PD-AAP-544
ISN 35561

CLASSIFICATION:

AID 1120-1		
PAAD	AGENCY FOR INTERNATIONAL DEVELOPMENT PROGRAM ASSISTANCE APPROVAL DOCUMENT	1. PAAD NO. Grant No. 0267 Amendment 9 Grant Agreement 519-K-606 2. COUNTRY El Salvador 3. CATEGORY Cash Transfer 4. DATE May 1983

5. TO: A/AID M. Peter McPherson	6. OYB CHANGE NO.
7. FROM AA/LAC (Acting) M. D. Brown	8. OYB INCREASE TO BE TAKEN FROM: Economic Support Fund (ESF)
9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 75,000,000	10. APPROPRIATION 72-1141037 LESA-84-35-519-KG-31

11. TYPE FUNDING	12. LOCAL CURRENCY ARRANGEMENT	13. ESTIMATED DELIVERY PERIOD	14. TRANSACTION ELIGIBILITY DATE
☐ LOAN ☐ GRANT	☐ INFORMAL ☐ FORMAL ☐ NONE	FY 84	

15. COMMODITIES FINANCED

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only:	U.S.: $75,000,000
Limited F.W.:	Industrialized Countries:
Free World:	Local:
Cash: $75,000,000	Other:

18. SUMMARY DESCRIPTION

The purpose of this program is threefold: to ameliorate the country's balance of payments crisis; to assist the private sector by requiring the Government of El Salvador (GOES) to provide adequate foreign exchange resources to permit the importation of essential inputs for the private sector; and to help restore economic stability to El Salvador. The objective of this particular $75 million program amendment is to support a projected 3% real GDP growth rate in 1984.

Upon obligation of these funds, the Government of El Salvador (GOES) will agree to provide $75 million in foreign exchange for the importation of raw materials, intermediate goods, spare parts, agricultural inputs, and capital goods imported from the United States and used by the manufacturing, agroindustrial, agricultural, commercial, and transportation subsectors of the economy. The local currency generated by the dollars will be allocated to specific line items in the GOES budget for the priority program activities in the areas of agrarian reform, employment generation, restoration of vital services, humanitarian assistance, and policy development, which have been agreed upon by the GOES and A.I.D.

The $75 million will be disbursed in two or three tranches, depending upon the GOES's progress towards meeting the Conditions Precedent to release of each tranche and the timing of the passage of the Supplemental.

19. CLEARANCES	DATE	20. ACTION
GC/LAC:RMeighan		☒ APPROVED ☐ DISAPPROVED
LAC/CEN:PASkin	5/4/84	
AFA/ECP:PBash	5/9/84	Frank B Kimball — AUTHORIZED SIGNATURE — June 1, 1984 DATE
FM:[illegible]Christensen		
LAC/DR:DRJohnson	5/7/84	
[illegible]	5/10/[illegible]	C/AID — TITLE
PPC/PDPR:HHandler		
AA/PPC (Acting):RDerham		
LAC/DP:JOleson	5/9/84	

CLASSIFICATION:

-1-

MAY 11 10 04 AM '84

EXECUTIVE SECRETARIAT

MAY 10 1984

ACTION MEMORANDUM FOR THE ADMINISTRATOR

THRU : AA/PPC, Richard Derham, (Acting)

FROM : AA/LAC, Marshall D. Brown, (Acting)

SUBJECT: PAAD Amendment: El Salvador Private Sector Support I (519-0267)

Problem: Your approval is requested to authorize an increase in grant funding to the subject Program of $75 million, which will bring the LOP funding for El Salvador to a new total of $340 million.

Discussion: This program was initially authorized on November 26, 1980 with the first $20.0 million ESF cash transfer intended to provide balance of payments support to the Government of El Salvador (GOES). The Grant Agreement required that the GOES make available an equivalent amount of foreign exchange for the importation of raw materials and intermediate goods needed by the manufacturing, industrial, and business sectors. Under the Agreement, the GOES was required to provide the local currency equivalent of $20.0 million in credit to the agrarian reform sector, and to establish a working capital credit fund for industry, also in an amount equivalent to the $20.0 million.

In FY 1982, the Program was increased by $100 million, with $25 million provided in March 1982 and $75.0 million, from the Caribbean Basin Initiative Supplemental, in September 1982. The local currencies deposited as a result of these increments and those in FY 1983 were programmed under an arrangement which passed them to the GOES for allocation to the private and public sectors of the economy. Further, the Mission and the GOES established a series of budgetary and monetary targets for CY 1982 and CY 1983 in areas of priority interest to AID such as the agrarian reform, public sector employment generation, restoration of vital public services, humanitarian assistance and credit to the private sector. In Fiscal Year 1983 three more increments were added to the Program, a $39.6 million tranche in December 1982, a $42.4 million amendment in May 1983, and a $38.0 million tranche in July 1983, all of which followed the dollar and local currency approaches outlined above.

The objectives of this FY 1984 balance of payments assistance Program are to reverse the economic decline experienced in El Salvador and to support a projected three percent increase in the real Gross Domestic Product (GDP) growth rate.

The subject PAAD Amendment updates the Mission's case for balance of payments assistance and estimates that requirements for this type of assistance in CY 1984 now total $178 million. The Mission proposes to meet the need by using $100 million in ESF funds already programmed in its OYB, ($25 million of which have already been obligated), together with another $65 million contained in the Central American Supplemental Request for FY 1984 and $13 million in additional PL-480 assistance. Of these amounts, only the $100 million, $75 million of which will be authorized by this Amendment, can definitely be counted on at this time.

On the use of local currencies, the GOES projects a fiscal deficit of 642 million colones for 1984 in comparison with the 587 million colon deficit experienced in 1983, or an increase of about five percent. The Mission estimates that the deficit can be covered in part by external loans (including A.I.D. Project financing, but excluding ESF generations), leaving a balance of 278 million colones to be covered by domestic borrowing. The Mission plans to help ameliorate this problem by using ESF and PL-480 local currencies to directly finance specific line items in the GOES budget which accord with the Mission's counterpart requirements and its priority program for the year in such areas as agrarian reform, employment generation, restoration of public services, humanitarian assistance, and policy development.

At this time, the Mission is requesting authorization of $75 million of ESF funds from its OYB. The authorized amount is to be obligated immediately, with two or possibly three disbursements (depending on the outcome of negotiations on the conditions) to be made through July 1984. The final text of the conditions relating to each of the disbursements will be set forth in Memoranda of Understanding, which will be cleared with the Bureau prior to disbursement. The outcome of negotiations on the foregoing conditions and Congressional action on the Supplemental request could change the timing and sizes of the second or third tranches, depending on the Mission's and the Bureau's reading of the situation at the time.

+with C/AID

The Mission is presently negotiating the conditions to disbursement of balance of payments assistance in Memoranda of Understanding to promote economic stabilization and recovery. The principal conditions are designed to cause the GOES to take specific actions to move more export transactions to the parallel market; remove disincentives to the exportation of industrial products outside of the Central American Common Market; review (and correct if necessary) rate structures of semi-autonomous utility agencies; require the GOES to make funds available for land compensation; provide adequate credit to small and medium enterprises; and continue improving foreign exchange allocation and control procedures in the Central Reserve Bank (BCR).

The DAEC discussed the following issues:

1. Attribution of ESF Dollars. Under the terms of the subject Program, the GOES agrees to provide an amount of foreign exchange equivalent to the ESF assistance received to permit the importation of raw materials, intermediate goods, spare parts, agricultural inputs, and capital goods from the United States. The question was raised at the Bureau review as to whether El Salvador will be able to import a sufficient level of eligible goods from the U.S. in 1984 to enable it to meet this condition for the $75 million under consideration plus the $25 million obligated in January 1984. While the Mission indicated that enough eligible imports are expected in 1984 to enable the attribution of funds programmed in the OYB, it was asked to vigorously press the BCR on the issue of importing additional goods from the U.S. As for the Supplemental, there was a consensus that if additional funds were authorized, eligibilty, as it is now defined could become a problem. Therefore, for future PAADs, the Mission was asked to consider expanding the categories of eligible goods. The Mission was authorized also to look at and analyze the implications of broadening source and origin requirements to permit attribution of imports from other Central American Common Market countries.

2. Conditionality. With respect to its strategy for conditionality, the Mission has requested, and the DAEC endorsed, the concept that since it is dealing with a provisional government and a series of complex and sensitive issues, the Mission needs some latitude in negotiating

Conditions Precedent to Disbursement. Therefore, while the Mission has detailed the proposed Conditions Precedent for each disbursement in the PAAD (pages 4 and 5 of Tab A), it has requested that for authorization purposes, the following broad conditionality parameters be approved by you:

a. Movement of additional and export transactions from the official to the parallel market to bring about a revaluation of the colon. Actions which the Mission hopes to effect in this area include shifting all proceeds from one of El Salvador's major export earners, shrimp, to the parallel market, together with 25 percent of the proceeds from the sale of coffee. The Mission plans to negotiate shrimp transactions as a Condition to Disbursement of the first tranche, while a percentage of the coffee sales would be discussed prior to the second disbursement.

b. Removal of disincentives that currently discourage the exportation of industrial products outside of the CACM. One example of actions to be negotiated in this area will be the removal of a regulation which requires that enterprises exporting outside of the CACM which earn foreign exchange in excess of the total value of imported inputs related to the exports, must purchase all of their imported inputs (including those related to production for the domestic market) at the parallel market rate.

c. Review of rate structures for semi-autonomous utility agencies. Negotiations with the GOES on this subject will take place prior to the second disbursement. The Mission intends to work on increasing water and power distribution rates.

d. Provision of adequate credit to small and medium enterprises on terms that most borrowers can meet. Discussion and negotiation of the details pertaining to this general area will occur prior to the second disbursement. The Mission is particularly interested in ensuring that the credit requirements of cotton growers, other agricultural producers and non-traditional exporters are met.

e. Continued actions by the BCR which will improve the foreign exchange allocation and control systems. The Mission will ask the GOES and the BCR to take further actions recommended by Arthur Young and Co. in their study of the BCR in such areas as published foreign exchange allocation criteria, mechanization of the allocation process, and forecasting of foreign exchange availabilities. These actions will be negotiated prior to the first disbursement.

The foregoing conditions are viewed by the Mission and the Bureau as steps to be taken in laying the groundwork for a new agreement with the IMF. Consequently, the Mission plans to condition disbursement of funds under the third tranche on achievement by the GOES of actions that will lead to negotiation of a standby agreement with the IMF.

While the Bureau concurred with the Mission's approach on conditionality in general, the Mission was requested to negotiate inclusion of agrarian reform compensation payments as a Condition Precedent to Disbursement of the second tranche, rather than the third, as was proposed by the Mission. In addition, as part of the strategy of helping the GOES get a handle on its recurring deficits, the Mission was asked to take a look at the possibility of a value added tax and provide the technical assistance to the BCR to evaluate this option. The results of study work here could be used to help to improve the GOES's revenue situation through conditions to future tranches of balance of payments assistance. Finally, it was decided that the Mission should consider linking conditionality for the subject Program with that of the proposed Industrial Stabilization Project (519-0287), where the relevant analysis work has been done, and where such linkages would make sense.

3. <u>Use of Local Currency: Public vs. Private Sector</u>. The DAEC noted the Mission's strategy calling for the use of all local currency generation in the public sector. Given that much of the conditionality relates to the private sector, this issue was discussed fully, and since all reports indicated that there is presently adequate credit for the private sector, the Mission's proposal was accepted. We asked, however, that the USAID analyze carefully the public and private sector credit situations, particularly with respect to private sector credit requirements. Further, the BCR's private sector credit strategy and the interest rate structure in El Salvador are to be reviewed by the Mission. Finally, we have asked the Mission to monitor carefully any change in the level of private sector credit so that appropriate alterations can be made in its strategy for use of local credit from the Supplemental, if approved.

Recommendations:

1. That you approve the updated conditionality strategy proposed by the Mission.

MOU to each disbursement to be cleared with C/AID

APPROVE ______

DISAPPROVE ______

DATE June 1, 1984

2. That you sign the attached PAAD amendment to authorize an additional $75 million in ESF grant funds for the Private Sector Support I Program.

Attachment:
Tab A - PAAD Amendment - $75 million ESF

Clearances:
GC:HFry ______
PPC/PDPR:EHullander ______

LAC/DR:LKlassen/SHerrell:(0687B):04/19/84:ext. 29152