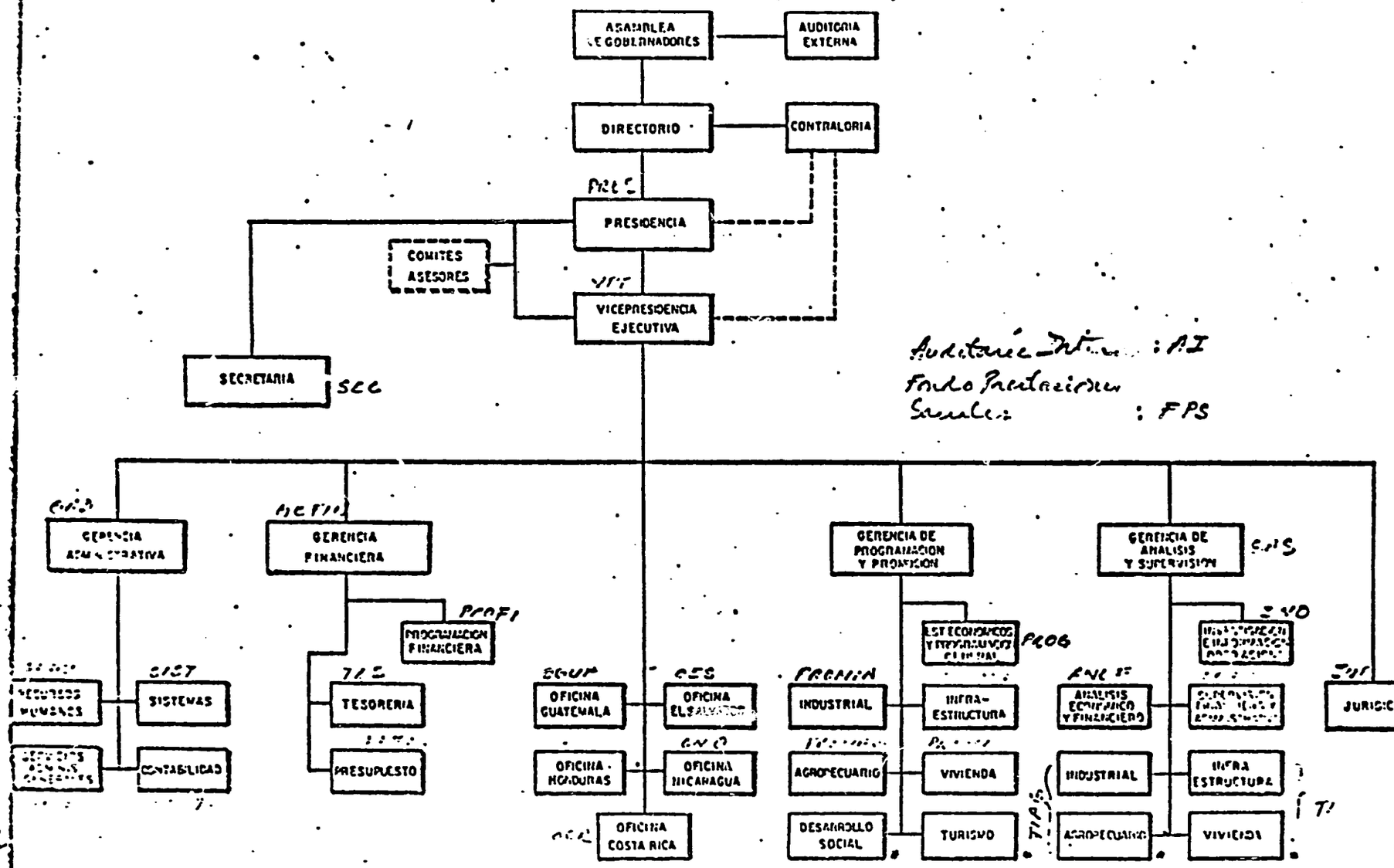
The principal objectives of the 1984 reorganization process were:

- To promote efficiency and effectiveness in the management of bank operations

Exhibit V-1

ORGANIGRAMA ESTRUCTURAL DEL BCIE

APROBADO POR EL DIRECTORIO EN SESION Nº 601
DEL DIA 12 DE FEBRERO DE 1976 (Actualizado)



- To develop more effective stategies and mechanisms for obtaining new financial resources to ease the liquidity crisis and permit a resumption of lending
- Development of procedures to identify and promote selected development projects in both public and private sectors which are in accordance with stricter lending criteria and policies in order to improve project quality and minimize risks
- To upgrade and improve the Bank's strategic and operational planning function
- To improve internal coordination and communications
- To organize a special unit to plan and manage the rehabilitation of the Bank's delinquent private sector portfolio
- To reduce administrative, particularly personnel, costs
- To move experienced Bank staff into different senior and middle-level managment positions than they previously occupied
- To reflect a more dynamic and revitalized external image

3. Reorganization Process

Reorganization planning was undertaken by a small group of senior executives supported by a technical staff. The President and the Executive Vice President directed the process.

In planning the reorganization, the Bank did not utilize outside professional consulting services. When the reorganization was finally implemented in October 1984, there was no organizational document distributed to staff for its orientation. Such a document could have explained the concepts, rationale and objectives of the reorganization to better meet the Bank's revised goals and stategies. In announcing the reorganization, senior management stressed that an organizational reform

"process" was under way which would be continually evaluated and revised where necessary. Bank officials indicated that an initial evaluation of the reorganization process would be undertaken in January 1985, or after about three months of implementation experience.

An initial organization chart was distributed to senior executives and finally approved by the Board of Directors on February 25, 1984 (see Exhibit V-2). This initial organization chart was extensively discussed within the Bank. The Board of Directors actively participated in adjusting and refining the reorganization design. On the basis of guidelines set down by the Board and the Presidency. the technical staff undertook special studies including preparation of new organizational and operational procedures manuals.

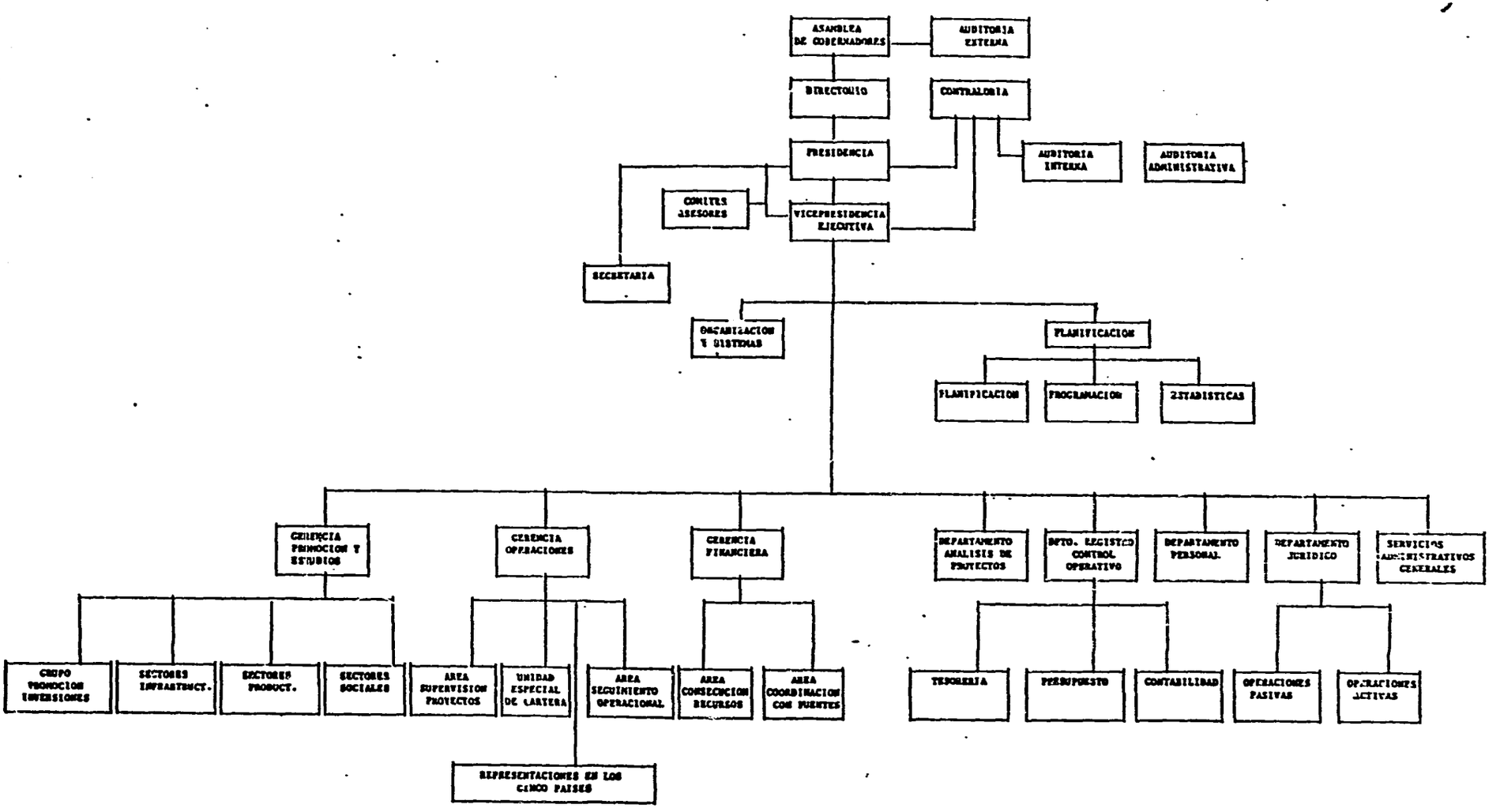
On July 17, 1984, the Board of Directors approved a new version of the reorganization chart--(See Exhibit V-3).

During the period February through September of 1984, a special workforce reduction occurred affecting both professional and administrative personnel with the result that, approximately 90 persons retired or otherwise left the Bank. A generous incentive retirement program was announced. Personnel of retirement age but considered by senior management to be valuable to Bank operations were invited to remain on duty.

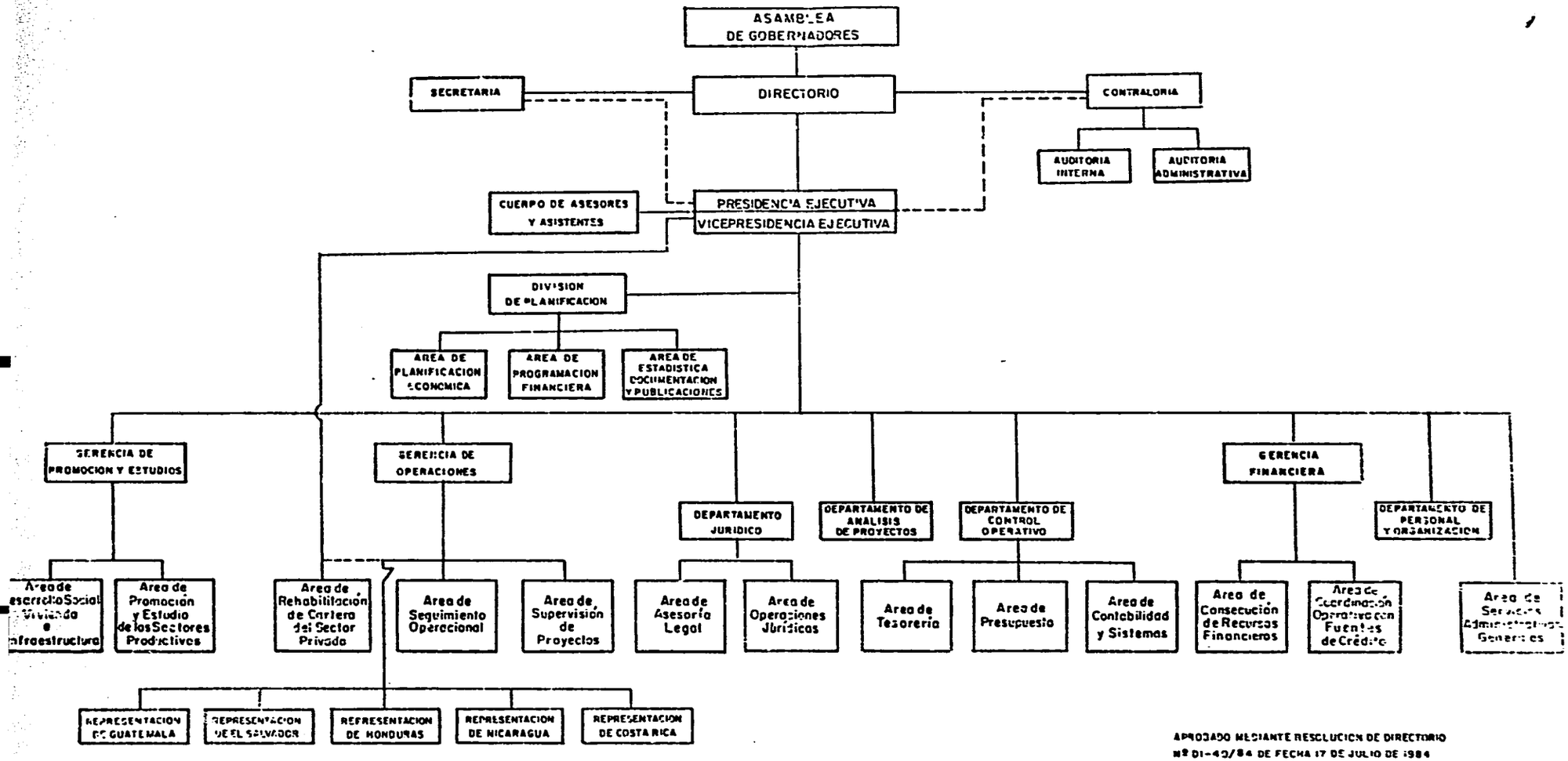
On October 1, 1984, after the workforce reduction was completed, the reorganization approved in July 1984 was officially implemented. Most of the senior and middle level manager positions are currently being filled by experienced Bank personnel who previously occupied different positions. As a result, most had only been in their jobs about three weeks when our Project Team interviewed them.

Exhibit V-2

ESQUEMA PRELIMINAR
ORGANIGRAMA ESTRUCTURAL DEL BCIE
Aprob / el Directorio en Sesion No. 1081 del
25 de febrero de 1984



GRAFICA GENERAL DE ORGANIZACION



APROBADO MEDIANTE RESOLUCION DE DIRECTORIO
Nº DI-40/84 DE FECHA 17 DE JULIO DE 1984
Y MODIFICADO POR ACDI-82/84

4. Principal Features of the 1984 Reorganization

The principal features of the new organizational structure are as follows:

a. The Financial Gerencia

The functions of the Financial Gerencia were modified to concentrate on seeking out and obtaining increased financial resources. The accounting, systems, budgeting and treasury functions were placed in a separate Department of Operational Control reporting directly to the Executive Vice President. The new Financial Gerencia is composed of two supporting units:

- The Area for Resource Development (Consecucion de Recursos)
- The Area for Coordination with Credit Sources

The rationale for these changes is to focus the energies of the Financial Gerencia exclusively on establishing the Bank's credit reputation in major capital markets and obtaining new financial resources. This change reflects a clear response to the Bank's current financial crisis and its current difficulties in obtaining new resources.

b. Promotion and Studies Gerencia

A new Promotion and Studies Gerencia is established composed of two areas: one for social development, housing and public sector infrastructure; and the other for promotion of productive sector investments. This Gerencia is basically structured out of the old Gerencia for Programming and Promotion

The organizational objective here is to reorient the process of identifying and selecting development projects from one of responding to requests to one of actively targeting and promoting projects meeting revised strategic planning priorities. It is hoped that this new orientation will help improve the quality of the loan portfolio and reduce risks.

c. Operations Gerencia

An Operations Gerencia is created to direct the loan project monitoring process and to supervise the Bank's loan portfolio. This Gerencia is composed of three areas:

- The Area for Rehabilitation of the Private Sector Portfolio. This unit is administratively attached to the Operations Gerencia but functionally will report to the Executive Vice President-reflecting the need for senior management attention for this priority area. The creation of this unit was recommended by the World Bank to ensure effective management of the effort to resuscitate the delinquent private sector portfolio.

- The Area of Monitoring (Seguimiento) is responsible for monitoring and controlling the processing of loan applications prior to their formal approval.

- The Area of Project Supervision responsible for portfolio management and control, contacts with clients and for supervising loan projects from start through final debt payments.

d. Department of Planning

The Department of Planning was established to strengthen and give increased hierarchial status to the Bank's strategic and operational planning unit. This unit was formerly located in the old Programming and Promotion Gerencia. The newly created department reports directly to the Executive Vice President and is composed of three areas:

- Economic planning
- Financial programming
- Statistics, documentation and publications

The department undertakes operational/financial programming for the Bank. It prepares annual operational plans describing financial resource requirements by sector, program and project and indicating the desired borrowing terms and conditions. This annual operational plan provides guidance to the Financial Gerencia in obtaining required resources for financing approved projects. The Department is also responsible for analysis of the development situation and economic trends in the countries of the region. It prepares short and medium-term financial projections of cash flow.

e. Coordinating Committees

To improve internal coordination, four new coordination committees have been established. These committees involve the participation of the President, the Executive Vice President and senior executives of key organizational units. There is an awareness in the Bank of the need to improve both horizontal as well as vertical information flows and coordination practices.

The new coordinating committees are:

- The General Coordination Committee The Executive Vice President uses this committee to interact with senior executives on policy and operational matters.
- The Planning Coordination Committe is responsible for coordination and advising senior management on the design of policies, strategies, plans and programs of the Bank.

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- The Credit Coordination Committee is responsible for advising senior management on credit policies, standards and operations.

- The Financial Coordination Committee is responsible for review and approval of all major financial policies and operations, particularly in respect to obtaining new financial resources.

The General, Planning and Credit Coordination Committees have advisory responsibilities. The Financial Coordination Committee is the only one with executive (decision-making) authority.

f. Department of Project Analysis

This department has responsibility for appraising loan projects in both the public and private sectors. It used to be part of the old Analysis and Supervision Gerencia. Under the reorganization, it was made independent reporting directly to the Executive Vice President. The rationale for this change is reportedly to avoid potential conflicts of interest which might arise where the unit which appraises a project is located in the same gerencia responsible for supervising it.

g. Department of Operational Control

This new department is responsible for financial management and control of Bank resources. It reports directly to the Executive Vice President. It combines the treasury. budgeting, accounting and systems functions. In the previous organization, accounting and systems formed part of the Administrative Gerencia. The treasury, financial programming and budget function were in a separate Financial Gerencia. This new department was set up separately from the Financial Gerencia to ensure that financial operations and control did not divert attention of the Gerencia from the priority of financial resource procurement.

Since the highest current priority for systems development is the design and installation of a modernized accounting system, the Bank's systems unit has now been combined with the accounting area.

h. Department of Personnel and Organization

With the disappearance of the old Administrative Gerencia, the Personnel Department has now been functionally combined with the Organization and Methods unit. The new department reports directly to the Executive Vice President. The Organization and Methods unit had no staff on duty as of the time of the Team's visit.

i. Relationship between the President and the Board of Directors

In 1982, prior to the recent reorganization, the role of the President on the Board of Directors was modified. While he previously was an ex-officio voting member of the Board, a change was made in 1982 to make him a non-voting member.

5. Current Status of the Reorganization Process

The 1984 reorganization was formally activated on October 1, 1984.

The current status of the reorganization is as follows:

- The majority of heads of organizational units are new in their jobs although most are career Bank employees who have worked in other positions and are experienced in a variety of operational activity.

- The Bank is planning to recruit outside to fill vacancies in its new organization particularly in the Audit, Systems, Organization and Methods, and Personnel Departments. In addition, it is recruiting a small staff for the Area for the Rehabilitation of the Private Sector Portfolio.

- Since most executives are new in their jobs, they are currently in the process of organizing their staffs, reviewing their functional responsibilities, coordinating and establishing their relationships with other units.

D. Key Findings and Recommendations

In this section, we present the results of our analysis of the organization and management of CABEI.

We have organized this section so as to combine our findings and recommendations relating to specific organization and management areas as follows:

1. General Findings
2. Specific Findings and Recommendations
   a. Organizational Structure
   b. Management Policies and Practices
   c. Management Information Systems
   d. Loan Promotion, Approval and Operations
   e. Personnel and Training
   f. Coordination and Communications

1. General Findings

- The Bank has certain organization/management problems which impair its operational efficiency and detract from its external image. Some of the key problem areas include:

- Lack of an automated management information system and particularly an effective financial information and reporting system

- A need to improve its external image as an agile, efficient financial institution

- Inadequate institutional experience and capability in relating to the private sector

- A past tendency toward a short term management focus characterized by improvisation in responding to crisis situations, inadequate attention to careful strategic, operational and administrative planning

These and other problems, to be discussed below, have developed over time. We consider that they can readily be overcome in time, given priority management attention and diligence in undertaking remedial action. We consider these institutional problems, while important, to be similar to those afflicting a number of development finance institutions in Latin America to which AID is providing economic and technical assistance. The specific recommendations related thereto and their priorities for implementation are discussed below.

o The 1984 reorganization reflects a commendable initiative of the Bank to address its principal organization and management problems which the Board of Directors and senior executives well understand.

o The Bank's organization and management problems merit an equally high priority as that accorded to obtaining new financial resources. The Bank's capacity to attract new resources depends importantly on its external image as a financially sound and well-managed institution.

o With continuous and diligent attention to organizational and management improvement activities, the Bank should over time be fully capable of meeting the institutional requirements of its medium and longterm strategic plans.

o The Bank is fortunate in having a number of experienced, competent professionals in different organizational units who can play a key role in the institutional improvement effort.

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3. Specific Findings and Recommendation

a. The Organizational Structure

(1) Findings

We recognize that the 1984 reorganization has only recently been activated. Time is needed to assess its results. An in-house evaluation of the reorganization process is scheduled for January 1985. The following findings and recommendations are respectfully submitted as constructive inputs to that evaluation.

The positive features of the 1984 reorganization are as follows:

- The logical grouping of the three main line organizations into (1) promotion and studies (the demand) (2) the financial (the supply) and (3) the operations gerencias
- The creation of a new Department of Planning reporting to the Executive Vice President and reflecting an appropriate recognition of the need for and importance of strategic and operational planning
- The establishment of an Area for the Rehabilitation of the Private Sector Portfolio
- The creation of four (4) senior level coordinating committees
- The revised definition of the functions of the Promotion and Studies Gerencia to foster greater selectivity in identifying and promoting projects meeting stricter lending priorities
- The preparation of new manuals of organization of operating procedures
- The concentrated focus of the Board of Directors and senior executives over several months on organization and management issues which has sensitized and oriented

Bank Directors and staff on the importance of these matters

- The reduction in force which significantly reduced the number of personnel and operating costs.

The principal weaknesses identified in the reorganization are:

- Inadequate advanced technical planning as evidence by:
  - Lack of documentation setting forth the organizational goals, specific objectives, rationale, and anticipated benefits of the process
  - Inadequate communication with Bank staff during various stages in the process to inform on the goals, objectives and rationale of the process and how it may effect them
  - Lack of qualifications statements accompanying each position description for key executives listing education, training and experience requirements needed to perform effectively the functions and responsibilities of the position
  - Lack of documented qualitative and/or quantitative benchmarks for evaluating progress in meeting the goals and objectives of the reorganization process
- The new organizational structure appears to reflect an ad-hoc response to a crisis situation rather than a stable structure reflecting sound organizational concepts applicable over time to changing institutional circumstances (e.g., the combination of systems function with accounting reflecting the priority given to automating the accounting system.)
- There is a fragmentation of the Bank's financial management function into three separate organizational units: (1) financial programming in the Department of Planning; (2) financial operations and control in the Department of Operations Control and (3) financial resource development in the Financial Gerencia. It appears there is no single point below the Executive Vice President where expeditious financial decision making can be made. The Financial Coordination Committee, while possessing

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decision making authority, is an unsuitable mechanism for this purpose.

- The absence of a separate Systems and Organization Department, reporting to the Executive Vice President which could combine organization and methods (O+M) functions with a systems operations unit to serve the needs of the entire institution.

- The almost simultaneous activation of the reorganization, reduction and reassignment of personnel and changes in operating procedures which together represents a triple shock to organizational stability.

- The excessive number (11) of organizational units reporting to the Executive Vice Presidency.

- The location of the Project Analysis Department as an independent staff unit reporting to the Executive Vice President. The appropriate place for this unit is as a separate area under the Operations Gerencia which should be responsible for managing the entire project appraisal, monitoring and supervision process. The potential for conflicts of interest between the project analysis and supervision areas can readily be limited through effective control by the Operations Manager.

- An inappropriate division of labor as between the Department of Planning and the Financial Gerencia. The Area for Financial Programming of the Department of Planning has current responsibility for making short term projections of cash flow. (see pg. 152.02 (3) of Organization Manual) We consider that short term cash flow projections (up to one year) are more appropriately performed by the Financial Gerencia.

(2) Recommendations

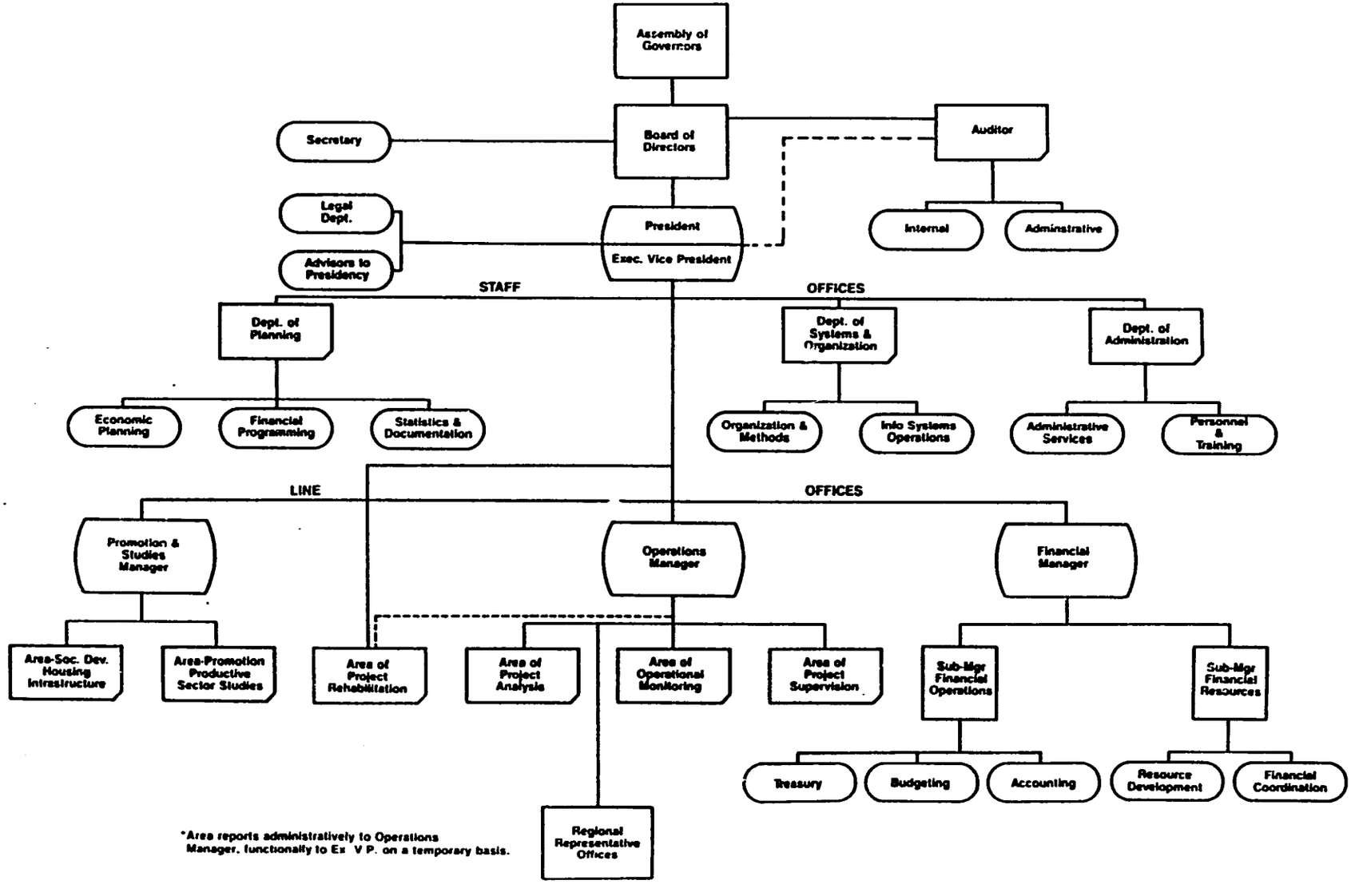
In Exhibit V-4, we provide an organization chart reflecting proposed adjustments to the current structure.

The recommended changes are as follows:

- Clearly discriminate between staff and line functions

Exhibit V-4

CABEI
PROPOSED ADJUSTMENTS TO 1984 REORGANIZATION



*Area reports administratively to Operations Manager, functionally to Ex V P. on a temporary basis.

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- Establish a Department of Systems and Organization reporting to the Executive Vice President as a new staff office including O+M and information system operations units. This Department will serve the entire institution but will give priority to developing an automated accounting system.

- Establish a new staff Department of Administration with sub-units for (1) Personnel and Training and (2) Administrative Services.

- Reorganize the Financial Gerencia to incorporate two sub-gerencias:

  - a Sub Gerencia for Financial Operations

  - a Sub Gerencia for Financial Resources

  This change will ensure that the Financial Gerencia has clear responsibility and decision making authority on key financial matters relating both to obtaining as well as controlling resources. There is a need for a single decision point below the Executive Vice President on financial matters. With this change, the Gerencia's functions will shift from one of meeting a transitory "crisis" to one of a stable organizational unit capable of financial management over the long term.

- Redefine the functions of the Gerencia Financiera to include the preparation of short term (1 year or under) projections of cash flow to assess the Bank's liquidity situation. This function should be transferred from the Area of Financial Programming to the Gerencia Financiera.

- Locate the Department of Project Analysis within the Operations Gerencia. This change is indicated to place the project analysis function as an independent area within the Operations Gerencia where it appropriately fits in. It is important for there to be continuous coordination and feedback between those who appraise a project and those who supervise it.

- Change the name of the "Area of Rehabilitation of the Private Sector Portfolio to the "Area of Project Rehabilitation". This change reflects the need to permanently provide rehabilitation services to both public and private sector projects and to emphasize preventive as well as curative care of the loan porfolio. Heretofore, public sector projects have not required

rehabilitation services in the same financial sense that applies to private projects. On the other hand, public sector projects may also benefit from technical assistance services (e.g., institutional improvements, project management, etc.). The Area will naturally give its highest priority to rehabilitating the delinquent private sector portfolio. Once the area is well established and its functions are being performed effectively, we recommend that the Area chief report functionally to the Operations Manager.

- Prepare qualifications statements for all senior and middle management executives which are based on requirements of their position descriptions.

b. Management Policies and Practices

(1) Findings

- General Management

The Bank needs to improve its external image of being an agile, efficient and dynamic financial institution. It presently suffers from a negative external image. Whether justified or not, the image exists and must be dealt with as a serious management problem. The Bank management is fully aware of this problem and has demonstrated courage and commitment in undertaking on its own a comprehensive reorganization designed to improve the institution's efficiency and effectiveness. Success in changing this image depends on selecting outstanding professionals for its senior and middle level executives, defining their functions, responsibilities and authorities, and holding them accountable for high standards of performance in carrying out their duties.

o Lack of Management Information System

Bank management is severely handicapped by the lack of an effective management information system providing all organization units timely, correct and complete information needed to perform their functions. This critical management problem will be discussed further below:

o Delegation of Responsibility and Authority

The position descriptions in the new organization manual set out the specific responsibility and authority for each senior official including all heads of organizational units. Senior Bank management is concerned with ensuring that delegation of responsibility and authority serve as practical guides to action for improving operations and, in particular, the decision-making process. Reportedly, some senior officials have tended in the past to avoid making decisions within their competence and authority and passed on matters requiring action to the Executive Vice Presidency for resolution, resulting in an added work load for him.

o The Decision-Making Process

The decision-making process appears in need of improvements. It is important that all managers make decisions within their competence and authority while passing up only those important matters requiring attention of senior management. There is also a need for improved staff work by middle level managers in preparing decision or action memoranda for senior Bank executives. Such staff work normally involves correct and precise formulation of the problem, and for key issues, provision of essential data and analysis, preparation of alternative

courses of action and their likely consequences, and lastly, recommendations for decision or action.

- Management Policies and Practices Documentation

A series of manuals cover organization, management practices and operational procedures. These include:

- A manual on organization (recently prepared covering the 1984 reorganization)
- A manual on operational procedures (recently prepared based on 1984 reorganization)
- A manual on personnel administration
- A manual on budget preparation
- A manual on financial norms and policies

These manuals are being reviewed to reflect changes stemming to the 1984 reorganization and to serve as practical guides for action by all organizational units.

With respect to the new manual on operational procedures, we did not find any flow or critical path charts which identify each discrete step in operational processes. Thus, there is at present no means of telling if there has been an increase or reduction in the total number of steps in new operational procedures. Such charts are important for assessing work simplification, identifying informational requirements and preparing the conceptual design of a management information system.

o Accountability

Accountability is the concept that senior management holds subordinate managers and staff accountable for the effective discharge of their responsibilities. Ensuring personnel accountability is usually achieved by both informal and formal means. The informal means involves direct supervision by senior management of subordinate staff where the senior manager defines the qualitative requirements of a subordinate's performance and monitors results. Rewards and penalties are then distributed depending on performance.

The more formal means is the operation of a personnel evaluation system where an official's overall performance is regularly evaluated. Since 1982, the Bank's personnel evaluation system has not been operative. At that time the Directors advised senior management of its discontent with the operation of the then existing evaluation program and suggested a study to develop a more effective system. To date, a new personnel evaluation system has not been implemented. Reportedly, Bank personnel have not received formal evaluations or either cost of living or in step base salary adjustments since 1982.

o Relationships between the Board of Directors and the Bank Management

The Directors of the Bank work on a full time basis although they meet in Tegucigalpa one week per month. There have been some indications that Directors on occasion tend to get involved in day-to-day bank operations including contacting operational staff. While they have the right to do so, such interventions could have an impact on how well senior management performs. This is a delicate area where there are no clear answers.

Suffice it to say that senior bank management and the Directors could usefully review their working relationships and agree on appropriate roles and responsibilities. The objective is to provide senior management with maximum authority and autonomy in running the Bank on a day-to-day basis within policies approved by the Directors.

(2) Recommendations on Management Policies and Practices

- Filling Vacancies at Senior and Middle Management Levels

A number of senior and middle management positions are or may become vacant soon. It is essential that these positions be filled with exceptionally qualified professional bankers with proven management abilities. The quality of senior executives selected impact directly on the Bank's external image.

- The Decision Making Process

Training seminars should be organized to orient professional staff on the requirements for effective staff work in preparing action or decision memoranda for senior management.

Flow charts or critical path charts should be prepared for operational procedures which identify discrete steps in each process. Such charts are necessary to assess operational efficiency and management information user requirements.

- Relationship between the Board of Directors and Senior Bank Management

We recommend a review of the appropriate relationships between the Board and senior management. Such a review could clarify the authority of senior management to run day-to-day operations within general policies and guidelines established by the Board.

c. Management Information Systems (MIS)

(1) Findings

- There is a unanimous concensus among all managers and senior executives interviewed that the lack of an automated management information system constitutes a major impediment to the effective discharge of their functions.

- Despite the fact that the Bank has had for some time an information systems unit, the applications developed have never been placed in an integral conceptual design for a management information system. As a result, there are at present a series of independent and isolated systems.

- Financial and administrative accounting is mixed into one system which, at best, does not satisfy the needs of senior management for timely, correct and complete information needed for decision making.

- The present accounting system appears fully capable of providing complete and correct information on the financial situation of the Bank. Its main deficiency is that it is not fully automated and preparation of information is slow.

- The accounting system now used has not been modified since the bank was established. Its original structure was designed to satisy the information and reporting requirements of its major creditors (AID, IDB, private commercial banks) rather than the information needs of senior bank management. Specifically the accounting

system is oriented toward how the bank is managing its credit lines from its funding sources rather than how the bank is managing its own loan portfolio.

- To overcome some of the problems described above, the Accounting Department has developed independant "modules" to capture and process different types of data but this data occasionally does not agree with the formal accounting records.

- There exists a mixture of manual and automated procedures for treatment of information. This makes it difficult to obtain timely, reliable information.

- There does not exist clear and established procedures for the internal flow of information, whether produced manually or by computer.

- The computer process in the Bank is basically geared to the "batch" concept. To produce reports, it is necessary to wait for the closing of the computer run, find discrepancies, try to conciliate these with the manual accounts, interpret the differences, make the adjustments and finally produce the report. The product consists of a large volume of pages of little use to an executive who needs specific information contained in the report in order to take a decision.

- The inadequate internal availability and flow of information needed by managers throughout the Bank has led to unhealthy tendencies:

  - Some managers want to buy minicomputers and set up their own personal information systems

  - Managers tend to guard jealously their own information and not distribute it where needed

  - Users tend to ask for much more information and processed data than is absolutely essential for the performance of their jobs

  - There appears to be inadequate appreciation among staff of the cost of generating and processing data

  - The decision-making process is impeded at all levels.

- The Bank has contracted with an experienced data processing consultant to assist in the design and

automation of a modern accounting system. The new system should be operative in a year according to current plans.

(2) Recommendations Relating to a Management Information System

It is urgent that the Bank have an effective management information system. To this end, we recommend twin approaches that are mutually complementary:

- Quickly seek out and select specialized banking software packages that can operate on mini-computers. Specifically, try to obtain programs for handling financial accounting modules and which can operate in various currencies. Acquire the computers necessary for operating the packaged softare programs. There is no need for separate mini-computers for each program. The volumes and priorities will indicate the programs/equipment relationship.

- Undertake a study to develop a conceptual design for a integrated management information system. The first step in such a study is the preparation of a document defining user information requirements for all organizational units. The Accounting/Systems area, with the assistance of the Area for Statistics and Documentation is currently preparing this document. Once this is prepared, the preparation of the conceptual design for the integrated system can be undertaken. While the process of preparing a conceptual design for the mangement information system is going forward, the independent modules being used with the mini-computers could constitute a prototype for the integrated system.

The planning, design and installation of a management information system can be a long process. In the current critical circumstances where Bank management needs information urgently, it cannot wait for the integral MIS system to be completely designed and installed. For this reason, we recommend the use of mini computers with standard packages of banking

software. The software may not satisfy 100 percent of the Bank's requirements but it should satisfy a major portion (perhaps up to 80 percent) of these requirements. It also has the advantage that it can be installed relatively quickly.

The design and implementation of an integrated management information system should include:

- Definition of information requirements for all bank organizational units, (now underway).
- Review of existing computer programs in the memory to remove obsolete or infrequently used data.
- Preparation of a conceptual design of management information system and sub systems (financial, portfolio, and economic and statistical data).
- Design the architecture of the system.
- Implementation planning.
- Operational requirements for software/hardware configuration.
- Cross impact analysis. (Impact of proposed system on organization, management, personnel, training, and space utilization)
- Detailed systems design.
- Program design.
- Program coding.
- Program testing.
- System testing.
- Preparation of procedures and operating manuals.
- Training of operators, users and management personnel.
- Implementation and acceptance of the systems.

It is advisable that the Bank have available specialized consulting assistance in designing the management information system as well as in selecting software packages and adapting them to Bank's needs.

e. Loan Promotion, Appraisal and Operations

(1) Analysis and Findings

- The Department of Project Analysis is responsible for project appraisal from an economic, financial, technical, and social standpoint. The Department's project appraisal capabilities for public sector infrastructure projects are highly regarded by outside observers. The quality of the department's appraisals of private sector projects are reportedly satisfactory but could be strengthened by the addition of analysts with private sector experience.

- The Operations Gerencia is responsible for loan monitoring control and supervision.

  - The Area of Monitoring (Seguimiento) maintains a constant review and control of the loan application during processing.

  - The Area of Supervision takes over once a loan is approved and is responsible for loan monitoring, supervision and control during the life of the loan. The area consists of a Chief, 19 engineers, 5 business administration/financial analysts and 12 secretarial and administrative staff. The Area currently supervises 110 active projects.

- The Regional Representative's Office is responsible for ensuring that loan conditions precedent are met and maintaining continuing liason with the borrower.

- The Legal Department reviews the loan contract and documentation submitted to satisfy conditions precedent to the loan contract and to initial disbursement. It also intervenes in respect to legal action against delinquent borrowers.

Area staff members visit the clients at least once a year to assess performance in meeting provisions of the loan contract. During these visits, Area supervisors review the client's business plan (if in the private sector), financial reports, sales, inventory, and other financial indicators. These on-site reviews are designed to detect problems which could adversely affect the borrower's payment capacity.

There is a risk that the above supervisory procedures involving primarily review of client reports by headquarters staff may be insufficient to detect emerging problems of private clients located in member countries. There is a need to improve "early warning" and "preventive care" procedures. The Bank should consider using local agents in countries (outside Honduras) to make periodic checks on the financial health of private sector clients. Such agents could be local audit firms, trained members of the regional representative's office or a local bank. These agents could perform a semestral review of such indicators as cash flow, sales, inventory, and report to the Area of Supervision on their findings. Such an approach should both improve the Bank's information on client performance as well as keep clients more attentive to their obligations to the Bank.

o Collections

A priority for the Bank is the expeditious collection of debts from both public and private sector borrowers. In recognition of this priority, the new operating manual provides (in Section 1700) detailed procedures for debt collection and assigns functions and responsibilities for both normal and delinquent debt collection among various organizational units including

- Regional representative offices
- Treasury
- Operations Gerencia
- Area of Supervision
- Legal Department

In addition, a principal function of the new Area for the Rehabilitation of the Private Sector Portfolio is to assist delinquent clients reorganize their businesses to improve their capability to service their debts to the Bank. Treasury records debt schedules and communicates directly with public and private sector debtors. It also forwards debt information to the Operations Gerencia and its Area of Supervision so that its supervisors can raise the issue of debt collection during client visits. Collection of past due debts is only one of a number of items discussed with clients. The Legal Department is also involved in advising the Executive Vice Presidency on legal actions that may be required to adjudicate loan guarantees. The Executive Vice Presidency becomes directly involved in determining debt collection strategy for major government borrowers or private clients. Collecting debts from member governments requires a different strategy than collecting from private clients. One requires delicate diplomatic negotiations at high governmental levels while the other follows normal business practice.

While representing an improvement over past practices, the new collection procedures appear deficient in that responsibility for debt collection is dispersed among several organizational units. It appears that these units have different functions at various stages of the collections process and that personnel of

these units are involved only part time in debt collection activities.

There appears to be no single organizational unit below the Executive Vice Presidency that has primary responsibility for debt collection. Nor are there personnel who dedicate full time to debt collection.

There is a risk that the new collection procedures, with its wide dispersal of functional responsibilities, may prove ineffective in obtaining the desired results.

There is a need for careful preparation of separate debt collection strategies and action programs for the public and private sectors. Thereafter, clear responsibilities and authorities should be given to a designated organizational unit to implement the strategies in coordination with Treasury, Legal Department, etc. Trained personnel in such unit should be assigned full time to collections functions. If necessary, outside consultants, expert in debt collection, should be contracted in delinquent cases.

o Project Rehabilitation Assistance

Many development banks recognize that the financial health of its borrowers is essential to its institutional viability. They often establish separate offices to provide both technical assistance to clients to improve their operations as well as rehabilitation assistance once problems emerge. These offices sometimes provide these services directly or, more frequently, finance the services which are provided by consultants under contract. The clients usually contribute to the costs of such services.

The Bank should consider providing technical assistance to clients at an early stage of their development (preventive care), so that emerging problems can be identified and resolved thus forestalling the need for rehabilitation assistance when the client is already in trouble (curative care).

(2) Recommendations Relating to Loan Promotion, Appraisal and Supervision

- That efforts be made to recruit personnel with successful private sector experience to work on appraisal and supervision of private sector projects
- That consideration be given to using local agents of the Bank to undertake semestral checks of client's financial health in order to improve the Bank's early warning system for detecting emerging problems
- That the Operations Gerencia be given primary responsibility for collections planning, strategy and action programs. That trained personel in the Gerencia be designated to work full time on implementing collections activities with private sector clients. That a special collections strategy be prepared to deal with public sector clients.
- That Bank portfolio management give priority to "early warning" systems and "preventive" care of client financial health to forestall the need for curative care.

f. Personnel and Training

(1) Findings

- Personnel Utilization

Since most heads of organizational units are new to their positions, it will take time before they learn about their jobs, their staffs, and their relationships with other parts of the Bank. We consider that with a well planned and implemented orientation program for all

senior executive and heads of units, the learning process can be speeded up and a reasonable level of operational efficiency can come about relatively quickly.

There is a need to fill key vacancies throughout the Bank. The overall distribution of Bank personnel by level is shown in the following table:

Table 1

Personnel Distribution by Level

Level	Numbers of Personnel
Management officials	123
Technical officials	32
Secretarial	100
Others	127
Vacancies*	10
Subtotal	392
	17
Total	409

* The vacancies apply to management official positions.

Exhibit V-5 shows the provisional distribution of Bank staff.

o Training

Several key officials of the Bank as well as subordinate staff have received fellowships to both short and long term training abroad. Some officials take leave of absence and pay their own way for training abroad.

The Bank is undergoing a reorganization in which many of its most experienced people have retired, many senior and middle level officials are new in their positions. In addition, the strategic plans of the Bank indicate a shift in program emphasis to promotion of private, export-oriented productive investment. This means that the Bank is going to have to recruit staff with proven management experience in the private sector.

The Bank should undertake a new training needs assessment in order to identify the positions and areas where training is needed, what types of training (long or short term) as well as the specific training objectives

Exhibit V-5

CABEI - PROVISIONAL PERSONNEL DISTRIBUTION
(NOTE: Reorganization Not Yet Complete - 11/84)

	Funcion-Arios	Tecnicos	Secre-tarial	Otros	* Vacantes	Total	Por Contrato	Grand Total
Directorio	10	0	4	5	1	20	0	20
Presidencia Ejecutiva	3	1	3	0	0	7	3	10
Vice-Presidencia Ejecutino	2	1	1	1	0	5	0	5
Secretaria	2	0	3	0	0	5	0	5
Contraloria			1		1	2	0	2
Auditoria Administrative	2	2	1	0	1	6	0	6
Auditoria Interna	3	1	1	0	0	5	0	5
Planificacion	1	0	1	0	0	2	0	2
Planific. Economico	3	1	3	0	0	7	0	7
Program/Financiero	4	0	3	0	0	7	1	8
Estadistica	4	0	3	3	0	10	0	10
Gerencia de Promocion	0	0	1	0	1	2	0	2
Desarrollo Social Vivienda e Infraestruct.	7	0	4		1	12	0	12
Promocion e Estudios Sectores Sectores Productivos	7	0	3	0	1	11	2	13
Gerencia de Operaciones	1	0	1	0	0	2	0	2
Rehab. de Cart. Privada	6	0	3	0	0	9	0	9
Representacion-Oficinas Regionales	5	0	11	26	1	43	0	43
Seguimiento Operacional	5	0	3	0	0	8	0	8
Supervision Proyectos	10	2	6	3	0	21	1	22
Gerencia Financiera	4	0	3	0	0	7	0	7
Consecucion de Recursos	5	0	2	1	0	8	0	8
Coordinacion de Fuentes	4	0	3	1	0	8	0	8
Depto Juridico	1	0	1		0	2	0	2
Asesoria Legal					1	1	0	1
Operaciones Juridicas	4	0	4	1	0	9	1	10
Departamento Analysis de Proyectos	9	0	4	3	0	16	0	16
Depto Control Operativo	1	0	1	0	0	2	0	2
Tesoreria	5	9	7	5	0	26	0	26
Presupuesto	3	1	1	1	0	6	0	6
Contabilidad Y Sistemas	9	11	8	11	0	39	2	41
Depto De Personal y Admin.	3	2	8	4	1	18	0	18
Area De Servicios Adminis.	0	1	2	62	1	66	7	73
TOTALS	123	32	100	127	10	392	17	409

*All the vacancies are for funcionarios
Source: Tomás Sanchez, Asst. to Pres. CABEI

for each individual for which training is recommended. Such a needs assessments is best performed by experienced, professional training advisors. Once the needs assessment is complete, the international agencies (World Bank, AID, IDB) could be approached to finance the training programs.

- Compensation and Job Classification

The 1984 reorganization has not had repercussions on salary levels at the Bank. Since the personnel evaluation system was suspended in 1982, there have been no salary or cost of living increases. A new position classification and salary survey is planned for January 1985. Bank salaries for professional staff are adjusted to the prevailing level of bank salaries in the region (with the exception of Costa Rica).

- Personnel Evaluation

There is currently no operations personnel evaluation system. Such a system is essential to evaluate personnel performance, establish the principal of accountability, and serve as the basis of a system of rewards and penalties in fostering operational efficiency and effectiveness. The Bank should undertake a study as soon as possible to design a new evaluation system.

(2) Recommendations Relating to Personnel and Training

- There is a need to fill existing vacancies throughout the Bank. That recruitment activities be undertaken to fill vacancies, where appropriate, with experienced managers from the private sector. Such experience is particularly needed in the Department of Project Analysis, the Area of Supervision and the Area of Rehabililation of the Private Sector Portfolio.

- That a training needs assessment be undertaken to be used as a basis for carrying out a medium and longterm training program for Bank personnel at the executive and middle management level. The international donor agencies should be approached to finance such a program.

- That a study be undertaken to design a new personnel evaluation system which should be implemented as soon as possible.

- That a study be undertaken to assess the medium and long term manpower needs of the Bank. At present levels of operation, the Bank is probably overstaffed. The study should analyze manpower requirements at various alternative levels of operations so as to permit advance planning of recruitment and training activities.

g. Coordination and Communications

(1) Findings

- There is a need for significant improvement in internal coordination and communication. It is necessary to break down the "barriers" that have over time been established in the internal communications system. Individual organizational units of the Bank have tended to become accustomed to operating as "islands" within the organization. The vertical communications have not always been two-way and the horizontal communications have generally been severely limited. Hopefully the situation will improve under the new reorganization.

- Bank management is quite aware of the needs for improvement in coordination and communications and has taken important measures in this regard. The establishment of the four high level coordinating committees could help in improving coordination only if these committees are well managed. Specifically, careful planning of agendas, skillful direction of the meetings by the chairman, the advance availability of documentation and minutes of meetings, the active and effective participation of members-all these are ingredients of successful committee management. Committees do not automatically improve coordination and communication. Unless well managed and supported by all participants, they will fall into disuse.

- There is also a need to strengthen external coordination not only with member governments and external funding sources but also with sister development banks around the world. Senior Bank officials should undertake a program of visits to other regional development banks to learn about their operations and about their techniques

for solving critical problems similar to those encountered in CABEI (e.g., debt collection techniques).

(2) Recommendations relating to Coordination and Communication

- That Bank senior management provide instructions to all organizational units to ensure free information exchange at all levels.
- That training sessions be organized to advise senior and middle management on the requirements and techniques for careful planning and management of coordinating committees.
- That plans be developed for improving information exchange and coordination with sister regional and sub-regional development banks around the world.

E. Ranking of Specific Recommendations by Implementation Priority

We recommend that Bank efforts to improve its organization and management merit equal priority with that accorded to raising new financial resources. Within this general priority, it is possible to rank the specific organizational and management recommendations according to priorities in three broad categories as follows:

Category A - Recommendations that should be implemented on an urgent basis within the next six months.

Category B - Recommendations that can be implemented on a normal basis but no later than the end of 1985.

Category C - Recommendations that require continuing attention and which should be implemented as staff and time permit over the next two years.

Our ranking of specific recommendations by category are as follows:

Category A

- o Recruit signly qualified professionals with proven management abilities to fill executive vacancies
- o Undertake following organizational changes:
  - -- Establish Department of Systems and Organization, including Organization and Methods (O+M) unit
  - -- Restructure Financial Gerencia to incorporate present Department of Operational Control as new Sub-Gerencia coequal with Sub-Gerencia for Resource Development
  - -- Transfer short term financial projection functions from Area of Financial Programming to Financial Gerencia
  - -- Establish new Department of Administration combining present Department of Personnel and Department of Administrative Services
  - -- Refine collections functions and procedures to give Operations Gerencia primary responsibility for planning and executing collections strategies and programs. Assign full time personnel to collections function.
- o Accelerate efforts to design and install Management Information System including:
  - -- Select and install bank software packages to provide general ledger, financial reporting and portfolio management information
  - -- Acquire mini-computers as needed to utilize software selected
  - -- Complete survey to define user information requirements definition for integral management information system

- -- Undertake study to prepare conceptual design of integral management information system
- -- Train staff in use of information system

- o Undertake study and implement new personnel evaluation system
- o Define qualitative and quantitative benchmarks for evaluation of reorganization process
- o Prepare qualifications statements for all senior and middle management position descriptions
- o Initiate regular orientation sessions with Bank staff on progress of reorganization process

Category B

- o Complete design and initiate installation of integral management information system
- o Transfer Department of Project Analysis as Area under the Operations Gerencia
- o Undertake following studies:
  - -- Appropriate relationships between Board of Directors and senior Bank management
  - -- Medium and long term manpower requirements
  - -- Analysis of operating procedures (via flow charts) to reduce number of steps in loan request screening, appraisal, approval, monitoring and supervision processes.
- o Undertake staff training needs assessment and prepare medium and long term training program. Secure financing from international donors
- o Undertake job classification and salary survey

Category C

- o Improve screening procedures for management of internal paper flow to office of President and Executive Vice President

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- Provide orientation and training to Bank staff on
  - -- Preparation of action/decision memoranda to senior bank management
  - -- Planning and management of coordination committees
  - -- Use of newly operative management information system
- Strengthen loan supervision by assigning local agents in member countries to monitor financial health of private sector clients
- Design and implement procedures for early warning system for detecting problems with Bank clients
- As Area for Rehabilitation of Private Sector Portfolio develops its program, consider expansion of functions to provide technical assistance services to Bank clients in line with preventive care concepts.

- U.S. political and financial support is critical to CABEI's long term viability.

Without the political and financial support of countries from outside the region, particularly the U.S., it is unlikely that CABEI could evolve into a dynamic and effective financial institution in the region. Several potential external donors which could provide financial assistance or become members are holding back on their commitments until the position of the U.S. government is better defined. U.S. support for CABEI is therefore critical to the long term viability of CABEI. Absent U.S. political and financial support, it is probable that CABEI will progressively decline.

- U.S. government support of CABEI should be conditioned on concrete evidence of support by member governments for the institution.

Unless the member governments of CABEI demonstrate their full support for the institution, it is unlikely that the institution can succeed. The clearest definition of support should be the resumption of debt service payments to CABEI by the member governments.

- U.S. financial assistance to CABEI should be on a concessionary basis, represent a contribution to capital structure, and be designed to leverage generation of additional external financing.

U.S. financial assistance under the above conditions would certainly be most beneficial to CABEI while assuring the maximum potential impact of the support. On this latter point, it is important that any support provided by the U.S. be designed to

leverage the generation of additional external financing from the international financial community.

- o U.S. financial assistance should be conditioned on funds being used to further U.S. government development priorities.

It is important that any funds committed to CABEI be used to promote private sector development of export-oriented productive investments consistent with the objectives of the Caribbean Basin Initiative.

- o U.S. assistance to CABEI should be coordinated with other donors such as the World Bank and IDB.

It is important that whatever assistance provided by the U.S. not duplicate assistance being offered or provided by other international donors. CABEI is actively seeking financial and technical assistance from other international agencies. It is imperative that close coordination among all potential donors take place to ensure a rational division of labor which best meet CABEI's needs.