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UNITED STATES INTERNATIONAL DEVELOPMENT COOPERATION AGENCY  
AGENCY FOR INTERNATIONAL DEVELOPMENT

Washington, D.C. 20523

EL SALVADOR

PROJECT PAPER

INDUSTRIAL STABILIZATION AND RECOVERY  
(Amendment # 1)

AID/LAC/P-351 & CR 198

Project Number: 519-0287

UNCLASSIFIED

<b>AGENCY FOR INTERNATIONAL DEVELOPMENT</b> <b>PROJECT DATA SHEET</b>	<b>1. TRANSACTION CODE</b> <input type="checkbox"/> A = Add <input type="checkbox"/> C = Change <input type="checkbox"/> D = Delete <input checked="" type="checkbox"/> <b>A</b>	<b>Amendment Number</b> <u>1</u>	<b>DOCUMENT CODE</b> <u>3</u>
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<b>2. COUNTRY/ENTITY</b> EL SALVADOR	<b>3. PROJECT NUMBER</b> <u>519-0287</u>
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<b>4. BUREAU/OFFICE</b> IAC <u>4</u> <u>05</u>	<b>5. PROJECT TITLE (maximum 40 characters)</b> <u>Industrial Stabilization and Recovery</u>
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<b>6. PROJECT ASSISTANCE COMPLETION DATE (PACD)</b> MM DD YY <u>0</u>   <u>9</u>   <u>3</u>   <u>0</u>   <u>8</u>   <u>9</u>	<b>7. ESTIMATED DATE OF OBLIGATION</b> (Under "B" below, enter 1, 2, 3, or 4) A. Initial FY <u>B</u>   <u>4</u> B. Quarter <u>4</u> C. Final FY <u>8</u>   <u>8</u>
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8. COSTS (\$000 OR EQUIVALENT \$1 = )						
A. FUNDING SOURCE	FIRST FY <u>85</u>			LIFE OF PROJECT		
	B. FX	C. L/C	D. Total	E. FX	F. L/C	G. Total
AID Appropriated Total						
(Grant)	( 1,850 )	( 712 )	( 2,562 )	(23,792.8)	( 5,667.2 )	( 29,460 )
(Loan)	( )	( )	( )	( )	( )	( )
Other U.S.	1.					
	2.					
Host Country (ESF counterpart)		870	870		5,246	
Other Donor(s) (Part. Inst.)		147	147		892	
<b>TOTALS</b>	1,850	1,729	3,579	23,792.8	11,805.2	35,598

9. SCHEDULE OF AID FUNDING (\$000)									
A. APPROPRIATION	B. PRIMARY PURPOSE CODE	C. PRIMARY TECIL CODE		D. OBLIGATIONS TO DATE		E. AMOUNT APPROVED THIS ACTION		F. LIFE OF PROJECT	
		1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan	1. Grant	2. Loan
(1) ESF	730	840		9,460		7,000		29,460	
(2)									
(3)									
(4)									
<b>TOTALS</b>				9,460		7,000		29,460	

<b>10. SECONDARY TECHNICAL CODES (maximum 5 codes of 3 positions each)</b> <u>831</u> <u>874</u> <u>920</u>	<b>11. SECONDARY PURPOSE CODE</b>
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<b>12. SPECIAL CONCERNS CODES (maximum 7 codes of 4 positions each)</b> A. Code <u>DEL</u> <u>PVON</u> B. Amount <u>15,000</u> <u>11,900</u>	
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**13. PROJECT PURPOSE (maximum 480 characters)**

To stimulate growth in the non-traditional export sectors of El Salvador, resulting in increased levels of employment, income, investment, and foreign exchange earnings.

<b>14. SCHEDULED EVALUATIONS</b> Interim MM YY <u>0</u>   <u>1</u>   <u>8</u>   <u>7</u> Final MM YY <u>0</u>   <u>8</u>   <u>8</u>   <u>9</u>	<b>15. SOURCE/ORIGIN OF GOODS AND SERVICES</b> <input checked="" type="checkbox"/> 000 <input type="checkbox"/> 941 <input checked="" type="checkbox"/> Local <input checked="" type="checkbox"/> Other (Specify) <u>CACM</u>
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**16. AMENDMENTS/NATURE OF CHANGE PROPOSED (This is page 1 of a \_\_\_\_\_ page PP Amendment)**

- To add \$20.0 million in grant funds to the original authorized amount.
- To extend the Project Assistance Completion Date by two years.

Payment Verification Procedures  
 Approved: WJ Grizzard  
 CONT: WJGrizzard

<b>17. APPROVED BY</b>	Signature: <u>Robin L. Gomez</u> Title: <u>Robin L. Gomez</u> <u>Mission Director</u>	Date Signed MM DD YY <u>0</u>   <u>8</u>   <u>2</u>   <u>8</u>   <u>8</u>   <u>4</u>	<b>18. DATE DOCUMENT RECEIVED IN AID/W, OR FOR AID/W DOCUMENTS, DATE OF DISTRIBUTION.</b> MM DD YY <u>0</u>   <u>3</u>   <u>2</u>   <u>4</u>   <u>8</u>   <u>7</u>
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PROJECT AUTHORIZATION

(AMENDMENT NO. 1)

Name of Country/Entity: El Salvador  
Salvadoran Foundation for Economic  
and Social Development (FUSADES)  
The Government of El Salvador (GOES)

Name of Project: Industrial Stabilization and  
Recovery

Number of Project: 519-0287

The authorization for this Project dated September 17, 1984 (hereinafter "Authorization"), is hereby amended to read as follows:

A. Sections 1 and 2 of the Authorization are hereby deleted in their entirety and the following new Sections 1 and 2 are substituted therefor:

1. Pursuant to Section 531 of the Foreign Assistance Act of 1961, as amended, I hereby authorize the Industrial Stabilization and Recovery Project for El Salvador, encompassing a grant to the Salvadoran Foundation for Economic and Social Development (FUSADES) and a grant to the Government of El Salvador (GOES), and involving planned obligations not to exceed Twenty Nine Million Four Hundred Sixty Thousand United States Dollars (\$29,460,000) in grant funds over a five year period from date of original obligation, subject to the following conditions: in accordance with the A.I.D. loan process, to help in financing foreign exchange and local currency costs for the project.

2. The project consists of technical and financial support to El Salvador's private and public sectors in order to stimulate growth in the country's non-traditional export sectors, resulting in increased levels of employment, income, investment, and foreign exchange earnings.

B. Section 3.5, "Conditions Precedent to Disbursement", of the Authorization is hereby amended by adding the following additional paragraph:

(iv) Prior to any disbursement, or the issuance of any commitment documents under the Project Agreement with FUSADES, of AID funds into the Investment Fund, FUSADES shall, except as A.I.D. may otherwise agree in writing, furnish in form and substance satisfactory to A.I.D.:

(a) An executed subsidiary agreement entered into by FUSADES and a recognized U.S. financial institution for the establishment of an Investment Fund to support industrial export projects which specifies, inter alia, the roles and responsibilities of FUSADES and the financial institution for carrying out the activity in accordance with the Project Description.

(b) Quantifiable financial targets for the Investment Fund against which performance of the participating financial institution and FUSADES can be measured over time.

(c) The criteria to be used by FUSADES in determining if an industrial project qualifies for support from the Investment Fund. Such criteria will include, but will not necessarily be limited to: market orientation, impact on employment, impact on foreign exchange earnings, importance of the economic subsector to El Salvador's future development, the project's ability to service foreign exchange debt, and the financial soundness of the proposed project.

(d) Documentation establishing an Investment Fund Committee in FUSADES which specifies in detail the initial composition of the Committee, the authorities delegated to the Committee, and the Committee's operational policies and procedures including conflict of interest policies and procedures applicable to Committee members, which shall not be modified during the life of the Project unless AID agrees otherwise in writing.

Except as expressly amended or modified herein, the Authorization remains in full force or effect.

  
\_\_\_\_\_  
Robin L. Gomez  
Mission Director

7/23/76  
\_\_\_\_\_  
Date

Drafted by: J. DeLoe, FPU:4511B  
Cleared by: A. J. Merrill \_\_\_\_\_ Date 7/1/76  
PRE: Fluger 7/2/76 \_\_\_\_\_ Date \_\_\_\_\_  
CONF: Davidson 7/2/76 \_\_\_\_\_ Date \_\_\_\_\_  
FPU: [unclear] \_\_\_\_\_ Date \_\_\_\_\_

INDUSTRIAL STABILIZATION AND RECOVERY  
PROJECT PAPER AMENDMENT

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H. Technical Reports \*

1. "Economic Growth Strategies for El Salvador: Preliminary Analysis of Possible New Approaches," Arthur D. Little, Inc.
3. "Diagnostic Assessment of the Women's and Men's Wear Sub-Sectors of the Apparel Industry in El Salvador," Kurt Salmon and Associates, Inc.
4. "Diagnostic Assessment of the Diversified Wear Sub-Sector of the Apparel Industry in El Salvador," Emanuel Weintraub Associates Inc.
5. "Diagnostic Assessment of the Associated Fashion Products Sub-Sector of the Apparel Manufacturing Industry in El Salvador," Atlanta Consulting Associates Inc.
6. "Background Review of Export Market Potential for Salvadoran Light Manufactured and Assembled Products," Arthur Young and Co., Inc.
7. "Investment Climate Profile of El Salvador," Coopers and Lybrand, Inc.

\* The complete reports are Bulk Annexes available in A.I.D. files.

LIST OF ACRONYMS

BCR	Central Reserve Bank
CAQM	Central American Common Market
CBI	Caribbean Basin Initiative
C/CAA	Caribbean/Central American Action
COEXPORT	Corporation for Export Development
DES	Department of Economic Studies (FUSADES)
FORTAS	Association Strengthening Activities Program (FUSADES)
FUSADES	Salvadoran Foundation for Economic and Social Development
FX	Foreign Exchange
GOES	Government of El Salvador
GDP	Gross Domestic Product
ISRP	Industrial Stabilization and Recovery Project
JV	Joint Venture
LC	Local Currency
MICE	Ministry of Foreign Trade
MIPLAN	Ministry of Planning
PACD	Project Assistance Completion Date
PP	Project Paper
PRIDEX	Trade and Investment Promotion Service (FUSADES)
PVO	Private Voluntary Organization
TA	Technical Assistance

CONTRIBUTIONS TO THE PROJECT PAPER SUPPLEMENT

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/

I. PROJECT AMENDMENT SUMMARY AND RECOMMENDATIONS

A. Recommendations

The USAID Project Development Committee recommends an authorization amendment for the Industrial Stabilization and Recovery Project (ISRP) to provide greater support to the development of export-oriented light manufacturing/assembly industry in El Salvador. The amendment proposes: (1) an increase in the authorized life of project grant funding of \$20.0 million (from \$9.46 million to \$29.46 million); and (2) a two-year extension of the Project Assistance Completion Date (from September 30, 1987 to September 30, 1989). The Project Committee also recommends that, with guidance from LAC/GC, the USAID seek approval of a blanket waiver to source, origin and nationality requirements from AID Geographic Code 000 (The United States) to Code 899 (Free World) countries for procurements of goods and services with a cumulative cost of \$5.0 million.

The proposed changes to the authorization, if approved, would be reflected in an amendment to Cooperative Agreement No. 519-0287-G-00-4387-00, through which an increment of \$7.0 million would be obligated in FY 1986, with the remainder of the \$20.0 million authorized funding increase to be obligated in subsequent Agreement Amendments. A Congressional Notification on the proposed Project Amendment was submitted to Congress on June 17, 1986 and expired on July 1, 1986.

LAC Redelelegation of Authorities to the Field, dated February 12, 1985, provides authority for USAID review and approval of this amendment to the Project and its authorization. Ad Hoc Redelelegation of Authority No. 149.1.48 (per STATE 119680 dated April 19, 1986, and STATE 200178 dated June 25, 1986) gives the Mission Director authority to sign an amendment to Cooperative Agreement No. 519-0287-G-00-4387 to obligate funds in an amount not to exceed \$7.0 million, subject to the clearance by an AID contracting officer.

B. Grantee

The Grantee for the proposed supplementary funds will be the Salvadoran Foundation for Economic and Social Development (FUSADES), a local, private, non-profit organization with principal implementing responsibilities for the ongoing ISRP.

C. Summary Description

The ongoing Industrial Stabilization and Recovery Project is one of the USAID's key programs for generating employment, income and foreign exchange for El Salvador. The Project, currently funded with AID grant funds in the amount of \$9.46 million, provides support to both the

public and private sectors for non-traditional export and investment promotion efforts. The ISRP is providing exporters of non-traditional products in El Salvador with policy development support through the public sector and with technical assistance, technology transfer, market information and other promotional services from the private sector. The public sector component, funded with \$2.56 million in grant funds, is being implemented primarily by the Ministry of Foreign Trade (MICE). The private sector portion is being implemented by FUSADES with a grant of \$6.9 million. Among the activities being implemented by FUSADES is a Trade and Investment Promotion Service program (PRIDEX) which facilitates information, technical assistance, and business development services to Salvadoran non-traditional export enterprises through the establishment of linkages between interested enterprises and entities both within and outside of El Salvador which can provide the needed services. In the first 12 months of operation (1985), PRIDEX assistance to firms resulted in the creation of 1,395 new full time jobs and 456 seasonal jobs, \$2.8 million in export earnings, and \$2.6 million in new investment.

Consistent with the objectives of the ISRP and the Mission's overall industrial recovery strategy, a Project Amendment is being proposed in order to increase the anticipated Project results in terms of employment and foreign exchange generation. The Amendment concentrates on providing greater support for drawback or light manufacturing/assembly industrial expansion through an amendment of the Cooperative Agreement with FUSADES. The Agreement Amendment will extend ISRP activities by two years, to a new assistance completion date of September 30, 1989. No new funding is needed for the public sector portion of the Project.

Most of the new funding, \$15.0 million, will be used to establish a new Investment Fund to provide financing for medium and long term capital requirements, primarily those having foreign exchange costs, of industrial projects exporting to non-CACM markets. The Investment Fund will be established by FUSADES in a U.S. bank with off-shore (Edge Act) operations. FUSADES and the financial institution will sign a subsidiary agreement - such as a trust agreement or a restricted commercial account management agreement - acceptable to the USAID, which will provide instructions to the institution on the uses of the Fund resources and the disbursement mechanisms to be utilized. Repayments of principal from the investments will be used to replenish the Fund for lending, and a portion of the interest earnings will be used to set up a bad debt reserve to help maintain the nominal value of the Fund. Other interest earnings will be used to finance the administrative fees of the financial institution and FUSADES' recurring operational costs. In addition, \$0.6 million in new supplementary resources will be provided to cover the costs associated with investment project analysis and review; \$2.8 million for the PRIDEX program to enable it to make available a greater level of specialized technical services to new or expanding export projects; and \$1.6 in additional funds for FUSADES' Program Coordination and Administration costs related to the two-year extension of the Project's life.

The original goal of the Project has been amended to reflect greater consistency with the USAID's major assistance goals: to accelerate economic growth and diversify the economy to attain higher levels of economic well-being. The purpose of the Project has been amended to emphasize quantitative results to be achieved: to stimulate growth in the non-traditional export sectors of El Salvador, resulting in increased levels of employment, income, investment, and foreign exchange earnings. A summary breakdown of contributions to the ISRP is as follows:

(US\$000's)

	AID			HOST COUNTRY			TOTAL PROJECT
	ORIGINAL PROJECT	THIS SUPPL	TOTAL	ORIGINAL PROJECT	THIS SUPPL	TOTAL	
FUSADES	6,900	20,000	26,900	624	268	892	27,792
GOES	<u>2,560</u>	<u>--</u>	<u>2,560</u>	<u>5,246</u>	<u>--</u>	<u>5,246</u>	<u>7,806</u>
TOTAL	9,460	20,000	29,460	5,870	268	6,138	35,598

## II. BACKGROUND AND RATIONALE

The Project Paper (PP) for ISRP, completed in August 1984, discusses EL Salvador's macroeconomic performance in recent history and the structural problems - legacies of the import substitution model followed since the early 1960's - which were constraining export-led economic recovery and growth. The limited growth prospects of EL Salvador's traditional export crops (coffee, cotton, and sugar) and of manufactured exports to the Central American Common Market (CACM), high rates of unemployment, and the expected growth of the labor force were recognized as serious problems that were undermining the country's future well-being. The ISRP was thus developed to support a new growth strategy based on the growth of non-traditional products to extra-regional markets to generate employment, income, and foreign exchange.

The sections below discuss the ISRP's results to date, the rationale for accelerating and expanding the development of export industry in El Salvador, and the constraints to this type of development.

### A. Project Results to Date

The ISRP was authorized on September 19, 1984. A Cooperative Agreement with FUSADES was signed on September 24, 1984, and a Grant Agreement with the GOES was signed on September 25, 1984. The Project Assistance Completion Date (PACD) for both Agreements is September 30, 1987. Funding for the Project has been obligated in increments, as follows:

AID FUNDS OBLIGATED FOR THE ORIGINAL ISRP

	<u>GOES</u>	<u>FUSADES</u>	<u>TOTAL</u>
09/24/84	\$ ---	\$2,157,000	\$2,157,000
09/25/84	843,000	--	843,000
01/29/85	358,000	3,142,000	3,500,000
07/19/85	--	1,601,000	1,601,000
07/24/85	1,359,000	--	1,359,000
TOTAL	<u>\$2,560,000</u>	<u>\$6,900,000</u>	<u>\$9,460,000</u>

1. Private Sector Export and Investment Promotion Services

As of March 31, 1986, total expenditures of the FUSADES portion of the ISRP, as reported by FUSADES, amounted to \$2,258,300, or 33% of the total amount obligated with FUSADES. Grant funds made available to FUSADES were spent for financing expenditures in four sub-components: a) Trade and Investment Promotion Services, b) Association Strengthening Activities, c) Policy Research and Development, and d) Program Coordination and Management.

The FUSADES budget for ISRP for the period April 1 to December 31, 1986, as adjusted in April 1986, is as follows:

Trade and Investment Promotion Services	\$1,604,400
Association Strengthening Activities	136,100
Policy Research and Development	309,200
Program Coordination and Management	371,500
Total	<u>\$2,621,200</u>

Given the amount expended through March 31, 1986, and the amount programmed for the remainder of CY1986, the amount available for the January - September 1987 period, approximately \$2.04 million, will be inadequate to allow FUSADES to replicate expected 1986 results, let alone 1985 actual results. These results have been:

a. Trade and Investment Promotion Services (PRIDEX)

Since inception of PRIDEX in January, 1985, initial staffing increased from an Executive Director, 4 Project Managers, and two secretaries to 20 persons working in offices in San Salvador (with 13 staff members) and in New York (with 7 staff members). The New York office opened in August, 1985, following the signing of a Project-funded, competitively let, 28-month contract for technical assistance with Arthur Young, Inc. In CY 1985, the PRIDEX staff accomplished the following:

EMPLOYMENT, FOREIGN EXCHANGE, AND NEW INVESTMENT  
GENERATED THROUGH PRIDEX ASSISTANCE IN CY 1985

	<u>Employment Generated</u>	<u>FX Generated</u>	<u>New Investment Generated</u>
Apparel	686	\$ 1,602,000	\$ 300,000
Non-Trad. Agriculture	114 (456)*	532,000	1,610,000
Light Manufacturing	-	-	104,000
Industrial Handicrafts	580	639,000	56,000
Aquaculture	-	-	45,000
Other	15	-	454,000
Total	<u>1,395 (456)*</u>	<u>\$ 2,773,000</u>	<u>\$ 2,569,000</u>

\* Seasonal jobs, not adjusted.  
Source: FUSADES, 1985 Annual Report.

These accomplishments occurred as PRIDEX worked with 19 textile manufacturers/processors, 5 agricultural enterprises, two investors each in light manufacturing and industrial handicrafts, one aquaculture project where the investment has been made, and 2 other projects where new investment occurred but no exports yet realized. PRIDEX services, for Salvadoran and foreign clients, include six project assistance areas:

Project Development Assistance

- conceptual development
- partner searches
- technology searches

Financial Assistance (Direct Support)

- feasibility studies
- institutional travel
- opportunity consultations

Market Access Assistance

- assessments
- price studies
- quantity estimates
- quality requirements
- direct marketing and contacts

Technical Assistance

- product design
- production
- technology transfer
- training

Investment Services

- investor assistance (counselling)
- financing assistance
- investment promotion

Export Assistance

- financing advice
- transportation
- advice on export and import procedures

Since all PRIDEX assistance is directed to non-traditional, extra-regional exports, in 1985 PRIDEX designed a series of special programs where evidence pointed to special advantages in El

Salvador. Those programs focused on the following subsectors: apparel processing ("maquila"); non-traditional agriculture (e.g. melons, watermelons, cucumbers); leather product processing; clay and ceramic tiles; and light industry. In addition, basic analysis was performed for: fresh vegetables; ornamental plants; flowers; medicinal plants for industrial use; electronic manufacture; medical supplies and pharmaceuticals; ethanol; and artisan industry.

These analyses have led to specific, short-term consultancies for apparel, medical supplies, electronics, and light manufacturing and assembly. These consultancies are supplemented by PRIDEX with trade fair and conference participations, public relations and liaison activity in the U.S. and El Salvador, development of promotional materials, and provision of information on investment in El Salvador.

During 1985, PRIDEX provided its services to 101 separate firms, of which 62 were still receiving PRIDEX services in April, 1986, and are seeking export opportunity. Over the year, PRIDEX conducted 9 feasibility studies, provided technical assistance or diagnostic services to 40 firms, evaluated market access and/or provided production design guidance to 25 firms, provided 6 invitational travel trips for joint venture purposes, conducted information searches for 4 firms, and provided financial investment assistance to 3 firms.

b. Association Strengthening Activities (FORTAS)

This activity was designed to provide short-term technical assistance and training materials through FUSADES to Salvadoran business associations to improve the associations' ability to offer their members the general information and training required to upgrade general management and production skills and establish bases for future exportation of their products. FORTAS finances such activities, with the associations contributing at least 25% of the cost of an approved activity. Eligible activities include: a) seminars, conferences, workshops, expositions, courses and other similar activities which promote non-traditional exports; b) consultant contracting; c) technical assistance and training programs; d) publications; e) observation trips; and f) other support such as studies and participatory presence at special events.

Under the development of this program, FORTAS staff, composed of a Manager, Executive Assistant, secretary and clerk, were hired in late 1984. This staff achieved the following results in CY 1985:

- Coordinated and developed 9 seminars for associations which were attended by 820 participants.
- Provided 4 training trips to U.S. plants, factories, and associations for 29 participants.

- Funded 8 consultancies/technical assistance efforts.
- Assisted an association member to bring a new export project into operation.
- Provided funding to an association for computer support.
- Established a library with audio-visual material for use by associations.
- Conducted an introductory seminar to introduce its services to Salvadoran associations, followed up with personal visits to all major associations.

c. Policy Research and Development

This sub-component made funding available to FUSADES to enable it to undertake studies required to develop the conceptual and analytical basis for proposing recommendations to the GOES on policies or actions which are supportive of economic reactivation, trade, investment and export development. As a result, the Department of Economic Studies (DES) at FUSADES was supported to periodically analyze the country's economic and social problems and propose recommendations for improvement via publications and presentations, the purpose of which is to create public awareness of national problems and their solutions. The Department grew from 2 persons in 1984 to 5 persons in 1985. Major efforts by the DES included the following:

- Publication of 6 studies, including a new economic model for El Salvador, emphasizing export-led growth; an economic, financial and legal review justifying the opening up of El Salvador to foreign banks; and reviews of the 1984/1985 economic achievements.
- Publication of 7 major bulletins including articles on inflation, a view of El Salvador in the year 2000 under varying scenarios; foreign trade opportunities; and an update on the CAQM.
- Monthly presentations to universities and private sector associations on social and economic topics.

The Department functioned well in 1985, serving as an apolitical reviewer of economic and social trends in El Salvador, and made significant gains in shaping government and general public opinion on where El Salvador should head to achieve economic growth. An example of the influence of the Department was FUSADES' participation in the drafting and review of the GOES' Export Development Law, approved by the Legislative Assembly in March, 1986.

d. Program Coordination and Management

In 1985, FUSADES consolidated not only its program management functions, but also its role as a serious, effective promoter of Salvadoran non-traditional exports both within and outside of the country.

The organization of the Foundation was restructured to better implement the ISRP, as well as to take on new responsibilities for other programs and activities. A new Executive Director was hired and two new departments were created to support FUSADES' operations: the Department of Planning and Institutional Development is in charge of developing FUSADES' strategies and plans which are needed to achieve its goals and objectives; and the Department of Administration and Finance establishes and maintains systems for information and financial control, as well as personnel administration.

In addition, two commissions, comprised of FUSADES' board members, were created: a Commission on Legislation proposes new legislation or modifications of GOES laws in support of the new economic model proposed by FUSADES; and a Commission on Conflict of Interest has the responsibility for developing, implementing and administering FUSADES' policies to avoid conflict between the interests of FUSADES and its programs and the interests of its directors, members, employees and contractors with regard to the use of goods, resources, services and information of the Foundation.

Besides implementing the ISRP in a highly successful manner, FUSADES has projected its image, voice and influence to promote both the Project's goal and objectives and El Salvador as a productive partner of the CBI. In July, 1985, it coordinated and hosted a meeting of C/CAA representatives and delegates from Central America and Puerto Rico to discuss the organization of the 9th Annual Conference and Exposition of CBI Investments. It organized and coordinated with Salvadoran public and private sectors, El Salvador's participation in the Conference in Miami in November, 1985. FUSADES also participated in a number of other important events in the United States, Mexico, Colombia, and other countries.

## 2. GOES Export and Investment Promotion

As of March 31, 1986, total expenditures of the GOES portion of the ISRP, amounted to approximately \$164,800, or 6% of the total amount obligated with the GOES.

The Grant finances activities in the public sector in four sub-components: Export and Investment Strategy Formulation, Strategy Support Mechanisms, Policy Studies, and Free Trade Zone Development. Implementation of these activities rests primarily with the Ministry of Foreign Trade (MICE). These sub-components were based on the strategic assumption that the GOES is committed to non-traditional, extra-regional exports as a new initiative for the future economic development of the country. This public sector component was designed to provide flexibility and resources required to attack export-related problems. Results to date are summarized below.

a. Export and Investment Strategy Formulation

Under this sub-component, ISRP funds are available to finance technical assistance to help the GOES develop a policy framework and ground rules for the public sector role in support of new export efforts by private enterprises. No overall strategy was developed in 1985, although during 1985 some government policies related to export credit and delivery mechanisms were formulated by the GOES, through the Central Bank and the Ministry of Planning. MICE is preparing to undertake a series of other policy analyses in 1986.

b. Strategy Support Mechanisms

Project resources are provided to fund short term TA and training to improve coordination among government entities and streamline export procedures. Activities in 1985 included the submission of a new Export Development Law to the Legislative Assembly in September. The Law, passed in March, 1986, establishes tax holidays for export production and creates the basis for private sector free zone operation. It also calls for a one-stop export documentation center under MICE to facilitate exporters in the paperwork process. MICE has contracted for a study on the implementation of the one-stop center.

In addition, a Committee for Promotion of Non-Traditional Exports was established in mid-1985 to bring export opportunities and problems to the attention of various actors in the regulatory scene. In early 1986, a tripartite commission of the BCR, MICE and MIPLAN began meeting with FUSADES and the Corporación del Desarrollo de Exportaciones (COEXPORT) to resolve specific exporter problems. As a result, the BCR is working towards establishing an office which streamlines the allocation of foreign exchange and credit for exporters.

c. Policy Studies

Various studies and assessments required to establish sound policy for promoting exports and activities required to generate awareness of problems affecting exports are anticipated under this sub-component. No studies were carried out in 1985; however, terms of reference have been issued for studies in the areas of transportation, free zone development, investment climate profile, the use of El Salvador's foreign service for export promotion, and exportable Salvadoran products.

d. Free Zone Development

The Project provides technical assistance to the GOES to formulate and implement a plan for revitalizing the San Bartolo Free Trade Zone. No progress has been achieved in this area by the GOES, except to note the policies and results of free zones in the Dominican Republic, Haiti and Mexico, in order to develop and incorporate important features on

free zone development and management into the new Export Development Law mentioned above. Infrastructure improvements, to be financed with ESF local currency, are expected to be undertaken in 1986.

### 3. Summary

FUSADES' efforts under the Project have achieved commendable results. As a consequence of these achievements and of the areas identified wherein El Salvador has competitive advantage, incremental funding for additional employment and FX generation is proposed. In addition, FX support for new investments in non-traditional export activity is seen as a necessary strategy element to enhance El Salvador's competitive role in attracting new industrial development.

Implementation progress by the COES for non-traditional export promotion to date has lagged. However, dialogue with MIPLAN, the BCR, and MICE on the importance of active, sound policy support will continue without additional funding.

#### B. The Need for Expanded and Accelerated Light Manufacturing/Assembly Industry Development in El Salvador

##### 1. Macroeconomic Update

After a thirty year period of sustained economic growth with low inflation rates and without major fiscal deficits or balance of payments disturbances, El Salvador's economy entered a turbulent phase in 1979. Adverse external factors, aggravated by guerrilla activity and its sequel of disruption of the productive apparatus and erosion of private sector confidence, led to a decline in economic activity, high inflation and large budget and balance of payments deficits. With the adoption of a stabilization program in 1982, the inflation rate decreased, the budget deficit was curtailed, and an incipient recovery of confidence began.

The economic decline was thus arrested by 1983 and a modest growth of real GDP, the first in six years, was registered in 1983 (0.8%), in 1984 (1.5%), and in 1985 (an estimated 1.6%). According to preliminary data, in 1985, agricultural output fell by an estimated 2.4% (a drop from the 1.2% growth reported for 1984), manufacturing grew by 4.5% (up from 1.3% in 1984), and construction grew by 12.0% (up from -5.7% in 1984). GDP growth rates originating in other sectors were roughly at or below 1984 levels. The economic recovery remains fragile, however, and the improvement in the fiscal and balance of payments performance after 1982 was due, in large measure, to heavy infusions of U.S. aid, mainly in the form of grants.

During 1985, there was a deterioration in the fiscal situation, with increased domestic financing of the budget deficit. There was a steady buildup of demand pressures and increased speculation against

the exchange rate, leading to a widening spread between the street rate and the parallel market rate. The GOES countered with several exchange liberalization measures in 1985, transferring an increasing proportion of exports and imports to the parallel market and moving the parallel market rate closer to the street rate. However, these measures failed to stem the tide of speculation.

In January, 1986, taking advantage of the favorable international environment (rising coffee prices, falling oil prices), the GOES launched a rather comprehensive stabilization program. The program consisted of unification of the official and the parallel market rates (at a level below the street rate), some new revenue measures (temporary windfall tax on coffee exports, maintaining the domestic petroleum price above the international price in order to yield a differential for the government, and some luxury taxes), measures of monetary restraint, including a general increase of some 2% in interest rates and an increase in legal reserve requirements, increases in the minimum wage and some public sector wages, and subsidies and price controls.

As expected, the initial inflationary impact of the adjustment program has been strong and there has been a marked increase in discontent and in labor conflict. The fiscal program needs additional strengthening. While the spread between the unified rate and the parallel rate has narrowed, inflationary expectations remain strong. It is doubtful that the price performance in the second semester will be on target without additional measures of fiscal-monetary restraint.

Unemployment and underemployment, though imprecisely measured, remain alarmingly high. According to the Ministry of Planning, unemployment stood at about 32.6% in 1985, slightly below the 33.3% rate now estimated for 1984.

Regarding recent trade trends, preliminary data suggests an overall slight decrease in exports and imports, resulting in a trade deficit estimated at \$236 million in 1985, as compared with \$251.4 million in 1984. Coffee exports in 1985 were at about the same level as in 1984, despite the dramatic increase in world coffee prices in the closing months of the year; cotton recovered somewhat (to a great extent attributable to liquidation of inventories carried over from 1984); sugar fell slightly; shrimp declined considerably; and exports to the CACM also fell - to approximately \$105 million, down from \$157 million in 1984. "Other" exports, comprised of non-traditional products to countries outside of Central America, continued to do relatively well according to the latest estimates. Indeed, this category is the one consistently bright spot, albeit still a very small one, in El Salvador's balance of payments. Estimated earnings during 1985 total \$76.4 million, up from \$63.7 million in 1984 and \$55.8 million in 1983.

## 2. Investment Trends

The table below shows investment performance for the 1978-1985 period. During the first half of the period, there was a rapid fall in investment levels. Gross domestic investment in nominal terms declined 35.4% between 1978 and 1982. In real terms the decline was over 133%. As a percentage of GDP, gross domestic investment fell from 23.8% to 13.2% of GDP. This rapid decline is closely linked to a substantial erosion in investor confidence associated with domestic political developments, the desintegration of Central American trade and unfavorable economic conditions in the international markets for some of El Salvador's export products.

The drop in the private component of investment dramatizes this point. Gross private fixed investment fell 55% between 1978 and 1982 from a level of Q1203 million to Q539.2 million. In real terms the decline was over 200%. As a percent of GDP, gross private fixed investment fell from 15.6% to 6.2% of GDP.

While Gross Domestic Investment continued its decline in 1982, private fixed investment showed the first sign of a recovery, posting a small nominal increase of 8.5% or 1.5% in real terms. The trend has been sustained with the posting of 8.7% real growth in 1983, 12% in 1984 and 19.4% in 1985. This recovery has been linked with the replacement of some of the country's capital stock and some rebuilding of inventories.

While the current private investment trend is encouraging, it must be viewed from two different perspectives. First, the increment was largely financed with external savings, i.e., large current account deficits facilitated by U.S. economic assistance. Absent the assistance, internal savings may not have been sufficient to finance an expansion of investment during the period. Second, investment has not been sufficient to reach the 1978 real investment level. In fact, in 1985, real gross private investment was approximately 50% of the real level reached in 1978. It is clear that a sustained economic recovery will require growing levels of investment.

## 3. The Need for New Approaches

The preliminary data presented above revalidates the macroeconomic rationale presented in the original Project Paper for the ISRP. That is, that the "model" pursued to date - agricultural production which relies on a few traditional commodities for export and import substitution manufacturing for the domestic and CACM markets - will not provide an adequate response to El Salvador's pressing needs for economic growth and development, and that the expansion of production of non-traditional goods for export to extra-regional markets must be developed as a major pillar to support sustained future growth.

EL SALVADOR: INVESTMENT TRENDS IN NOMINAL TERMS

(In Millions of Colones)

	<u>1978</u>	<u>1979</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984</u>	<u>1985</u>
<u>GROSS DOMESTIC INVESTMENT</u>	1834.0	1556.0	1183.0	1231.0	1185.4	1223.7	1394.4	1535.8
PRIVATE SECTOR	1203.0	990.0	566.0	539.2	585.0	715.7	880.6	1242.0
PUBLIC SECTOR	449.0	522.0	644.0	633.4	544.6	464.1	455.3	457.3
INVENTORY CHANGE	182.0	44.0	-27.0	58.4	55.8	43.9	58.5	-163.5

(As a Percentage of Nominal GDP)

<u>GROSS DOMESTIC INVESTMENT</u>	23.8	18.1	13.3	14.2	13.2	12.1	12.2	11.0
PRIVATE SECTOR	15.6	11.5	6.3	6.2	6.5	7.1	7.7	8.9
PUBLIC SECTOR	5.8	6.1	7.2	7.3	6.1	4.6	4.0	3.3
INVENTORY CHANGE	2.4	0.5	-0.3	0.7	0.6	0.4	0.5	-1.2

This conclusion was reconfirmed in a 1985 study funded by the USAID on "Economic Growth Strategies for El Salvador: Preliminary Analysis of Possible New Approaches." The study, presented as a bulk annex to this PP Amendment, found that neither the agriculture sector (because of a limited arable land base) nor the manufacturing sector (constrained by the limited domestic and CACM markets) can generate the level of employment needed to absorb ever greater numbers of entrants into the labor force and the level of foreign exchange earnings to support needed investments for economic growth and development.

According to the study, El Salvador's most pressing economic need becomes one of employment generation, given that over 30% of its economically active population is unemployed and another significant percentage is underemployed, that approximately 30,000-40,000 persons will be entering into the labor force per year in 1986 and in 1987, and that an annual population growth rate of nearly 3% will fuel increasing numbers of new entrants into the labor force for years to come even if the rate were dramatically reduced today.

Agriculture, even at the 1978 peak level, will not provide the answer. According to the analysis, if full pacification of the country were achieved in the near term and the historical (1961-1978) growth of 3.5% per year in the GDP of the agriculture sector was resumed on the same basis (with high labor utilization) as before, 10,000 Salvadorans could become fully employed in this sector per year, leaving some 20,000-30,000 new labor force entrants unemployed. While the creation of some 10,000 new jobs would be a very significant achievement, it should be realized that the economic use of labor in agriculture on the same basis as before would demand maintaining wages and per capita income to the rural population at constant real levels for another 20 years, as was the case before.

To achieve the goal of fairly rapid and dynamic employment generation, the study recommended, and this PP Amendment proposes, that El Salvador look to drawback industry in the early stages of a new economic growth model. This type of industry demands high labor utilization, and that is precisely where El Salvador has significant comparative advantage owing to its large pool of relatively cheap, but productive and trainable manpower. El Salvador also has good entrepreneurial and managerial resources, some of which have had experience in "maquila" and other industrial operations. This focus would also generate secondary employment in the services sector for the rapidly growing urban population of the country. Moreover, according to the study, for every dollar invested in El Salvador in a drawback or light manufacturing/assembly operation, approximately one dollar per year of net foreign income would be generated, even during the early stages of the industrialization program, based on present wages.

C. Constraints to the Expansion of Light Manufacturing/Assembly Industry in El Salvador

In the course of developing this PP Amendment, the USAID and FUSADES contracted for several analyses to determine more comprehensively the potential for "maquila" or light manufacturing/assembly industries in El Salvador, the constraints to such development, and recommended interventions. "Maquila" sectors in which El Salvador has had experience and which, according to the technical analyses carried out, appear to offer the most promise for development and/or expansion, include: 1) apparel (women's wear, men's wear, diversified wear, and associated fashion products), 2) electronics assembly, 3) medical supplies and devices, and 4) other light manufacturing. The analyses are bulk annexes to this PP Amendment, and summaries are presented in Sections VI.A and VI.B.

Briefly, the studies corroborated the need for and feasibility of expanded industrial export development. Good management resources and productive labor supply, much of which has current or past experience in industry, were found to be ample resources that could be mobilized in new or expanded projects. During the development of this Project Amendment, enterprises in the textile subsectors were visited and their owners and managers interviewed by consultants, and client enterprises in the other sectors were also contacted by PRIDEX staff. Some of the enterprises visited had plans underway or were seriously interested in expanding their operations, but were held in check by several factors, one of which was the lack of hard currency investment capital.

The development of the original ISRP identified the need for investment capital as a further stimulus for the creation of employment and foreign exchange. The ultimate consensus of opinion between the Mission and AID/W when the Project was authorized in 1984 resulted in ISRP commencing without a credit component and with guidance for the Mission to investigate methods and identify institutions that could provide investment capital. The Mission, acting in compliance with the AID/W guidance, has arrived at the conclusion that AID funding of an investment finance component for export processors ("maquila") and light industry oriented to non-CACM export markets is needed in order to open up possibilities for resuming or leveraging the required levels of investment credits from commercial institutions.

To place the need for investment credit and/or the mobilization of such capital in proper perspective, El Salvador is considered by most appraisors of country credit risk as a member of the elite unworthy. Institutional Investor, which reports on the credit standing of 109 countries, ranked El Salvador 106 in 1985, ahead of only Uganda, North Korea, and Nicaragua and behind such stellar performers as Zaire, Ethiopia, Sudan, Sierra Leone, Bolivia, and Haiti. Euromoney, in its November 1985 issue, evaluated 119 countries on economic and financial risk and ranked El Salvador last (119 of 119) in financial risk and 111 of 119 for economic risk, just ahead of Ethiopia.

The 1985 Frost and Sullivan World Political Risk Forecast unsurprisingly ranks El Salvador "very high" in political risk. This category is the most severe and is used only when there is civil or international war. There should be little doubt that investment prospects for El Salvador are poor and that to encourage investment the perceptions of such high risk must be reduced. The hard truth is that foreign investors will not risk substantial sums, even with highly profitable opportunities, unless the odds can be brought more in line with opportunities elsewhere. At the same time, Salvadoran investors have immense difficulty accessing credit from the international financing community.

The Mission has struggled to alleviate investor constraints through a concerted effort in 1985 at consensus building for a "development bank" or "venture capital" institution. Despite the enthusiasm of the Salvadoran private sector, the timing for new institutions of this ilk was not consistent with current GOES priorities. Discussions at the highest levels with the GOES on this subject resulted in opposition. Combining this impasse with the "mixed" ownership (i.e. nationalized) status of the commercial banking systems; the very careful adherence of other institutions, such as Banco Hipotecario, to GOES credit policy; and the substantial evidence that commercial bankers have difficulty in reorienting decisions to investment banking criteria, the Mission cannot endorse any existing Salvadoran financial institution to fulfill the necessary flexible and encouraging investment credit role. The inability of existing institutions to adequately service the investment needs of non-traditional export projects and the opposition by the GOES to allow the establishment of a new, private sector venture capital institution led to the conclusion that the capital required for investment in industrial processing for export, the foundation for job and foreign exchange generation, must be stimulated in an innovative manner to reverse these existing internal and external constraints.

Given the external perceptions of El Salvador by the international investment community and the internal constraints, highlighted above, which preclude local financial institutions from providing flexible, innovative investment financing, it is fair to note that this proposed component for the ISRP is a high risk venture for AID. Even if markets and good potential projects are identified through PRIDEX, commercial bankers and others, and local investor commitments are secured and foreign interest aroused, the proposed investments might not be made, or might rapidly be abandoned or closed, should the internal violence escalate to untenable levels. Assuming that domestic unrest continues at current levels or even if it increases somewhat, the Mission is convinced that the risk of fund dissipation or of temporary aberrations to sustained investment can be overcome by careful management, and that the results achieved by incremental or new investment ventures in terms of employment generation and foreign exchange earnings warrant the risk. The Mission's recommended strategy to accomplish the provision of export processing investment resources is presented below in Section III.B.

D. Relationship to the Mission Program and A.I.D. Policies

One of the USAID's assistance goals for El Salvador is to achieve economic recovery and growth. One of the three principal program areas included in the Mission's 1986 Action Plan to address this goal is that of industrial recovery. The Mission's short term objectives to achieve industrial recovery are to increase investment and production in the agroindustrial and the industrial sectors with an emphasis on export assembly and processing ("maquila") industries. The USAID's medium to long term objectives in this program area are to help El Salvador stimulate permanent private sector employment and to increase foreign exchange earnings, domestic and foreign investment, and per capita income. The Mission's Action Plan strategy to achieve these objectives is to build the necessary Salvadoran institutional base to identify market opportunities in the U.S., particularly under the CBI and other non-regional markets, and to provide the necessary support (e.g., credit, foreign exchange, technology, technical assistance, free zones, and investment climate) to take advantage of those opportunities. By providing technical and financial support for the development of "maquila" or light manufacturing assembly industry in El Salvador, the proposed ISRP Amendment is fully consistent with the Mission's assistance objectives and strategy. The Amendment will also constitute a major effort for contributing to the achievement of the Mission's Action Plan performance indicators and benchmarks related to industrial recovery (e.g., expansion of "maquila" exports by \$24 million above 1984 levels by the end of 1987, creation of 8,000 jobs above 1984 levels by the end of 1987, and an increase in the demand for medium and long-term credit for "maquila" industry exceeding \$10 million by the end of 1987).

The proposed Amendment will complement other USAID efforts to reactivate the economy and stimulate economic growth. For example, the Mission's ESF Balance of Payments Program, which makes available foreign exchange for imports of raw materials, intermediate goods and spare parts, also serves as a major vehicle for guiding GOES economic policy. Local currency credit lines, established under the Balance of Payments Program, support private sector activity, and a local currency Investment Insurance Fund, to be initiated in mid-1986, will provide insurance coverage against losses to export enterprises caused by civil commotion.

The proposed Amendment conforms to NECCA recommendations and overall AID policies. The incentives provided will encourage private enterprise and individual initiatives, help create a favorable investment climate, and promote non-traditional export efforts. Technical support services to be financed are consistent with AID's policies on technology transfer. The proposed investment financing element is consistent with AID's policies on lending terms to private enterprises, which recommends that AID resources to private, profit-making enterprises producing goods and services for sale in commercial markets be made available at market interest rates. The provision of AID resources in the form of a grant to

FUSADES for the establishment of an Investment Fund is needed to promote long-term, high-risk investment. This allocation of grant funding to FUSADES is consistent with AID's "Guidelines on Terms of Aid" and, since a portion of the interest earnings from the Fund's investments will be made available for FUSADES' future recurring operating costs, will also further AID's priorities on institution building.

### III. PROJECT AMENDMENT DESCRIPTION

#### A. Project Goal and Purpose

The original goal of the ISRP was to generate employment, income and foreign exchange. The goal has been amended to reflect greater consistency with the USAID's major assistance strategy goals. The original purpose of the Project was to develop the capacity of the private and public sectors to provide policy support and technical assistance, technology transfer and training services to exporters of non-traditional products. The purpose has been amended to emphasize quantitative results to be achieved. The new goal and purpose are:

Goal: to accelerate economic growth and diversify the economy to attain higher levels of economic well-being.

Purpose: to stimulate growth in the non-traditional export sectors of El Salvador, resulting in increased levels of employment, income, investment, and foreign exchange earnings.

#### B. Project Amendment Strategy

Three key assumptions formed the strategy for the ISRP when it was originally developed and continue to do so. They are:

1. The GOES is committed to an extra-regional, non-traditional export strategy as a new initiative for the future economic development of El Salvador;
2. The private sector of El Salvador will play a major role in the implementation of the export strategy for non-traditional products; and
3. Domestic investment, complemented by foreign investment, will play a key role in the development of non-traditional exports to extra-regional markets.

The strategy designed to achieve the original Project goal and purpose split the ISRP into public sector and private sector components. The public sector strategy emphasized USAID's support to the GOES to formulate, articulate and implement a national strategy which supports efforts by the Salvadoran private sector to increase non-traditional exports to extra-regional markets. The Salvadoran Ministry of Foreign Trade (MICE) was selected as the principal implementing entity for the public sector

component because of its responsibilities to promote and regulate exports and foreign investment. The illustrative outputs for the public sector component emphasize priority policy-influencing activities.

The private sector component of the Project was built around FUSADES, a broad-based, apolitical organization composed of business leaders in a position to work with the GOES as well as all Salvadoran business organizations. Under the ongoing ISRP, FUSADES is providing El Salvador with PRIDEX services described above in Section II.A. The ISRP strategy recognized that excellent, though somewhat limited results vis-a-vis the country's needs, could be achieved over the three-year life of Project. Under ISRP, FUSADES also embarked on a program to deliver information and training to potential exporters through business associations to increase staff outreach. Training provided by associations emphasize skills required for export development, while other training and technical assistance supply industry or product-specific assistance to individual companies with specific export projects -- all to create additional employment and foreign exchange.

The ISRP strategy recognized the need for access to credit to finance new investments. While not a component of the original ISRP, new local currency lines of credit were created by the USAID in FY 1985 under the Balance of Payments Program to provide working capital, pre-feasibility financing, and "equity" loans for exporters. These funds were considered "bridge" financing while El Salvador's credit regulations and policy analyses became better defined. The review procedures instituted by the BCR proved cumbersome to potential users. In addition, the foreign exchange allocation process has discouraged use of these lines by some manufacturers, and the "equity" loans have been less than successful. The Mission continues to work with the BCR to ease the local currency credit delivery system.

The strategy for this PP Amendment is to provide additional resources to FUSADES in order to: (1) make available FX investment capital for new or expanded "maquila" or light manufacturing export projects in El Salvador; and (2) continue the provision of PRIDEX services to investors, producers or marketers of non-traditional exports, including those requiring investment capital. The strategy calls for a PACD extension for implementation of current Project activities from the current PACD of September 30, 1987 to a new PACD of September 30, 1989. While not otherwise noted in this PP Amendment, it is possible that the proposed activities may take longer than is provided by a two-year extension. For this reason, should the results obtained by FUSADES in achieving the Project purpose and outputs through this strategy be representative of USAID expectations, further extension of the ISRP with concomitant new funding or a follow-on project should be considered for review by the Mission and AID/w.

The strategy for making available investment capital for industrial export projects is to create an Investment Fund designed to encourage foreign investors to locate in El Salvador by providing access to

medium and long term credit at competitive market rates and to provide local investors, who are foreseen to be the most likely group to initially assume investment risk, with access to this Fund. This activity facilitates the creation of jobs and dollars in El Salvador, but in order to do that the investment credit should be channeled in a timely, innovative and cost-effective manner. The strategy for accomplishing this hinges on the institutional arrangements and incentive structure to elicit, to the extent possible, the "right" investment lending decisions. Such an incentive structure should encourage sound though not excessively conservative credit decisions, timely and adequate though not costly credit analysis and review, and maintenance of the Fund's integrity.

One design alternative considered during the development of the Project Amendment was to operate the Fund through a local commercial bank. This alternative was rejected because USAID experience has shown that the typical local commercial banker makes commercial rather than investment decisions. This alternative was seen to decrease the incentive for timely, innovative investment approaches and approval decisions, raised risks of discouraging equity funding and, because the local tradition of collateralized, as opposed to cash-flow, lending would result in over-management of the Fund. Moreover, if the Fund were operated through a local commercial bank, the cooperation expected for joint-project financing would probably not materialize as the other local commercial banking institutions would not wish to divulge their clients' needs to another commercial bank in this relatively small financial community.

A second design strategy considered, with the advisory assistance of three experts in international financial markets and management, was to place the Fund in an off-shore trust or restricted account. The issue then centered on who would have responsibility for reviewing Salvadoran projects and making the decisions on the Fund's investments. One option was to place this responsibility with the investment banking arm of the trustee institution, and the other option was to place it with FUSADES. The first option was seen to have the advantage of insulating FUSADES from potential negative political backlash to its association with determining which industrial projects would have access to the Fund, and it also avoided possible accusations of partiality from entrepreneurs who are turned down for assistance from the Fund. However, this design strategy had negative implications, given the underlying incentive structure. First of all, the placing of this responsibility with a disinterested third party with little local knowledge had several disadvantages. One, if the trustee decision maker were asked to assume the risk on investments made, it was likely to take an overly conservative approach, especially given its lack of knowledge of local factors. Moreover, in order to make prudent decisions it would undertake significant examination and review of proposed projects, which would result in costly fees charged for the service. On the other hand, if the trustee were absolved of assuming the risk on the investments, it was likely to take an overly lenient approach which, when combined with the lack of local knowledge, could result in unsound decisions without accountability for those decisions.

Since FUSADES already has the capacity to put projects together and some experience in initial project investment analysis, and since it has an intimate knowledge of the local environment, it made sense that the decision making responsibility for Fund investments be borne by FUSADES, rather than the international financial institution. FUSADES might have a tendency to also take an excessively conservative or lenient approach in the decision making unless an incentive arrangement were built in to elicit sound yet timely credit decisions. Allowing FUSADES to reap certain financial benefits from the investments made, i.e. to allow interest earnings from the investments to accrue to FUSADES as endowment support, was considered to be the appropriate incentive vehicle. Nonetheless, because it would have an interest in preserving its endowment, FUSADES might have a tendency to be overly cautious in its decision making. However, this possibility would be compensated for by the fact that if the AID funds were not disbursed, the endowment would not materialize. Thus, under this implementation strategy, it would be in FUSADES' interest both to make sound investment decisions and to make decisions leading to disbursements of the AID funds.

This last strategy for implementing the Investment Fund is the preferred one. With this strategy, it is anticipated that FUSADES will channel the investment resources from the Fund in a timely manner and yet take care, to the extent possible, to preserve the integrity of the Fund and the endowment that it represents to FUSADES. An additional benefit of this implementation strategy is that the Fund's interest earnings will promote the institutional security and viability of FUSADES. FUSADES could utilize this income to cover its future recurring operating expenses. Thus, FUSADES would be assisted in becoming a "going concern", i.e. a strong, independent PVO not overly dependent upon future annual AID donations.

No other alternative seemed logical for an independent Fund operation having as its objectives the marshalling of investment capital for El Salvador's industrial export processing. The management of the Fund by FUSADES will strengthen its ability to enhance its PRIDEX effort with a new source of assistance for export projects, to work closely with local private sector institutions and entrepreneurs, to provide broader assistance to potential local and foreign investors, and to remain an active player in Salvadoran society in support of El Salvador's development.

### C. Project Amendment Elements, Inputs and Outputs

#### 1. Investment Fund

##### a. Introduction

The Project Amendment will provide \$15.0 million for the establishment of an Investment Fund in an off-shore financial institution. This activity is designed to make available investment credit or equity support to domestic and/or foreign investors for the purpose of stimulating

the establishment of new or expanded industrial "maquila" operations or of light manufacturing/assembly export enterprises in El Salvador. Agroindustrial projects are specifically excluded from being considered for investments from the Fund, because of the existence of other USAID-FUSADES projects which promote and support such activities.

b. Uses of the Fund

The Investment Fund is defined as a financial instrument which can be used to provide foreign exchange (FX) or local currency (LC) resources to a new industrial export project or for the expansion of existing industrial concerns for export activity. The Fund would not be limited to the provision of loans, but could, if required, take back an equity position up to prudent limits in order to leverage additional capital from third parties. As the Fund is a limited resource, leverage would be sought out for its use by seeking cofinancing from other sources, including other responsible institutions. It will avoid taking short-term positions in order to secure that leverage.

The principal uses of the Fund's resources will be for the FX costs of investment in "maquila" projects exporting to non-CACM markets, because of their sole orientation to FX earning markets. Investments by the Fund in other industrial projects may be made, depending on the prospects of the enterprises to penetrate non-regional markets and to service dollar debt. Investments for import substitution for local or CACM markets would not be eligible for Fund assistance. As projects exporting to non-CACM markets earn foreign exchange, the sale of their products would provide the FX required to pay off their debt to the lender accessing the Fund's resources. The FX earnings inherent in export operations also provide the revenue necessary to pay off LC requirements. If an investor were to convert FX borrowings to LC for LC purchases, through a Salvadoran bank, repayment in FX to the institution accessing the Fund's resources would be required of the borrower.

By avoiding the provision of short-term credit, the Fund's resources will complement local commercial bank activity, and thus the Fund can be recognized as a partner with the traditional banking community rather than as a competitor to these institutions. Another positive benefit is that avoiding short-term financing precludes mixing commercial banking criteria with investment objectives. Short-term working capital requirements in "maquila" or other industrial export projects can be financed with the projects' own equity, through material consignment or supply contracts, or through commercial financial instruments. The Fund will similarly avoid offering commercial banking services such as opening letters of credit.

A series of advantages should accrue to the Investment Fund by following this approach. One example would be the encouragement of local or foreign banks to participate in cofinancing programs, with the

Fund's resources taking the later maturities of longer term loans or by discounting early maturities to the banks. The cooperation expected from local commercial banks should result in cross-referrals once the banks recognize that the Fund's resources are complementary to their services. Should this cooperation be less than anticipated, with the result that local banks are not willing to provide working capital credit that is vital to achieving investment objectives of a specific project, the Mission may, during implementation, consider the possibility of the Fund providing less than three year term lending for selected, exceptional cases. As FUSADES is also expected to consider using the Fund for financing equity positions in cases where residual capital is required, a serious constraint for investment projects in El Salvador, as reported by the BCR and commercial banks, can also be partially addressed.

c. Fund Services

The Fund's resources should provide positive impact on El Salvador's high unemployment rate and the country's urgent need for foreign exchange within a relatively short period. El Salvador's risk profile, which from a foreign perspective is thought to deter project investment, should not pose a problem for the reaction of the Fund. In order to operate professionally and expeditiously, the following activities are considered appropriate for Fund operations:

1) Loan Financing: Loan financing for medium and long term requirements of "maquila" or other industrial export projects in El Salvador will be a principal source of income for the Fund and will help resolve a lack of confidence in El Salvador's investment climate. Financing will be aimed at "maquila" investments which, by definition, are export projects, and those industrial projects established for extra-regional exports. No agroindustrial project financing will be made by the Fund. Loan terms acceptable for financing from the Fund's resources should be for a minimum of three years at commercial rates. Total loan funding to one project, financed with grant resources from the Fund, will not exceed \$500,000 (unless AID agrees otherwise in writing). Loan funding terms will exclude premiums for El Salvador's economic and financial risk.

2) Equity Financing: FUSADES will have the flexibility to provide up to 25% of a project's equity requirements from the Fund's resources, if necessary to maintain a reasonable debt/equity ratio and solidify the obtaining of other funds. The total combined loan/equity financing provided by the Fund's grant resources will not exceed \$500,000 (unless AID agrees otherwise in writing). While equity could include common or preferred stock, convertible debentures and earnings participation clauses are the favored means of providing such funding. As the purpose of the Fund is not to own or operate companies, the equity position will be of less than five years' duration (unless AID agrees otherwise in writing), with contractual buyback provisions by the investors established in advance.

3) Correspondent Bank Relationship: In promoting the types of industrial projects which are to be supported by the Fund, FUSADES will work closely with potential investors. In addition, the financial institution administering the Fund should have the ability to liaison with the investor's bank(s) or to place funds through an institution of the investor's choice.

4) Guarantees: Excessive physical guarantee requirements is a constraint to new borrowing from local banks. It would appear that the provision of stand-by guarantees by the Fund to another financial institution for financing an investment in El Salvador might be a useful service of the Fund. However, because AID's financial management policies do not allow for guarantee funding until the value of a contingent liability is established, and since the terms for the on-lending by the Fund are medium to long term, the provision of such guarantees with AID funds would constitute less than prudent management of the AID funds. Therefore, stand-by guarantees using AID funds will not be provided. FUSADES may, however, elect to provide such guarantees with the Fund's reflows.

d. Implementation of the Fund

1) The Fund

The Fund will be structured as an investment trust - either as a trust account or possibly as a restricted commercial account - for the primary purpose of encouraging investment in El Salvador. The Fund will be established by FUSADES in, and administered by, a selected U.S. financial institution with off-shore (Edge Act) operations, approved by AID and qualified to perform functions of trust, such as an international full service lender. The responsibilities of the financial institution would be: (a) to disburse resources from the Fund according to instructions provided by FUSADES for investments in "maquila" or light industrial export operations in El Salvador after the USAID authorizes FUSADES through a Project Implementation Letter that it (FUSADES) has satisfied the conditions precedent to disbursement for this activity and that it may initiate the Investment Fund activities; (b) to set aside in secure, liquid instruments a portion of the interest earnings from the Fund's investments as a bad debt reserve; (c) to disburse interest earnings from the Fund's investments to FUSADES as provision of financial support for the latter's operating expenses after the PACD; (d) to temporarily invest idle investment reflows in short term, secure, liquid investments; (e) to report periodically and as circumstances warrant to USAID, FUSADES, and other parties as to the status of the Fund's operations; and (f) to provide other services as may be requested by FUSADES for reasonable fee. These responsibilities, as well as FUSADES' role and responsibilities, will be specified in a subsidiary agreement, approved by the USAID, to be signed by both parties. The executed subsidiary agreement will constitute a condition precedent to disbursement of AID funds to the Investment Fund. The financial institution will make no value judgment of debt or equity financing other than the investment limits and criteria prescribed in the subsidiary agreement between it and FUSADES.

The financial institution will be selected by FUSADES through informal competition. Each prospective institution will be requested to disclose how it can best perform the required services and the proposed fee schedule for performance. While it is anticipated that various U.S. banks with Edge Act operations will be respondents to FUSADES' inquiries, the most likely arrangement may be through a U.S. bank which has direct representation in El Salvador or which has historical correspondent relationships with El Salvador's local banking community.

While procedures for disbursement from the Investment Fund for financing of "maquila"/industrial export projects may vary depending on the specific circumstances of each project, the most likely transaction would be for the Fund to disburse to the financial institution, under a contractual arrangement with the financial institution, and the financial institution to on-lend to the end-user. The financial institution would not assume the credit risk, so that default by the end-user would be passed back to the Fund. An administrative "spread" of up to 3 percent for the intermediary institution may be likely, e.g. if the end-user paid 13 percent on its loan, the Fund would receive 10 to 11 percent. This represents a very attractive arrangement for the intermediary, as it is not risking any of its own funds.

This procedure for Fund disbursements is assumed due to the need for companies in El Salvador to register FX debt with the Central Reserve Bank (BCR). For repayment purposes, debt registered to recognized international financial intermediaries generally receive higher priority by the BCR if FX must be allocated.

Thus, all borrowings from the Fund's resources by an investor will be registered at the BCR in accordance with local regulations. In the case of LC requirements, assumed to be for buildings or land, FUSADES may assist an investor in negotiations with the local commercial banks for the provision of LC credit in a manner which does not preclude the investor from being frozen out of future borrowing by being required to pledge excessively high security to the local bank. Should an investor require more LC credit than the local banks can give, the Fund's resources could provide the LC through equity shares, subordinated debentures, or an FX loan for LC needs. The latter position would require maintenance of the FX value.

The financial institution administering the Fund will request, through FUSADES, AID direct disbursement of the Project grant funds for this component directly into a non-interest bearing Fund account as required to cover investment for projects in compliance with the terms and conditions established in the subsidiary agreement for the Fund. AID funds would then flow to the investor, or to another financial institution administering the credit, or to companies providing equipment for the export project. Depending on the fee schedule negotiated with the financial

institution for administering the Fund, there may be a need for AID funds to be used to pay bank management fees in the initial start-up period of the Fund, i.e. before the Fund generates any interest earnings. Payments of principal and interest, or dividends and capital gains, will immediately be deposited into an interest-bearing Fund account, where those funds can be reinvested in short-term, secure liquid instruments until required for new investments, in accordance with the purpose of the Project.

In order to help maintain the nominal value of the Fund, a bad debt reserve will be established with the interest payment reflows from the Fund's investments. Initially, the reserve will be set at 2% of the portfolio and may be adjusted, with joint concurrence between FUSADES and AID, based on lending and repayment experience. The funds for this reserve will be invested in secure, liquid instruments. Other interest earnings would be used to pay the administrative "spread" accruing to the financial institution and for FUSADES' operating expense support, in accordance with the terms and conditions of the subsidiary agreement. After the PACD, the amount of interest earnings of any one-year period available to FUSADES will be net of any set-aside necessary for the bad debt reserve and the bank's administrative fees.

## 2) FUSADES' Role

Given that El Salvador has a nationalized banking system, lending activity by a private sector entity could potentially come up against political backlash. This potential problem was carefully considered by FUSADES. On July 1, 1986, the FUSADES Board met and agreed that the political risk was manageable, in light of the fact that FUSADES has been able to establish a positive relationship with the GOES and, moreover, that FUSADES has recently been able, with GOES knowledge, to establish another investment account for supporting investments in irrigated agriculture under the AID-financed Water Management Project. The Board also agreed that an off-shore Fund could make loans or take equity positions in Salvadoran firms, that earnings or losses could be absorbed by the Fund, and that reflows from the investments would then be reinvested in new "maquila"/industrial export projects, with net interest earnings going to help defray FUSADES' future operating expense requirements.

### e. Project Analysis, Review and Approval

To manage the Fund and avoid charges of conflict of interest or favoritism being brought against the Board, FUSADES will establish an Investment Fund Committee, composed of five persons, of which the majority will be non-Board members, to evaluate investment proposals and approve or deny using the Fund's resources to support proposed project needs. FUSADES' intent is to not pay honoraria to the Committee members; however should it become necessary to compensate Committee members for the time spent in discharging their responsibilities, FUSADES may consider instituting some form of compensation. FUSADES currently has a general conflict of interest policy and procedures (see Annex H); those to be specifically applied to the Committee members will be elaborated upon. As mentioned below, explicit criteria will be used by the Committee in making its decisions. The Committee will have the final say on the investment decisions, with those decisions reported to, but not subject to appeal to, the FUSADES Board. As a condition precedent to any AID disbursements to the Fund, FUSADES must receive USAID approval of the authorities delegated to

the Committee, its initial composition, and its operational policies and procedures including conflict of interest policies and procedures applicable to the Committee members. Should changes to any or all of these be proposed by FUSADES during the life of the Project, the prior written approval of the USAID will be required.

The Committee will employ prudent decision making criteria in reviewing possible project investment requirements. While the decision criteria will be based on a project's financial viability, market orientation, and its impact on employment, other criteria necessary to reduce risk, such as the security of the project's market, its ability to repay FX debt (debt coverage), its FX earnings potential, and the ability of El Salvador to compete in international markets in specific product areas represent other factors to be considered by the Committee. Cases that will require special scrutiny by the Committee will be those where an ongoing enterprise serving both the domestic and CACM markets, with a small portion of plant output destined for extra-regional sales, presents a proposal to increment the extra-regional export component of its business. In such cases, the company's overall capability of earning FX and paying off a FX denominated investment credit debt will be carefully considered by the Committee. Review of sales commitments, proposed joint venture correspondence, the degree of non-CACM market security, and possible creation of a separate export company would be potential factors to be taken into account in the decision making criteria to avoid to the extent possible the diversion of the planned exports to the local or CACM markets. An additional condition precedent to AID disbursements to the Fund will be the specification of the criteria (see Annex F) to be used in determining if an industrial project qualifies for support from the Investment Fund.

The Committee will be provided with a small investment project staff, which will serve as a technical secretariat to the Committee. This unit will review and summarize potential funding proposals presented to the Committee for consideration by PRIDEX or outside parties, submit its findings and recommendations on the proposals to the Committee, track the investments made and spot-check procurement purchases by the borrowers of the Fund, and prepare reports on the investments. The staff's project analysis function may require specific short term technical assistance in assessing specific industry projects or assertions on cost elements. ISRP funding for PRILEX technical assistance will offset the costs of this TA when the projects are sponsored by PRIDEX since much of the packaging work will already have been done by PRIDEX, for which the beneficiary firm has made a counterpart contribution. Projects presented to FUSADES by commercial banks or other persons or entities (e.g. COEXPORT), will require that the investor pay for any out-of-pocket costs incurred by the staff, and a basic fee, in advance, for staff review. The Committee's approval of financing for a project may include instructions for the Fund to provide an amount which covers the investor's up-front payment.

Grant funds in the amount of \$0.6 million will be made available from the Project Amendment to cover the costs of the investment project unit, short term TA required for special project evaluation, and possible honoraria to Committee members.

## 2. PRIDEX

Section II.A.1 provides background on PRIDEX and its role in ISRP implementation. Under the Project Amendment, the basic conceptual PRIDEX role would expand to include project financial review, and the service orientation and organizational structure will reflect some modification. The 1987-1989 period will more directly concentrate PRIDEX efforts on promoting projects in the (a) apparel/textile, (b) electronics, (c) medical supplies, and (d) light manufacturing and industrial handicrafts sectors, as a response to more detailed familiarity with El Salvador's competitive advantages. The concentration of PRIDEX effort responds to a more focused approach, but it does not preclude assistance in areas outside of these four major groupings.

Given the emphasis in these four major areas, FUSADES' operating cost projections for PRIDEX reflect a leaner, more local organization, and this operating mode is reflected in Section IV, "Project Amendment Cost Estimates and Financial Plan." FUSADES/PRIDEX will carry out joint venture or contracting efforts through industry specialists and would upgrade its staff efforts to perform initial investment packaging work locally. It is anticipated that expatriate staff will not be needed locally after 1987.

The initial promotional activities required to present a well-rounded investment promotion package for El Salvador can be carried out by FUSADES/PRIDEX. These activities include the support arrangements for preliminary planning and technical assistance for potential projects, the promotion of "maquila" joint ventures, and sub-contracting or supply contracting arrangements with U.S. or other international companies.

Initial project investment analysis is also not new for PRIDEX. It has assisted in arranging local financing and has prepared prefeasibility and some feasibility analysis support services for local investors. This role will continue, but with the added advantage of being able to access the Investment Fund. As most legwork for the project packaging can be performed by local staff, and FUSADES personnel are in a position to comment on the character of most local investors, the cost of providing a financial commitment from the Fund is thus not expected to be inordinately high. While PRIDEX is the expected leading sponsor, the local commercial banks, local chambers and associations, and other institutions could also put potential investors in contact with PRIDEX. If PRIDEX is requested to find a "partner" for a potential project, it will make efforts to put the investor in contact with institutions or individuals with the capacity to play that role.

When PRIDEX personnel feel that an investment project has merit, it will notify the Investment Fund Committee and, at the same time, submit the project documentation to the investment project unit which will review the project package for the Committee.

FUSADES/PRIDEX personnel will also work with other local institutions, such as COEXPORT and local banks, in order to inform them of the Investment Fund, its purpose and uses. As mentioned in the preceding section, project proposals may be presented to FUSADES by outside groups. For such cases, any packaging or staff review costs incurred by FUSADES would be borne by the investor. Such costs may be included in the loan arrangement, if the project financing is approved.

Grant funds in the amount of \$2.8 million will be made available under the Project Amendment for the PRIDEX component. These funds will cover the projected costs of technical assistance, personnel, invitational travel, program support (advertising and publications, and seminars and conferences), equipment and supplies, and overhead.

### 3. Program Coordination and Management

Section II.A.1.d provides background on FUSADES management and the role it has played in the ISRP implementation. Annex G presents the updated organization chart of FUSADES, and Section VI.E provides an updated administrative analysis of this Foundation. FUSADES' organizational structure has management, staff, and line offices. The executive management function resides in the Office of the Executive Director. Staff functions are carried out by the Offices of Planning and Development, Administration and Finance, and Marketing and Communications. The line offices are in charge of implementing FUSADES' specific programs, which at this time include the Department of Economic Studies, PRIDEX, FORTAS, Agriculture Diversification (DIVAGRO), Small and Micro Business (PROPEMI), and Irrigated Agriculture Development.

Grant funds in the amount of \$1.6 million will be provided under the Project Amendment to FUSADES to cover the costs through the PACD extension of the Office of the Executive Director and of the staff offices. This funding will fund personnel, technical assistance, equipment and supplies, invitational travel, program support (advertising and publications and seminars and conferences), and overhead expenses. This funding increase will also enable FUSADES to increase personnel of these units, including the possible hiring of an Executive Assistant to the Director of Planning and Development, a Director of Marketing and Communications (which would include the function of fund raising), a Manager for Public Relations, a personnel assistant, and two additional accounting clerks.

### 4. Other ISRP Components

During the course of developing this PP Amendment, the USAID and FUSADES discussed the future directions and projected expenditure requirements of the Association Strengthening Activities (FORTAS) and the Economic Studies (DES) components of the original ISRP Project with FUSADES. It was noted that both these activities had been planning and budgeting programs in excess of available funding. FUSADES concurred with a Mission proposal to provide short term TA to help focus better the role and

program definition of those components, which might better be carried out under a separate Cooperative Agreement. As a result, no new grant funds provided under this Project Amendment are proposed for FORTAS or DES.

As noted in Section II.A.2, the public sector portion of the original ISRP has sufficient funds to continue implementation of the activities contemplated in that component. No new funding under the Project Amendment is proposed for the GOES/ISRP activities.

#### D. End of Project Status

It is anticipated that at completion, the Project will leave behind public and private institutions with substantially strengthened capabilities to develop, give direction to and promote non-traditional export activity by private enterprises for extra-regional markets. Other anticipated major outputs of the overall Project include:

- An estimated 14,000 new jobs created for skilled and unskilled workers of export enterprises assisted by the Project. This employment will result in approximately \$17.5 million in wages and salaries annually by the end of the fifth year of the Project.
- An estimated \$45.0 million in foreign exchange earnings generated by export enterprises assisted by the Project.
- An estimated \$25.0 million of new direct investment made in export enterprises assisted by the Project.

### IV. PROJECT AMENDMENT COST ESTIMATES AND FINANCIAL PLAN

#### A. Financial Plan and Analysis

This Project Amendment will add \$20.0 million in grant funds to the Industrial Stabilization and Recovery Project for a total AID contribution to the ISRP of \$29.46 million. The \$20.0 million being proposed will be provided to FUSADES. Of this amount, \$15.0 million will be used to establish the new Investment Fund, approximately \$0.6 million will be for funding the investment project unit, \$2.8 million for the PRIDEX Program and \$1.6 million for FUSADES' administrative costs.

Annex D contains six financial tables showing: 1) the budget for the original ISRP/FUSADES Project by component and funds available under the original grant funding as of 3/31/86; 2) projected use of grant funds through 1986; 3) the budget for 1987; 4) the budget for 1988; 5) the budget for 1989; and 6) the budgetary allocations of the grant funds from this Project Amendment.

The following tables summarize the cost estimates and financial plan, projections of expenditures by year, and the distribution of grant funds to be provided by this Project Amendment by Project activity.

SUMMARY COST ESTIMATE AND FINANCIAL PLAN  
FOR THE PROJECT AMENDMENT

(In US\$000' s)

	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>TOTAL</u>
<u>AID</u>				
Technical Assistance	541.0	420.0	500.0	1,461.0
Personnel	468.4	808.0	930.0	2,206.4
Equipment & Supplies	—	15.0	15.0	30.0
Overhead	—	—	71.8	71.8
Invitational Travel	—	100.0	121.0	221.0
Program Support	—	201.0	241.0	442.0
Sub-Total	<u>1,009.4</u>	<u>1,544.0</u>	<u>1,878.8</u>	<u>4,432.2</u>
Invest. Proj. Unit	117.8	220.0	230.0	567.8
Investment Fund	<u>3,000.0</u>	<u>5,000.0</u>	<u>7,000.0</u>	<u>15,000.0</u>
Total AID Suppl. Grant	<u>4,127.2</u>	<u>6,764.0</u>	<u>9,108.8</u>	<u>20,000.0</u>
<u>FUSADES</u>				
Counterpart Funds Applied	<u>91.4</u>	<u>80.0</u>	<u>97.0</u>	<u>268.4</u>
<u>TOTAL PROJECT</u>	<u>4,218.6</u> =====	<u>6,844.0</u> =====	<u>9,205.8</u> =====	<u>20,268.4</u> =====

SUMMARY PROJECTION OF EXPENDITURES  
UNDER THE PROJECT AMENDMENT

(IN US\$000' s)

	<u>AID</u>		<u>FUSADES</u>	<u>TOTAL</u>
	<u>FX</u>	<u>LC</u>	<u>LC</u>	
1987	3,658.8	468.4	91.4	4,218.6
1988	5,821.0	943.0	80.0	6,844.0
1989	<u>7,991.0</u>	<u>1,117.8</u>	<u>97.0</u>	<u>9,205.8</u>
TOTAL	<u>17,470.8</u> =====	<u>2,529.2</u> =====	<u>268.4</u> =====	<u>20,268.4</u> =====

SUMMARY OF GRANT FUNDING BY ACTIVITY  
UNDER THE PROJECT AMENDMENT

(IN US\$000' s)

	<u>INVESTMENT</u> <u>FUND</u>	<u>Invest. Proj.</u> <u>Unit</u>	<u>PRIDEX</u>	<u>PROGRAM</u> <u>ADMIN</u>	<u>TOTAL</u>
1987	3,000.0	117.8	624.0	385.4	4,127.2
1988	5,000.0	220.0	1,000.0	544.0	6,764.0
1989	<u>7,000.0</u>	<u>230.0</u>	<u>1,227.4</u>	<u>651.4</u>	<u>9,108.8</u>
TOTAL	<u>15,000.0</u> =====	<u>567.8</u> =====	<u>2,851.4</u> =====	<u>1,580.8</u> =====	<u>20,000.0</u> =====

B. Assessment of Methods of Implementation and Financing

The methods of implementation and financing for this Grant Amendment are as follow:

<u>Inputs</u>	<u>Implementation</u>	<u>Financing</u>
Investment Fund	Investment Trust Agreement or Restricted Commercial Account	Periodic Advance with Direct Reimbursement
PRIDEX Program	Indigenous Private Voluntary Organization	Periodic Advance with Direct Reimbursement
Invest. Proj. Unit	Indigenous Private Voluntary Organization	Periodic Advance with Direct Reimbursement
Administrative Expenses	Indigenous Private Voluntary Organization	Periodic Advance with Direct Reimbursement

All AID appropriated funds for foreign exchange costs other than the Investment Fund will be managed directly by FUSADES. The Investment Fund will be administered by an international financial institution, as discussed in Section V.C.1.d.1), with AID retaining cash management responsibilities to ensure disbursements from appropriated funds are for immediate needs. FUSADES will be charged with the responsibility of sound cash management and fiscal control of all funds disbursed directly to it, including detailed accounting and reporting for cash receipts, cash outlays

and expenditures by obligating documents. Specific reporting formats and procedures will be those established by the USAID for local currency and US dollar financing.

It should be noted that initial disbursement of AID funds to the Fund may not be placed in interest bearing accounts but used only for project investment and, possibly, initial Fund costs; reflows into the Fund must be used for the purposes established under the Project and may be placed in interest bearing accounts based on the prudent management of the financial institution in accordance with the subsidiary agreement for the Fund; and AID grant funds may be drawn down to fund all new project investments prior to use of reflows.

The original Cooperative Agreement with FUSADES for the ISRP provided that an independent audit of FUSADES financial records be carried out annually. Independent audits are currently being provided by Peat, Marwick and Mitchell. This provision will be continue to apply under the Amendment to the Agreement which obligates the supplementary grant funds. In addition, all AID appropriated funds for FX and LC costs will be subject to audits or reviews as may be arranged by AID.

Presently, Price Waterhouse and Co. is also providing technical assistance to FUSADES in the area of financial management.

## V. - PROJECT AMENDMENT IMPLEMENTATION ARRANGEMENTS

### A. Implementation Responsibilities and Administrative Arrangements

The \$20.0 million grant supplement will be obligated by means of Amendments to the current Cooperative Agreement with FUSADES for the private sector component of the Project, subject to the availability of AID funding.

#### 1. Role of USAID

The Mission's Private Enterprise Office (PRE) will be responsible for monitoring the implementation of the Project. Initial assistance in establishing the contractual relationship for the Investment Fund will be provided through an AID Legal Advisor. With the assistance of the Mission support offices, PRE will:

- Report on the Project to Mission Management as appropriate;
- Monitor Project activity, ensuring compliance with conditions and covenants of the Cooperative Agreement and the subsidiary agreement for the Investment Fund, and taking action as necessary;
- Review Project reports and other related correspondence, taking action as needed;

- Periodically attend Investment Fund Committee review meetings, as requested.
- Make periodic visits to Project sites;
- Supervise evaluation activities; and
- Approve requests to AID for disbursements.

To assist this effort, a USAID Project Implementation Committee will be formed, consisting of PRE and representatives from the Projects Office (PRJ) and the Controller's Office (CONT).

## 2. Responsibilities of FUSADES

FUSADES will be responsible for sound management of the PRIDEX program, which is expected to play a lead role in encouraging new Salvadoran business and arousing foreign investor interest in El Salvador. FUSADES will also be expected to:

- Create the mechanism for managing the resources of the Investment Fund. This will include the formation of an Investment Fund Committee to approve or deny investment funding proposals, formulation of the specific criteria to be used in reviewing and approving proposed projects, and the policies and operating procedures to guide the work of the Committee.
- Create a small investment project analysis staff which will work closely with PRIDEX and provide technical support to the Investment Fund Committee to determine the merits and creditworthiness of investment proposals.
- Monitor the performance of the investments made with the Fund's resources. FUSADES will provide the USAID, on a quarterly basis, descriptive profiles of the investment projects approved and on each project's impact on FX earnings, employment, and total investment generation. In addition, FUSADES will supply the USAID with a periodic (semi-annually or as may be mutually agreed upon by FUSADES and the USAID) summary of its portfolio including delinquency, borrowers' project financial status, portfolio performance, and comparison to planned financial targets for the Fund.
- Track the procurements financed with AID grant funds, including spot-checking of procurements made by the Fund's borrowers and report to the USAID on the amount of procurements which have been made from non-U.S. or CACM countries, in accordance with source, origin and nationality waivers.
- Take steps to increase its membership base and/or increase its fund-raising efforts to expand its current endowment;

- Continue its efforts as a modulating voice between the Salvadoran public and private sectors so that El Salvador's economic recovery is better assured; and
- Continue to conduct its affairs in a professional manner.

3. Responsibilities of the Financial Institution Administering the Investment Fund

As noted in Section III.C.1.d.1), the responsibilities of the financial institution would include: (a) the disbursement of resources from the Fund according to instructions provided by FUSADES for investments in "maquila" or light industrial export operations in El Salvador after the USAID has authorized FUSADES to begin the Investment Fund activities; (b) the establishment of a bad debt reserve with a portion of interest earnings from the Fund's investments; (c) the disbursement of annual interest earnings from the Fund's investments to FUSADES as provision of financial support for the latter's cash operating expenses after September 30, 1989, the PACD, or as agreed to in writing by FUSADES and USAID; (d) the temporary investment of idle investment reflows in short term, secure, liquid investments; (e) the periodic reporting, and as circumstances warrant, to FUSADES and USAID, and other parties as to the status of the Fund's operations (the reports will supply information needed by FUSADES for the latter's portfolio reports to the USAID, and the frequency of the reports to FUSADES will be agreed upon in the subsidiary agreement between the two parties); and (f) the provision of other services as may be requested by FUSADES for reasonable fee. These responsibilities and the corresponding administrative guidelines and procedures will be specified in a subsidiary agreement, approved by USAID, to be signed by FUSADES and the financial institution.

4. Evaluation

The original Cooperative Agreement includes language on the establishment of an evaluation program, as well as annual reviews of Project implementation carried out by FUSADES with AID participation.

In addition, an assessment of the initial implementation performance of the Investment Fund component will be carried out prior to the obligation of the second AID funding increment for the Fund. This assessment will be carried by FUSADES and the USAID, with the possible participation of AID/w and/or an outside finance/banking specialist. The assessment will focus on the implementation arrangements and operational procedures for the review, analysis, approval, and funding of investment projects; investment projects submitted to FUSADES for financing consideration and investments approved; and any implementation difficulties which may have been experienced. The results of this assessment will assist in determining whether adjustments should be made in the implementation arrangements and procedures, including, for example, changes to the loan or loan/equity funding levels per project which require prior AID written approval.

## 5. Implementation Plans

A Cooperative Agreement Amendment obligating \$7.0 million will be signed with FUSADES in July, 1986. Subject to the availability of AID funds, future Agreement Amendments will obligate a total of \$13.0 million. The Amendment will provide management and administrative expense support to FUSADES through 1989 to cover a two-year extension of the original Agreement, and PRIDEX program expenses associated with expanding original Project targets.

FUSADES will select the U.S. financial institution to administer the Investment Fund through informal competition and using criteria approved by the USAID. Letter requests for expressions of interest, developed jointly by FUSADES and the USAID, will be sent to U.S. banks with Edge Act operations in September, 1986. The selection for negotiation will be based upon the quality of services offered for the most competitive fee structure in order to maximize the return to the Investment Fund. It is likely that the financial institution selected to administer the Fund would be one with local representation or with strong correspondent relationship with a local bank to facilitate arrangements within the local financial sector for the provision of short term financing and of local currency financing which investment projects may require.

A subsidiary agreement, approved previously by USAID, would be signed by FUSADES and the selected financial institution by December, 1986. This agreement will include a clause permitting FUSADES, with prior USAID written approval, to change the financial institution for cause if the latter is not performing adequately based upon mutually agreeable performance factors. In the event the financial institution is changed, another institution may be engaged by following the procedures outlined above or as AID may otherwise agree in writing.

Annual implementation plans and budgets for the Investment Fund component will be prepared by FUSADES, in close consultation with the USAID. The plans and budgets will be submitted to the USAID for approval. The first plan will be due in January, 1987. The Fund's operating experience will be reviewed in June, 1987, in order to determine any implementation modifications applicable to the FY 1987 funding increment. Annual plans and budgets for other FUSADES activities included in the Project Amendment will also be submitted to the USAID for approval.

### B. Disbursement Procedures

#### 1. To the Trust

Disbursements of grant resources to the Investment Fund account will be made by the USAID utilizing a 90 day advance/direct reimbursement of funds method based on Fund disbursements to, and projected

funding requirements of, investments in industrial export projects. The advance requests and liquidations will be submitted to the USAID by FUSADES, based on funding requests from the financial institution for approved project needs. More detail on the disbursement procedures to the Fund and by the Fund is presented in Section III.C.1.d.1).

2. To FUSADES for Other Project Components

Disbursements for other Project components shall continue to be made by the USAID to FUSADES utilizing an advance/reimbursement of actual costs method for both local currency and foreign exchange costs of the Project activities. Disbursements of grant resources in local currency will be made to FUSADES' local bank account established for the receipt and control of Project funds. Disbursements of grant resources in dollars will be made to FUSADES' U.S. bank account.

C. Procurement Plan

1. Contracting for Technical Services for Investment Fund Establishment

The USAID will fund the costs of legal services, as required for the establishment of the Investment Fund. The major activities to be performed by the technical assistance will be the review of proposals from recognized financial institutions with experience in investment activity in Latin America and of the proposed subsidiary agreement which will establish the Investment Fund. USAID will contract with FUSADES for the procurement of the required services, allowing FUSADES to acquire the services through informal competition. The costs will be covered under the Mission's Program Development and Support budget, after the Mission has reviewed and concurred with FUSADES' procurement process and proposed arrangements.

2. Contracting for Other Technical Services

FUSADES will contract for technical services under the PRIDEX component, or for other technical assistance using its approved policies and procedures, developed by Price Waterhouse and Co., which are based upon competitive selection principles. AID prior approvals in writing for procurements in excess of \$50,000 will be required.

Should FUSADES require separate contracting efforts to select contractors or brokers for marketing of Salvadoran products under the PRIDEX component, they will be contracted using FUSADES' policies and procedures. Publication of intent to contract such assistance in the Commerce Business Daily (CBD) is not expected, as these persons would not normally be users of the CBD. Direct written solicitation, perhaps preceded by a notice in an industry trade publication, is anticipated to be the avenue for appropriate solicitation by FUSADES. As FUSADES has contracted for goods and services in the original Project, and has formal policy and procedural manuals prepared by Price Waterhouse which are acceptable to AID, no procurement problems are anticipated to arise.

3. Procurement of Goods and Services from Non-U.S., Non-CACM Suppliers

Implementation experience to date has demonstrated that in order to promote more effectively Salvadoran non-traditional exports to markets outside the CACM, the experience and expertise of individuals, firms, free trade zones, or other institutions from countries such as Mexico, Ireland, Korea, Taiwan, Singapore, and several CBI countries are oftentimes the most relevant to the efforts being undertaken in El Salvador with assistance from the Project. Moreover, to attract new potential investors from the Far East and other non-U.S. regions who may be interested in locating in CBI countries, it is necessary that such contacts be facilitated through invitational travel and observation visits. Additionally, participation by Salvadorans in non-U.S., non-CACM international trade events, conferences, seminars or other training, has been not only useful experience for the Salvadoran participants but a valuable means to promote El Salvador through representation at such international forums. It should be noted that one project from Far East investors has been established by PRIDEX, and interest from the Far East has been shown for other investments.

The original PP foresaw the need to grant a waiver from AID Geographic Code 000 (the United States) nationality requirements for the procurement of services, including technical assistance and training, to facilitate the achievement of the Project's objectives and purpose. However, it proposed to grant such waivers to allow for services from Code 941 (Selected Free world) countries on a limited case-by-case basis. Such waivers have been granted, but the USAID waiver approval process is relatively time consuming, which hinders taking advantage of special targets of opportunity. Equally important, the waiver possibility does not allow for the procurement of services from countries such as Hong Kong, Ireland and other Code 899 (Free World) countries not included in Code 941.

In addition, during the development of this PP Amendment the need for waiving source and origin requirements for equipment purchases by the Fund's borrowers was recognized. Many of the Fund's borrowers will be Salvadorans seeking to expand production for extra-regional markets. The plants of these investors, often with European equipment, argue well for procuring new equipment which is compatible with existing equipment and which imply cost economies due to mutually usable spare parts. In addition, as textiles and apparel are potential targets for new plant investment by the Fund, foreign investors interested in moving in from the Far East to take advantage of CBI and 806/807 opportunities often utilize equipment produced in that part of the world. For example, a new investor from the Far East is moving equipment to El Salvador with a depreciated book value of \$2.5 million to establish a plant for 202 new jobs with \$300,000 in local investment. While the investor does not need the Fund to provide support now, the firm's possible expansion in 1988 may result in a loan application to the Fund for financing new equipment of Far East manufacture for the same reasons of compatibility and cost economies mentioned above.

Because FUSADES is not an ICI, but its investment funds will be administered by a financial institution, and because AID funds granted to FUSADES will be used for investment purposes, AID's regulations on procurements deriving from new sub-loans or investments must be considered. While it is not the intent to create a bureaucracy, the conditions to create one by adhering to AID's regulations on procurements and waivers must be recognized. Even with a life of Project waiver authority, the monitoring of equipment purchases under the waiver would still be required of FUSADES and USAID. That process has the potential to become excessively cumbersome if repeated, individual waivers have to be sought, justified, processed and approved on a case-by-case basis.

It should be noted that some of the estimated goods and services which have been determined to be critical to achieving the Project's objectives could be procured from Code 941 countries. Rather than split the waiver approval into two waivers, one for Code 899 and the other for Code 941 Code eligibility, and thus avoid adding to the waiver monitoring burden and allow some flexibility, approval of one waiver to Code 899 is being proposed to allow grant funded procurements of goods and services, other than transportation services, needed for the Project, for a cumulative amount of \$5.0 million during the life of the Project.

Tables 7 and 8 of Annex D show the estimated requirements which could be facilitated with this waiver authority. As can be seen in those tables, the projected waiver requirements for procurement of services total \$886,500 and for procurement of goods \$5,250,000, for a combined total of \$6,136,500. It should be noted that these are very preliminary estimates at this point and are gross indicators of the need for a waiver. Since the assumptions on which the projections are based may change during implementation, justification cannot convincingly be made at this stage to request waiver approval for the full amount of the preliminary estimates. It is thus proposed that a life of project waiver for \$5.0 million be approved initially. During implementation, the USAID and FUSADES would track procurement amounts approved with the waiver authority. Should it become evident that additional waiver authority would be needed, the USAID will consider taking appropriate action to obtain the additional waiver approval. Even though this PP Amendment provides new funding only for the FUSADES component, it is further proposed that this \$5.0 million waiver authority apply to both the FUSADES Cooperative Agreement (up to a total cumulative amount not to exceed \$4,662,500) and the GOES Grant Agreement (up to a total cumulative amount not to exceed \$337,500).

Pursuant to AID Handbook 1, Supplement B, Section 5B4a, any waiver of the authorized list of eligible countries or geographic code must be based upon one of several criteria. Inasmuch as the proposed waiver is considered critical to promoting new investment under the Project, approval of the waiver meets the criteria of "such other circumstances as are determined to be critical to the success of project objectives."

The Mission will seek legal guidance from LAC/GC on AID's policy regarding authority for approving this waiver and, on that basis, will proceed to seek the approval.

## VI. SUMMARIES OF PROJECT AMENDMENT ANALYSES

### A. Technical Analysis

In May, 1986, Arthur Young & Co. performed an analysis of El Salvador's export potential based upon its past history. This analysis, "Background Review of Export Market Potential for Salvadoran Light Manufactured and Assembled Products," emphasized industrial sectors and products that had the potential for increased export activity over the short term. FUSADES/PRIDEX is following up on the report recommendations to investigate in further detail the electronic, medical supplies, and metals manufacturing segments. Additionally, detailed analyses of textile opportunities were completed by Kurt Salmon Associates, Atlanta Consulting Associates, and Weintraub Associates. These sector analyses identify the opportunities for El Salvador in export processing and establish targets and required resources to achieve those targets. The textile "business plan," augmented by the Arthur Young overview, provides the objectives to be achieved by the FUSADES Export and Investment Promotion Program through this Amendment. Those Project analyses are available as bulk annexes to this document, and a brief summary is given below.

The reports indicate that despite its internal problems, El Salvador has a good industrial base and can be competitive in the U.S. and other developed country markets. However, the conditions affecting these markets are dynamic, and El Salvador will have to constantly improve its position if it is going to stay competitive.

If El Salvador is to expand its manufacturing sector, it will have to increase its penetration of non-traditional markets and specifically those of the U.S. and other OECD countries. To that end, it must build on sectors of past export strength such as textiles and apparel, electronics, leather goods, and metal products.

Positive factors for the future include the ready availability of energy, relatively low external debt, high labor productivity and good managerial/entrepreneurial skills. There is plenty of excess capacity and a good skills base in the manufacturing sector which can be quickly put to use. This, however, will require an adequate flow of foreign exchange and external credit and relative domestic stability to restore the confidence of the private sector. (Arthur Young estimates that an investment of about \$250 million will be required just to bring plant and equipment to a level of production that is 80 percent of that achieved in 1978.)

Restoration of productive capacity and stimulation of the private sector need to be combined, however, with an aggressive program of industrial restructuring and reorientation, if El Salvador is to keep pace with neighbors such as Costa Rica and the Dominican Republic which seem to have a momentum (and normal internal conditions). The Arthur Young report emphasizes a number of subsectors for El Salvador's export processing fields and makes recommendations for the following product categories.

#### 1. Electronic Assembly

Electronic Components is the subsector where El Salvador has the major comparative advantage in the entire Caribbean region. El Salvador's exports are concentrated in semi-conductors and related components. However, given the country's track record in that type of product, there should be additional opportunities in other types of electronic components as well. The market is there.

In the category of Consumer Electronics there are opportunities for assembly as in the Radio/Television category. Finally, El Salvador could be competitive in supplying components for Air Conditioning, Refrigeration and Heating Equipment or for assembly of parts of such equipment.

#### 2. Medical Equipment and Supplies

The most promising subsector seems to be Surgical and Medical Instruments where the country has experience and capacity for exports. The same to a lesser extent can be said about X-Ray and Electromedical Equipment, although the export market in this subsector is much smaller. Niches can be found in two other categories, Surgical Appliances and Supplies and Dental Equipment and Supplies. Such niches could include: bandages, dressings, sutures, stretchers, sterilizers, gloves, masks, protective clothing, dental instruments and dental laboratory equipment. A useful strategy for El Salvador might be to take advantage of existing market penetration and experience and build on it both vertically and horizontally, taking advantage of the CBI.

#### 3. Rubber and Plastic Products

Most of the potential in this sector is in the Miscellaneous Plastics segment. There is a sizable import market in the U.S. and El Salvador has both good capabilities and export experience.

#### 4. Metal Products

Of the subsectors examined, Screw Machine Products and Industrial Fasteners and Miscellaneous Metal Products seem to hold promise. El Salvador has both the capacity and the experience for exporting into the U.S. Moreover, import markets are large, especially for industrial fasteners.

## 5. Leather Products

Opportunities for Salvadoran exports exist in all segments examined. Given the lack of substantial local supply of hides, opportunities in this industry will be mostly as drawback arrangements with U.S. producers, whereby the new material is imported in some form (possibly even as hides since good tanning capability exists in El Salvador) and leather products are exported as semi-finished or finished items. Certain products (not including footwear) in this category are covered by the CBI. The best potential for the U.S. market exists in the category of Handbags and Personal Leather Goods where many niches exist and can be exploited by a small producer like El Salvador.

Similar potential exists for Leather and Shoe Parts (e.g. leather uppers, soles, etc.). Luggage also may have possibilities, although competing with Asian importers and U.S. manufacturers would be much harder.

## 6. Textiles/Apparel

Given the possibilities inherent in the overview analysis, PRIDEX contracted the firms of Kurt Salmon Associates (KSA), Weintraub Associates, and Atlanta Consulting Associates to target specific export processing opportunity in the textile/apparel area. The results of a preliminary KSA analysis resulted in the following targets:

- (a) Long Term (1990+) Objective: 6,000 jobs per year in textiles and annual exports of \$530 million to the U.S. by 1995.
- (b) Short Term Strategy:
  - (1) Increase the number of textile plants serving the export apparel market from 19 to 56 by 1989;
  - (2) Increase apparel sector employment by 7,700 new jobs by 1989;
  - (3) Achieve \$81 million in FX generation by 1989.

The cost of achieving these objectives, according to KSA, requires \$3.2 million for working capital and \$36.7 million for medium and long term investment requirements. Additionally, consulting fees approximating \$300,000 for technical assistance, training and market penetration services would be required.

7. PRIDEX - Light Manufacturing

While the FUSADES/PRIDEX focus over the 1987-1989 period will concentrate on "maquila" - especially apparel/textiles - PRIDEX has also developed strategies for light manufacturing and handcrafted consumer products. The results of the strategies are:

- (a) Increase light industrial employment by 2,000 new jobs by the beginning of 1988 and generate \$3 million in new FX.
- (b) Increase handcraft consumer product employment by 3,000 jobs and generate \$5 million in FX by the end of 1988.

The PRIDEX program resources, carried out through the current PACD of 9/30/87, are anticipated to generate 7,900 new jobs by the PACD and \$24.4 million in FX earnings (cumulative). PRIDEX proposes to expand these outputs to 13,300 new jobs and \$43.6 million through additional emphasis on the apparel, light manufacturing, and industrial handicrafts areas. Involved in the efforts for light manufacturing would be a concentration on electronics and medical supply production. According to PRIDEX, the following incremental inputs are required:

	<u>INPUTS</u> <u>(\$000)</u>	<u>JOBS</u>	<u>FX</u> <u>(\$000,000)</u>	<u>INPUT</u> <u>COST/JOB</u>
Base Program	3,992.0	7,900	24.4	505
Expanded Program	<u>7,979.0</u>	<u>13,330</u>	<u>43.6</u>	<u>599</u>
Increment	<u>\$ 3,987.0</u>	<u>5,430</u>	<u>\$ 19.2</u>	<u>\$ 94</u>

The Mission strategy will be to build upon the impetus created by PRIDEX through FUSADES, and augment the PRIDEX services through specialized technical assistance for the textile, electronic, medical supplies, and possibly the leather goods areas. Each specialized contractor would be assigned the responsibility of achieving its annual plan in terms of FX generation and employment, failure to perform meaning cancellation of contract. Payment by FUSADES to the contractor would be based on monthly fees plus performance standard payments after start-up.

B. Market Analysis

The purpose of these consultant analyses was to quantify employment and FX generation targets for the PRIDEX business plan -- in effect, the development of performance targets by subsector upon which results compatible with the Project purpose could be measured. A secondary objective of these analyses was to quantify the levels and types of loan and investment financing which the Investment Fund could consider over its

first operating years. It defined investment profiles from which the Fund is expected to choose its portfolio obligations. While the Fund will have to expend effort to develop its portfolio, it can reasonably expect the indicated levels of potential demand in the marketplace.

The results of the industry overview, and the projections of performance objectives for jobs and FX generation are shown in Table I below. These figures were later adjusted to reflect FUSADES/PRIDEX targets by increasing employment generation figures and decreasing somewhat the FX generation total.

A 1985 Kurt Salmon Associates (KSA) study concentrated on the strategy and investment requirements to achieve a growth of 6,000 jobs/year in textiles and, as El Salvador has approximately 12% of the CBI country population, to capture 12% of CBI apparel exports to the U.S. (roughly \$530 million in 10 years.) The KSA study indicated an achievable goal is to increase the number of plants serving the export apparel market from 19 to 56 by 1989, increasing apparel sector employment by 7,700 by 1989 and setting the stage in the early 1990's for substantial export development. Apparel exports would increase by \$81 million between 1986 and 1989. To achieve this growth, KSA estimated the following investment requirements:

<u>Working Capital</u>	\$ 3.2 million between 1986-1989
<u>Investment Requirements:</u>	
Equipment	\$ 17.6 million
Buildings	10.1 million
Structural Working Cap.	<u>9.0 million</u> (incl. training/plant eng.)
<u>Total</u>	\$ 36.7 million

Considering all the information sources and estimates, the FUSADES/PRIDEX program is anticipated to create 14,000 new jobs by the end of 1989, generate \$45.0 million in FX, and encourage \$25.0 million in new investment over the same time period.

### C. Credit Demand

The field work for credit demand was done over a two month period and consisted of a series of interviews with existing investors and potential project sponsors, the commercial banks, heads of business associations, and PRIDEX and USAID staffs. Estimating medium and long term credit demand is, in the least, an inexact science as it makes a series of assumptions on rates and the financial viability of future projects. It is also limited by its "latent" attributes, which are generally filled to meet what is available. A recent World Bank team identified the need for medium and long term credit in excess of the proposed Project financing. The commercial banks reinforced the need for long term credit, as they are not

TABLE I

SUMMARY PROJECTIONS FOR EMPLOYMENT AND  
FX GENERATION ACCORDING TO TECHNICAL ANALYSES, AS ADJUSTED

	<u>Sales/Emp.</u> 1985	<u>Sales/Emp.</u> 1989	<u>Change</u> (Current \$)
1. <u>Apparel/Textiles - Sales</u>	\$ 28.4 MM	\$ 53.2 MM	
Local	\$ 20.4 MM	\$ 25.0 MM	
CACM	\$ 4.5 MM	\$ 6.0 MM	
Non-CACM	\$ 3.5 MM	\$ 21.2 MM	\$ 17.7 MM
-----			
Employment (Output/Emp = \$5,138/yr)	5,527	10,354	4,827
2. <u>Electronics - Sales</u>	\$ 13.2 MM	\$ 43.6 MM	
Local	\$ 9.4 MM	\$ 15.0 MM	
CACM	\$ 3.7 MM	\$ 5.0 MM	
Non-CACM	\$ 0.1 MM	\$ 23.6 MM	\$ 23.5 MM
-----			
Employment (Output/Emp = \$16,000/yr)	825	2,725	1,900
3. <u>Medical Supplies - Sales</u>	\$ 7.8 MM	\$ 23.2 MM	
Local	\$ 1.4 MM	\$ 2.5 MM	
CACM	\$ 0.8 MM	\$ 1.5 MM	
Non-CACM	\$ 5.6 MM	\$ 19.2 MM	\$ 13.6 MM
-----			
Employment (Output/Emp = \$21,000/yr)	371	1,104	733
<u>TOTAL SECTORS</u>			
SALES			\$ 54.8 MM
EMPLOYMENT			<u>7,460</u>

Source: Arthur Young, Inc., "Background Review of Export Market Potential for Salvadoran Light Manufacturing and Assembled Products".

generally prepared to lend long. The KSA analysis indicates a requirement of over \$36 million just for textiles/apparel. Because of similar analyses, the Mission expects the IBRD to create a new credit window for medium-long term needs; BLADEX has opened a new window, and the IDB is also poised to provide similar funding. Therefore, the Mission feels it prudent to rely only on in-house PRIDEX project proposals to serve as a demand guide.

The initial PRIDEX demand estimate was based on newly developing projects likely to require financing over the next twelve months. These demand figures were factored downwards to adjust for projects which might not meet investment criteria, and for projects wherein the Fund would be able to provide only partial assistance. The final results are shown in Table II, below, and reflect an existing project need for \$13.8 million in medium to long term credit. These figures are considered feasible in El Salvador's current political/economic climate, and they are conservative to the extent PRIDEX has not been acting as a financial intermediary.

The assumptions made to structure the demand analysis included:

- a. The Fund will only offer medium to long term loans (3-10 years) primarily in U.S. dollars, and convertible equity investment in dollars when needed to round out project financing.
- b. These services apply only to private sector companies (local, foreign, or joint-ventures) in the "maquila" or light industrial processing for product exports to non-CACM markets.
- c. The Fund will have \$15 million available from AID for its portfolio operations.
- d. There will be no further changes in GOES policies which would negatively affect the export processing fields.
- e. Sufficient working capital financing in FX and LC will be available from other sources (equity, commercial banks, etc) to support the Fund's long-term position.
- f. Sufficient management skills exist to manage new Salvadoran projects.
- g. While PRIDEX will be the major source of project identification, other parties, such as COEXPORT and the commercial banks, will also identify projects requiring funding.
- h. The people with export projects are willing to accept the exchange risk on FX as their dollar debt can be registered with the Central Bank, and earnings from exports can be used to pay off the loan.

TABLE II

## FUSADES/PRIDEX PROGRAM

SUMMARY OF ACTIVE INDUSTRIAL INVESTMENT PROJECTS

<u>Sector</u>	<u>Number Of Firms</u>	<u>Project FX Generation (MM\$)</u>		<u>Financial Needs (M\$)</u>				<u>Employment Generation (000)</u>	
		<u>YR2</u>	<u>YR5</u>	<u>FX</u>		<u>LC</u>		<u>YR2</u>	<u>YR5</u>
				<u>ST</u>	<u>LT</u>	<u>ST</u>	<u>LT</u>		
Textiles	9	31.0	52.0	1.9	2.9	3.1	2.8	6.0	10.1
Metal	5	7.4 <u>a/</u>	12.4 <u>a/</u>	2.2	2.7	1.0	0.3	1.1	1.8
Leather	1	12.0	20.0	2.0	0.6	1.2	0.4	2.3	3.9
Medical	1	0.1	0.2	0.1	0.2	0.1	-	-	-
Plastics	2	0.4	0.7	0.1	0.2	-	-	0.1	0.1
Other Ind. <u>b/</u>	<u>4</u>	<u>4.6</u>	<u>7.7</u>	<u>5.5</u>	<u>2.0</u>	<u>0.4</u>	<u>1.7</u>	<u>0.9</u>	<u>1.4</u>
Total	22	55.6	93.0	11.8	8.6	5.8	5.2	10.4	17.3

a/ One firm would not release sales projections.

b/ Includes toys, wood and clay products.

The demand estimate for the Fund is based on: (a) projects expected to begin in the next twelve months, (b) projects in the initial development phase but not expected to require financing in the next twelve months, and (c) projects which might be expected due to CBI and 806/807 incentives (e.g. apparel/textile - see Annex E). The (c) category projects reflect an underlying demand for the third year of project funding which is basically attributable to the expanded PRIDEX promotional effort. Known projects were screened to eliminate those without adequate sponsorship, design, equity or size. Those surviving the screening became the project base for Fund financing.

It was then estimated that the Fund would provide assistance to about 40% of the existing projects needs, 50% of the identified projects estimates, and about 50% of projects created by PRIDEX efforts in year 3. Because the Fund does not anticipate providing the entire capitalization required, as sponsors would provide equity and short term capital, it was assumed that on the average the Fund would provide about 50% of the total capital requirements of a project. A breakdown of \$2 million in equity financing and \$13 million in debt financing appears appropriate for the Fund. It was also assumed, as the majority of the finance needs would be for equipment, that 30% of the debt would be of 3 year duration, 50% in 3-7 year loans, and 20% in loans of 7-10 year variety.

The analysis produces conservatively biased demand levels which could reasonably be expected to require investment credit assistance. To the extent that the assumptions and identified projects do not hold true, demand may be negatively affected. However, the analysis shows that over a three-year period, the Fund should disburse approximately \$13 million in loan funds and provide approximately \$2 million in equity financing. While the first year's activity is relatively small due to the lack of knowledge of this service by local investors, customer relationships will probably increase rapidly after the first one or two financings.

The types of projects likely to seek financing will be potential 806/807-type textiles and accessories, electronics, and footwear. CBI incentives for light industrial products, medical supplies and industrial handicrafts are also expected to become a portion of the Fund's portfolio. During the first half of the project, the 806/807 companies are expected to play a predominant role. The initial demand will be through local investors (80% plus). However, there appears to be a small but growing acceptance by U.S. businessmen of El Salvador as an acceptable area to do business, so that there is expected to be an increased interest in joint venture (JV) activity over time.

The breakdown of the proportion of demand for equity investments and lending is based on stated needs for existing project proposals requiring financing. The investors represent Salvadoran capital, and their projects are of a magnitude that does not appear to require much in the way of JV investment. The distribution of loan maturities reflects funding for buildings and other structures with long depreciable life. Should

industrial parks and free zones grow in El Salvador, leasing of facilities may grow in frequency and the loan maturities may decrease to reflect a heavier equipment weighting.

The ability of the Fund to arrange other sources of debt and equity will relate closely to the perceived risks of a project and the Salvadoran environment. While this ability may result in additional earnings with no increase in Fund assets, no additional revenue for the Fund from these endeavors is considered. While the demand exists for this service, the investment environment remains too fragile to consider any partnership except for short term working capital loans which are not that complicated.

The demand figures generated were converted into Fund disbursements by increasing the annual demand figures by 10% to account for inflation over time. Then, of the resultant annual demand, it was assumed that the Fund would encounter difficulty in its early efforts and achieve only a \$3 million level of placement its first year. It was assumed that \$5 million of the Fund's \$ 15 million allocation would be placed the second year and \$7 million the third year, reflecting the growing effect of prior success stories and expanded interest in CBI incentives.

The Fund's credit disbursement projections utilized the following key assumptions:

1. 30% of the Fund's investments would be for equipment with a pay-back period of 3 years, 50% of the investments would be amortized in 5 years, and 20% of the investments would be amortized in 8 years.
2. The "average" return to the Fund would be 10% before costs.

CREDIT FUND DISBURSEMENT PROJECTIONS FOR TEN YEARS

Year:	<u>87</u>	<u>88</u>	<u>89</u>	<u>90</u>	<u>91</u>	<u>92</u>	<u>93</u>	<u>94</u>	<u>95</u>	<u>96</u>
Loans <u>a/</u>	2.5	4.0	6.5	2.7	2.8	2.8	3.5	3.7	3.3	2.8
Equity <u>b/</u>	<u>0.5</u>	<u>1.0</u>	<u>0.5</u>	<u>0.2</u>	<u>0.2</u>	<u>0.2</u>	<u>0.3</u>	<u>0.3</u>	<u>0.3</u>	<u>0.3</u>
Total	3.0	5.0	7.0	2.9	3.0	3.0	3.8	4.0	3.6	3.1
Investment Earnings	0.15	0.55	1.05	1.30	1.35	1.33	1.28	1.25	1.25	1.29

a/ Year 4-10 based on reflows, first loan year returns interest only at 10%.

b/ Convertible at 10%.

FUSADES' staff expenses in 1987, and possibly 1988, are expected to exceed investment income due to normal administrative charges and the cost of analyzing the initial investments. By 1989, the Fund should generate sufficient income to cover its expenses and to make a contribution to FUSADES' expenses.

It should be noted that minor erosion of the Fund has been built into the projections to reflect the instability in El Salvador. If this occurs, it will slowly decapitalize the Fund's earning capabilities. As mentioned initially, the Fund is a high risk venture, designed to promote investment rather than to seek a safe yield. Future Project evaluations will present opportunity to correct deficiencies in this initial design based upon the events which actually take place. The initial capitalization of the Fund at \$15 million may not be sufficient to meet anticipated requirements or provide a basis to leverage new investment and reduce an existing constraint - lack of investment capital for El Salvador - for more than a short period of time. As a result, if PRIDEK and the Fund are achieving their objectives, a further extension to the Project with additional AID resources may be warranted.

#### D. Analysis of Investment Repayment

In order to judge the feasibility of a Fund located off-shore, the Salvadoran regulations pertaining to foreign debt obligations and repatriation of capital and dividends were investigated. The results of the analysis indicate that a foreign investor is legally entitled to repatriation of its capital and dividends in foreign exchange, subject to proper registration of the capital brought into the country. Under the GOES' new Export Development Law, export projects involving foreign investment are entitled to repatriation of capital and dividends without remittance tax or dividend tax for periods ranging between 10 years and the life of the project. The distinction relates only to the percentage of production exported. Although the investor has to request the FX for these payments from the Central Bank, delays of six months or so for obtaining the FX in today's environment may occur, despite the fact that the project is a net FX generator.

Regarding repayment of FX loans, all borrowings must be registered at the Central Bank prior to recognition of the obligation to provide the FX. Although obtaining the FX is then subject to availability, the Central Bank has been cooperative for export projects. A selectively approved mechanism for repayment of FX debt from sales proceeds prior to repatriation of the FX to the Central Bank has been operational since mid-1985. Under this arrangement, exporters may retain a percentage of sales revenues in a FX denominated bank account outside of El Salvador for debt payment. The Central Bank approves the use of this mechanism prior to officially recognizing the debt obligation, and the exporter's account may be closed if the Central Bank suspects capital flight. While this

mechanism permits easy debt repayment, the usual channel of requesting the FX for debt payment is also followed. It is prone to delays in all countries which face a shortage of FX.

## E. Economic Analysis

### 1. Introduction

The economic analysis of this Project Amendment will consist of two parts. The first part reviews the economic analysis in the original Project Paper in order to gauge its appropriateness to test the economic feasibility of the Amendment. The second part modifies some of the assumptions utilized in the original Project Paper in order to analyze the economic feasibility of the amended version of the entire Project. The analysis in the second part consists of an estimation of economic internal rates of return for investment in the areas where the Project will provide assistance.

### 2. Analysis in the Original Project Paper

The original Project Paper estimated an economic internal rate of return of 32.5%. The methodology involved consists of utilizing estimated aggregate streams of costs and benefits associated with the Project, and using those streams to calculate an internal rate of return. The driving forces behind the streams of benefits and costs are assumptions about the characteristics of the kind of investment projects that would be generated from the activities of the ISRP. These assumptions are described first and then modified to reflect additional costs and information about the projects that will be assisted under the ISRP Amendment.

#### a. Economic Benefits

The original Project Paper estimated two types of economic benefits: direct and indirect. The direct benefit stream associated with the ISRP was assumed to consist of a 5% yearly increase in non-traditional export earnings. Indirect effects of twice the amount of direct effects are usually associated with agroindustries and other non-traditional exports.

#### b. Economic Costs

The analysis identified two types of economic costs: i) the costs financed by USAID and the GOES to establish PRIDEX and MICE activities; and b) the investment and operating costs associated with the projects that will generate the increased stream of non-traditional exports. The first type of economic cost was obtained from the Project's original budget which includes GOES contributions. The second type of costs were estimated on the basis of a few specific assumptions described in the following paragraphs.

Investment costs were expected to be equivalent to the 5% increase in non-traditional exports the first year. Investment requirements were spread over the second and third year of the Project. Operating costs were estimated at 85% of foreign exchange earnings for the first two years and 90% thereafter.

c. Modifications to the Assumptions

On the basis of information which has become available since the ISRP was initiated, several of the assumptions made by the original Project Paper were modified to more accurately reflect key relationships in investment projects associated with the Project. The combination of the modified assumptions with those that remain unchanged are utilized to estimate the rate of return of the amended version of the Project.

1) Economic Benefits

The original Project assumed that foreign exchange earnings from non-traditional exports would increase by 5% per year on a sustained basis and as a result of the Project assistance (the Project Paper assumed that in the first year, 1985, there would be no export earnings, whereas in the second year, 1986, earnings would reach 25% of the projected 5% increase in non-traditional exports or \$750,000). While this assumption appears reasonable and well founded, PRIDEX reported that its assistance generated approximately \$2.7 million in foreign exchange earnings for 1985. Thus, a change in assumptions is in order. Considering that the first year's performance was perhaps unusually strong, and that the Investment Fund component will probably be helpful in sustaining that kind of performance, for the purpose of this analysis, it was assumed that the impact of the first year (1985) will be replicated and sustained each subsequent year.

The timeframe of the analysis was reduced to 10 years instead of the 20 year period utilized in the original Project Paper. This change provides a more realistic assessment of the Project's payoff. Regarding indirect benefits, while the original assumption that indirect benefits will result is probably justified, the use of a multiplier of two was not. This assumption was adjusted to a more conservative multiplier of 0.25 to ensure that these benefits are not overestimated. Unlike the original analysis, the modified version assumed that the assets purchased with the initial investment would lose 10% of the market value every year. This was utilized to estimate a salvage value during the 10th year.

2) Economic Costs

The investment necessary to generate a unit of foreign exchange varies according to the type of investment activity. If one utilizes the data available from a series of typical project profiles

of the type assisted by this Project to estimate investment as a percentage of annual sales, a wide range of investment to maximum annual sales relationship becomes evident. For example, an industrial glove manufacturing operation would require an initial investment of 13.6% of projected annual sales. A similarly estimated figure of 66.6% applies to a medical supplies plant, 20% for an electronics assembly project, 33.3% for a shoe manufacturing project, 30% for a plastics firm, and 124% for a textile drawback operation. For purposes of the analysis, a median figure of 50% is utilized for each increment in export earnings achieved. This approach is clearly biased because it does not take into account the probability that projects will not generate maximum annual sales during the first year. This problem is overcome by testing the sensitivity of the IRR to this assumption later in the analysis.

The original assumption of incremental operating costs was changed to reflect information developed on the investment project profiles researched for this Project Amendment. The investment project profiles also estimated the cost of annual sales. If these costs are adjusted to eliminate financial costs and taxes, the cost of sales as a percentage of sales varies from 51% to 76%, with most of the estimated relationship clustered below the upper range. For purposes of the analysis 73% was adopted as the figure to generate the stream of operating costs.

The modified version of the analysis introduces recurrent GOES costs associated with the implementation of the public sector portion of the ISRP. This reflects more accurately the public investment involved. For purposes of estimation, the analysis attributes 15% of MICE's budget to the implementation of the component of assistance to the GOES. The budget is allowed to grow 5% per year.

### 3) Results of the Analysis

Table 1 presents the stream of benefits and costs associated with the modified assumptions in the analysis. The estimated economic internal rate of return is 30.2%. The estimated rate of return is meant to be illustrative of the economic feasibility of supporting export diversification, particularly in light assembly operations. The analysis is generic in the sense that it does not attempt to judge individual projects but investment in the industrial and agroindustrial sectors for export.

### 4) Sensitivity Analysis

The results of the analysis are critically dependent upon the following assumed relationships: a) Investment/Annual Sales; b) Operating Costs/Annual Sales; and c) Indirect Effects/Annual Sales. Thus, a sensitivity analysis was carried out in order to test the response of the IRR to change in each of the foregoing relationships.

TABLE I

COST BENEFIT ANALYSIS - INDUSTRIAL STABILIZATION AND RECOVERY

(\$000's)

	<u>1985</u>	<u>1986</u>	<u>1987</u>	<u>1988</u>	<u>1989</u>	<u>1990</u>	<u>1991</u>	<u>1992</u>	<u>1993</u>	<u>1994</u>
<b>I. <u>TOTAL COST</u></b>										
A. USAID	2562.0	3452.0	4563.2	1764.0	2108.8	0.0	0.0	0.0	0.0	0.0
B. GOES (includes recurrent costs)	1017.0	2678.0	2175.0	110.0	115.5	121.3	127.3	133.7	10.4	147.4
C. PRIVATE SECTOR	3936.0	5292.0	7263.0	9234.0	11205.0	13176.0	15147.0	17118.0	19089.0	21060.0
1. OPERATING	1971.0	3942.0	5913.0	7884.0	9855.0	11826.0	13797.0	15768.0	17739.0	19710.0
2. INVESTMENT	1965.0	1350.0	1350.0	1350.0	1350.0	1350.0	1350.0	1350.0	1350.0	1350.0
D. TOTAL	7515.0	11422.0	14001.2	11108.0	13084.5	13297.3	15274.3	17251.7	19229.4	21207.4
<b>II. <u>TOTAL BENEFITS</u></b>										
A. FOREIGN EXCHANGE EARNED	2700.0	5400.0	8100.0	10800.0	13500.0	16200.0	18900.0	21600.0	24300.0	27000.0
B. INDIRECT EFFECT	675.0	1350.0	2025.0	2700.0	3375.0	4050.0	4725.0	5400.0	6075.0	6750.0
C. SALVAGE VALUE										6136.5
D. TOTAL	3375.0	6750.0	10125.0	13500.0	16875.0	20250.0	23625.0	27000.0	30375.0	33750.0
<b>III. <u>NET BENEFITS</u></b>	-4140.0	-4672.0	-3876.2	-2392.0	3790.0	6952.7	8350.7	9748.3	11145.6	12542.6

Internal Rate of Return: 30.2%

Assumptions:

Investment/Annual Sales: 0.50  
 Operating Costs/Sales: 0.73  
 Indirect Effects/Sales: 0.25

As pointed out earlier, the relationship Investment/Annual Sales used in the analysis is biased in the sense that no provision is made for building up sales to maximum productive capacity, i.e. the analysis assumes that maximum capacity is achieved in the first year of the investment. Thus, it would be advisable to test the sensitivity of the IRR to changes in this relationship. For example, if the relationship is increased from 0.50 to 0.70, the IRR is reduced to approximately 26%. Thus, the IRR is not very sensitive to changes in the relationship.

Similar tests were carried out on the relationships Operating Cost/Sales and Indirect Benefits/Sales. The results showed that for every ten points that each of the relationships is changed, the IRR changes by approximately the same amount. For example, if indirect benefits are assumed to be 15% of annual sales, the IRR is reduced to approximately 20%. Likewise, if indirect costs are increased to 83% of sales, the IRR falls to approximately 20%.

### 3. Conclusions

A modified version of the economic analysis used in the original Project Paper shows that investment in the sector is an economically worthwhile activity, and that the Project Amendment is on sound economic grounds. It must be kept in mind that the analysis is generic in the sense that it did not try to incorporate specific estimates developed for the Project Amendment on projected investment volumes; the analysis utilized results to date as one of its bases. Whether those investment volumes are realized or not, continued implementation of the ISRP will make economic sense.

#### F. Administrative Analysis Update

##### 1. Organization - FUSADES

###### a. Legal Status

There is no change in FUSADES' legal status. It is legally constituted as a non-profit foundation under Salvadoran law, and it is also certified as a non-U.S. PVO by AID. FUSADES has indicated that it is investigating the possibility of registering for recognition as a U.S. PVO.

###### b. Financial Status

In 1983, the FUSADES Balance Sheet indicated it had ¢528,481 in capitalization (equity) from individuals and firms. By year-end 1985, contributions had increased the capitalization to ¢2,346,202. However, because of the devaluation of the colón from 2.5 colones = 1 dollar to 5.0 colones = 1 dollar, the ability to pay foreign

exchange costs out of contributions has been substantially reduced. Nonetheless, the 343% growth of its equity (endowment) in an unstable time is heartening. FUSADES is sending personnel to the U.S. to study fund raising techniques in order to more rapidly increase its endowment.

c. Organization

FUSADES' organizational growth reflects the implementation of AID funded programs for export promotion, association strengthening, small business support, agricultural diversification and water management. These last three programs are just underway and will grow in need for management support. Given the growth of these programs, FUSADES is considering adding the following administrative staff in 1986-1987:

- Executive Assistant to the Office of Planning and Development
- Two additional accounting clerks
- One personnel assistant
- One Director of Fund Raising and Communications
- One Manager for Public Relations

These six persons would increase the administrative staff from 17 persons, including 9 clerical functions, to 23 persons. FUSADES' organization charts are shown in Annex G.

Not initially contemplated by FUSADES, but required for implementing this Amendment, is the addition of a small investment project staff to its organization in order to provide technical support to the Investment Fund Committee in the latter's responsibilities for the lending decisions of the Fund. Initially one person is anticipated to be hired for the investment project unit, with several more persons added as needed.

VII. CONDITIONS, COVENANTS, AND WAIVERS

A. Conditions

A Cooperative Agreement Amendment with FUSADES will incorporate the following conditions under the Agreement's Schedule:

- Prior to any disbursement, or the issuance of any commitment documents under the Project Agreement with FUSADES, of AID funds into an Investment Fund for financing investment credit for industrial export projects, FUSADES shall, except as A.I.D. may otherwise agree in writing, furnish in form and substance satisfactory to AID:

(a) An executed subsidiary agreement entered into by FUSADES and a recognized U.S. financial institution for the establishment of an Investment Fund to support industrial export projects which specifies, inter alia, the roles and responsibilities of FUSADES and the financial institution for carrying out the activity in accordance with the Project Description.

(b) Quantifiable financial targets for the Investment Fund against which performance of the participating financial institution and FUSADES can be measured over time.

(c) The criteria to be used by FUSADES in determining if an industrial project qualifies for support from the Investment Fund. Such criteria will include, but will not necessarily be limited, to: market orientation, impact on employment, impact on foreign exchange earnings, importance of the economic subsector to El Salvador's future development, the project's ability to service foreign exchange debt, and the financial soundness of the proposed project.

(d) Documentation establishing an Investment Fund Committee in FUSADES which specifies in detail the initial composition of the Committee, the authorities delegated to the Committee, and the Committee's operational policies and procedures including conflict of interest policies and procedures applicable to Committee members, which shall not be modified during the life of the Project unless AID agrees otherwise in writing.

## B. Covenants

1. The covenant set forth in paragraph 3 of the "AID Involvement" section of the Schedule will be deleted in its entirety and substituted with the following provision:

All expenditures by FUSADES for the procurement of goods or services which are financed under this Agreement will require the prior approval in writing by the USAID when the estimated cost of the expenditure exceeds \$50,000 unless AID agrees otherwise in writing. USAID prior written approval of FORTAS assistance projects and of Economic Studies expenditures will be required when the estimated cost of a FORTAS assistance project or an Economic Studies expenditure exceeds \$20,000 unless AID agrees otherwise in writing.

2. Paragraphs 5 and 6 of the "AID Involvement" section of the Schedule contain provisions for AID direct disbursement for all foreign exchange costs of Project-funded activities. Since FUSADES now has a dollar-denominated account off-shore, these provisions are no longer needed and will thus be deleted in their entirety.

3. The "AID Involvement" section of the Schedule will be further amended by adding the following provisions:

- Prior USAID approval in writing will be required in order for FUSADES to change the financial institution administering the Investment Fund during the life of the Project. In the event that the financial institution is changed during the life of the Project, FUSADES shall engage another financial institution to administer the Fund by following the same procedures as were carried out initially to establish the Fund, unless AID agrees otherwise in writing.

- Prior USAID approval in writing will be required in order for FUSADES to approve: a) total loan funding from the Investment Fund's grant resources to one project which exceeds \$500,000; or b) total combined loan/equity financing provided by the Fund's grant resources to one project which exceeds \$500,000.

- Prior to obligation of the second increment of AID funds for the Investment Fund, an assessment of the Fund's operational performance will be undertaken by USAID and FUSADES with outside assistance.

- FUSADES covenants to make efforts to expand its endowment base through fund raising activities other than those which are derivative of AID financed projects.

### C. Waiver

Section V.C.3 of this PP Amendment provides a justification for a waiver of source, origin and nationality requirements for the procurement of goods and services, other than transportation services, from AID Geographic Code 000 to Code 899 countries, in a cumulative amount of \$5.0 million (\$4.7 million for FUSADES and \$0.3 million for the GOES). The Mission will seek approval of the waiver with guidance from LAC/GC. If approved, the respective "Authorized Geographic Code" sections of the Cooperative Agreement with FUSADES and the Grant Agreement with the GOES will be amended to incorporate this expanded source, origin and nationality eligibility.

LOG FRAME

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATOR	MEANS OF VERIFICATION	ASSUMPTIONS
<p><u>Goal</u></p> <p>To accelerate economic growth and diversify the the economy to attain higher levels of economic well-being.</p>	<p>1. Increased contributions to real GDP growth by non-traditional sectors.</p> <p>2. Increased non-traditional exports to non-CAQM markets.</p> <p>3. Increased employment in export-oriented, non-traditional sectors.</p>	<p>1. Macroeconomic data and statistics.</p>	<p>1. GOES formulates and implements an appropriate policy environment for export and investment promotion.</p> <p>2. Political, economic and social situation of El Salvador does not deteriorate further.</p>
<p><u>Purpose</u></p> <p>To stimulate growth in the non-traditional export sectors of El Salvador, resulting in increased levels of employment, income, investment, and foreign exchange earnings.</p>	<p><u>EOPS</u></p> <p>1. An estimated 14,000 jobs will be generated for skilled and unskilled workers of export enterprises assisted by the Project.</p>	<p>1. PRIDEX and Investment Fund records, Project reports, evaluations.</p>	<p>1.a. Domestic investment, complemented by foreign investment, will play a key role in the development of labor intensive export enterprises.</p> <p>1.b. CBI and other incentives are attractive for stimulating growth in labor intensive production.</p>

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATOR	MEANS OF VERIFICATION	ASSUMPTIONS
	2. New jobs created for skilled and unskilled workers of export enterprises assisted by the Project will result in approximately \$17.5 million in wages and salaries annually by the end of 1989.	2. Project records, reports and evaluations.	1.c. Salvadoran management resources are generally adequate for managing new or expanded labor intensive enterprises.  2.a. Salvadoran wage rates remain competitive in the Caribbean Basin.  2.b. Salvadoran enterprises are able to successfully penetrate non-CAQM markets, keeping production going and workers employed.
	3. An estimated \$25 million of new direct investment will be generated in export enterprises assisted by the Project's PRIDEX and Invest-Fund activities.	3. Project records, reports and evaluations.	3.a. CBI and other incentives are sufficiently attractive to stimulate investment, especially Salvadoran investment, in El Salvador.  3.b. The GOES maintains mechanism for repayment of FX debt from export sales proceeds prior to repatriation of FX earnings to the BCR.

2

NARRATIVE SUMMARY

OBJECTIVELY VERIFIABLE  
INDICATOR

MEANS OF VERIFICATION

ASSUMPTIONS

4. An estimated \$45 million in foreign exchange earnings will be generated by export enterprises assisted by the Project's PRIDEX and Investment Fund activities.

5. FUSADES will be a viable institution with capabilities to develop, give direction to and promote non-traditional export activity by private enterprises for non-CACM markets.

4. Project records, reports and evaluations.

5. Project reports, audits, and evaluations.

3.c. Sufficient working capital financing will be available from other sources (equity, commercial banks, and other) to support new investments in El Salvador.

4. There will be no further changes in GOES policies which would negatively affect exporters.

5.a. FUSADES is able to expand its fundraising activities in order to strengthen its endowment, thus developing greater financial viability.

5.b. FUSADES is able to hire and retain qualified personnel to meet the managerial and technical requirements of Project financed activities.

Outputs

1. Investment Fund disbursements for industrial export projects.

1. End of year projections - \$MM:

Year:	87	88	89
Loans	2.5	4.0	6.5
Equity	0.5	1.0	0.5

1. Trust records, reports and audits.

1.a. Demand for Fund financing will occur due to CBI opportunities and unmet demand.

NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATOR	MEANS OF VERIFICATION	ASSUMPTIONS						
<p>2. Sub-project identification, promotion and development by PRIDEX (arrangements for or provision of TA for non-traditional projects)</p>	<p>2. Approximate number of projects identified and assisted by PRIDEX:</p>	<p>2. Project records, reports and evaluations.</p>	<p>1.b. Sufficient working capital financing will be available from other sources to support the Fund's long term position.</p> <p>1.c. Investors of export projects are willing to accept the exchange risk on FX borrowings from the Fund, since the dollar debt can be registered with the Central Bank and earnings from exports can be used to pay off the loans.</p> <p>1.d. There will be interest among off-shore financial institutions in the administration of the Fund.</p> <p>2.a. Qualified and experienced contractors or consultants will be found to perform required services.</p> <p>2.b. FUSADES maintains the good will of Salvadoran public and private sectors.</p>						
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<u>87</u>	<u>88</u>	<u>89</u>							
75-100	75-100	75-100							

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NARRATIVE SUMMARY	OBJECTIVELY VERIFIABLE INDICATOR	MEANS OF VERIFICATION	ASSUMPTIONS
<u>Inputs:</u>	<u>Life of Project (\$000):</u>		
1. <u>AID Grant (Supplement)</u>		1. AID records, Fund reports and annual independent audit- ed statements.	1. Incremental AID funds will be available in FYs 87 and 88.
Technical Assistance	1,461.8		
Personnel	2,206.4		
Equipment & Supplies	30.0		
Overhead	71.8		
Invitational Travel	221.0		
Program Support (advertising, publications, seminars, & conferences)	<u>442.0</u>		
Sub-Total	4,432.2		
Invest. Proj. Unit	567.8		
Investment Fund (lending capital)	<u>15,000.0</u>		
TOTAL AID GRANT (SUPPL)	20,000.0		
2. <u>FUSADES</u>		2. FUSADES records and audited annual statements	2. FUSADES will continue to obtain member contributions.
Counterpart funds applied to the Proj. Amendment	<u>268.0</u>		
TOTAL FUSADES	268.0		

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Annex B  
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## 5C(2) PROJECT CHECKLIST

Listed below are statutory criteria applicable to projects. This section is divided into two parts. Part A. includes criteria applicable to all projects. Part B. applies to projects funded from specific sources only: B.1. applies to all projects funded with Development Assistance Funds, B.2. applies to projects funded with Development Assistance loans, and B.3. applies to projects funded from ESP.

CROSS REFERENCES: IS COUNTRY CHECKLIST UP TO DATE? HAS STANDARD ITEM CHECKLIST BEEN REVIEWED FOR THIS PROJECT?

### A. GENERAL CRITERIA FOR PROJECT

1. FY 1982 Appropriation Act Sec. 523; FAA Sec. 634A; Sec. 653(D).

(a) Describe how authorizing and appropriations committees of Senate and House have been or will be notified concerning the project;  
 (b) is assistance within (Operational Year Budget) country or international organization allocation reported to Congress (or not more than \$1 million over that amount)?

a) A Congressional Notification has been submitted.

b) Yes.

2. FAA Sec. 611(a)(1). Prior to obligation in excess of \$100,00, will there be

- (a) engineering, financial or other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?
- a) Yes.
- b) Yes.
3. FAA Sec. 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purpose of the assistance?
- N/A
4. FAA Sec. 611(b); FY 1982 Appropriation Act Sec. 501. If for water or water-related land resource construction, has project met the standards and criteria as set forth in the Principles and Standards for Planning Water and Related Land Resources, dated October 25, 1973? (See AID Handbook 3 for new guidelines.)
- N/A
5. FAA Sec. 611(e). If project is capital assistance (e.g., construction), and all U.S. assistance for it will exceed \$1 million, has Mission Director certified and Regional Assistant Administrator taken into consideration the country's capability effectively to maintain and utilize the project?
- N/A

6. FAA Sec. 209. Is project susceptible to execution as part of regional or multilateral project? If so, why is project not so executed? Information and conclusion whether assistance will encourage regional development programs.
- No.
7. FAA Sec. 601(a). Information and conclusions whether project will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; and (c) encourage development and use of cooperatives, and credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture and commerce; and (f) strengthen free labor unions.
- The Project is designed to increase the flow of international trade, foster private initiative and competition, and improve the technical efficiency of industry.
8. FAA Sec. 601(b). Information and conclusions on how project will encourage U.S. private trade and investment abroad and encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).
- The Project is specifically designed to stimulate growth in the non-traditional export sectors of El Salvador. Trade and investment promotion services to enterprises in El Salvador will continue to emphasize linkages with U.S. enterprise. Investment credit will also be made available to U.S., Salvadoran or other country investors looking for industrial opportunities in El Salvador.

9. FAA Sec. 612(b), 636(b);  
FY 1982 Appropriation  
Act Sec. 507. Describe  
steps taken to assure  
that, to the maximum  
extent possible, the  
country is contributing  
local currencies to meet  
the cost of contractual  
and other services, and  
foreign currencies owned  
by the U.S. are utilized  
in lieu of dollars.
10. FAA Sec. 612(d). Does  
the U.S. own excess  
foreign currency of the  
country and, if so, what  
arrangements have been  
made for its release?
11. FAA Sec. 601(e). Will  
the project utilize  
competitive selection  
procedures for the  
awarding of contracts,  
except where applicable  
procurement rules allow  
otherwise?
12. FY 1982 Appropriation Act  
Sec. 521. If assistance  
is for the production of  
any commodity for export,  
is the commodity likely  
to be in surplus on world  
markets at the time the  
resulting productive  
capacity becomes  
operative, and is such  
assistance likely to  
cause substantial injury  
to U.S. producers of the  
same, similar or  
competing commodity?
13. FAA 118(c) and (d).  
Does the project comply  
with the environmental  
procedures set forth in  
AID Regulation 16? Does

The Project will primarily fund foreign exchange costs. Most requirements for local currency will be met through the host country financial sector or other contributions by beneficiary enterprises.

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the project or program take into consideration the problem of the destruction of tropical forests?

14. FAA 121(d). If a Sabel project, has a determination been made that the host government has an adequate system for accounting for and controlling receipt and expenditure of project funds (dollars or local currency generated therefrom)? N/A

B. FUNDING CRITERIA FOR PROJECT

1. Development Assistance Project Criteria

- a. FAA Sec. 102(b), 111, 113, 281(a). Extent to which activity will (a) effectively involve the poor in development, by extending access to economy at local level, increasing labor-intensive production and the use of appropriate technology, spreading investment out from cities to small towns and rural areas, and insuring wide participation of the poor in the benefits of development on a sustained basis, using the appropriate U.S. institutions; (b) help develop cooperatives, especially by technical assistance, to assist rural and urban poor to help themselves toward better life, and N/A

otherwise encourage democratic private and local governmental institutions; (c) support the self-help efforts of developing countries; (d) promote the participation of women in the national economies of developing countries and the improvement of women's status; and (e) utilize and encourage regional cooperation by developing countries?

b. FAA Sec. 103, 103A, 104, 105, 105. Does the project fit the criteria for the type of funds (functional account) being used? N/A

c. FAA Sec. 107. Is emphasis on use of appropriate technology (relatively smaller, cost-saving, labor-using technologies that are generally most appropriate for the small farms, small businesses, and small incomes of the poor)? N/A

d. FAA Sec. 110(a). Will the recipient country provide at least 25% of the costs of the program, project, or activity with respect to which the assistance is to be furnished (or is the latter cost-sharing requirement being waived for a "relatively least developed" country)? N/A

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e. FAA Sec. 110(b).  
Will grant capital assistance be disbursed for project over more than 3 years? If so, has justification satisfactory to Congress been made, and efforts for other financing, or is the recipient country "relatively least developed"? (M.O. 1232.1 defined a capital project as "the construction, expansion, equipping or alteration of a physical facility or facilities financed by AID dollar assistance of not less than \$100,000, including related advisory, managerial and training services, and not undertaken as part of a project of a predominantly technical assistance character.

N/A

f. FAA Sec. 122(b). Does the activity give reasonable promise of contributing to the development of economic resources, or to the increase of productive capacities and self-sustaining economic growth?

N/A

g. FAA Sec. 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage

N/A

institutional development;  
and supports civil  
education and training in  
skills required for  
effective participation in  
governmental processes  
essential to self-government.

2. Development Assistance Project  
Criteria (Loans Only)

- a. FAA Sec. 122(b). Information and conclusion on capacity of the country to repay the loan, at a reasonable rate of interest. N/A
- b. FAA Sec. 620(d). If assistance is for any productive enterprise which will compete with U.S. enterprises, is there an agreement by the recipient country to prevent export to the U.S. of more than 20% of the enterprise's annual production during the life of the loan? N/A
- c. ISDCA of 1981, Sec. 724 (c) and (d). If for Nicaragua, does the loan agreement require that the funds be used to the maximum extent possible for the private sector? Does the project provide for monitoring under FAA Sec. 624(g)? N/A

3. Economic Support Fund  
Project Criteria

- a. FAA Sec. 531(a). Will this assistance promote economic or political Yes.

stability? To the extent possible, does it reflect the policy directions of FAA Section 102?

- b. FAA Sec. 531(c). Will assistance under this chapter be used for military, or paramilitary activities? No.
- c. FAA Sec. 534. Will ESF funds be used to finance the construction of the operation or maintenance of, or the supplying of fuel for, a nuclear facility? If so, has the President certified that such use of funds is indispensable to nonproliferation objectives? No.
- d. FAA Sec. 509. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made? No.

*Pdelbosque***CONFIDENTIAL****FUSADES**ROBERTO H. MURRAY MEZA  
PRESIDENTEACTION: PRJ: PdelBOSQUE  
cc: BBSchout RAW; RLGSan Salvador,  
22 de mayo de 1986Annex C  
Page 1 of 2Señor  
Robin Gomez  
Director  
USAID/El Salvador  
PresenteREF: Ampliación de Convenio 519-0287

Estimado Sr. Gomez:

En base a los resultados y experiencias encontradas en los primeros doce meses de operación del programa PRIDEX de FUSADES y de los otros programas de apoyo, y como es conocido por ustedes, la asistencia técnica y de mercadeo otorgada por PRIDEX, con la colaboración de otros programas, ha resultado en la creación de 1,395 nuevos empleos a tiempo completo y 456 empleos estacionales, con US\$2.8 millones de exportaciones y nuevas inversiones adicionales de US\$2.6 millones. FUSADES desea continuar este esfuerzo por tres años más y destinar US\$5 millones a esta actividad, incluyendo la administración de FUSADES.

Uno de los obstáculos más importantes que detienen las decisiones de inversionistas locales y extranjeros, para invertir en nuevas empresas de exportación o ampliar las existentes, es la falta de crédito en condiciones adecuadas de plazo y garantías. FUSADES considera que a pesar del ambiente general negativo que persiste en materia de negocios en El Salvador, se puede lograr entusiasmar a empresarios a invertir en empresas de exportación, si además de ofrecerles asistencia técnica, de mercadeo y contactos entre posibles socios locales y extranjeros, también se les ofrece crédito en condiciones adecuadas de acuerdo a los flujos de ingresos proyectados de los negocios. Es por eso que en esta ampliación del proyecto se solicita crear con fondos de la USAID un mecanismo para poder otorgar créditos a inversionistas de acuerdo a criterios cuidadosamente seleccionados, hasta por un total general de US\$15 millones.

En vista de lo anterior, por la presente atentamente solicitamos a la USAID/El Salvador una ampliación del Convenio 519-0287 conocido por "Industrial Stabilization and Recovery", para continuar y ampliar las actividades de promoción de exportaciones y fomento de nuevas inversiones, principalmente en el área de industria liviana y maquila. Se solicitan fondos adicionales por US \$20,000,000.00 para el programa que administra FUSADES y una extensión de la fecha de terminación del proyecto, del 30 de septiembre de 1987, al 30 de septiembre de 1989.

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FUSADES cree que la ampliación del proyecto en la forma solicitada va a resultar en un fuerte estímulo para las exportaciones de productos industriales no tradicionales a países fuera del área centroamericana, con los consiguientes incrementos en empleo y generación de divisas.

Lo aquí expuesto ha sido ampliamente discutido con funcionarios de la misión de USAID en El Salvador, quienes conocen a profundidad los razonamientos que han originado estas ideas, así como una serie de estudios y documentos de apoyo que se han obtenido o elaborado de distintas fuentes; por lo que estamos en la mejor disposición de explicar o proporcionar cualquier ampliación que ustedes requieran relacionada a esta solicitud.

Agradeciendo la oportunidad que hasta ahora nos han brindado y en espera de una resolución al respecto, se suscribe de Usted,

Muy atentamente,



Roberto H. Murray Meza  
Presidente

RMM/JEC/1fm

EXPLANATORY NOTES ON  
FINANCIAL ANALYSIS SUPPORT TABLES

This annex contains eight tables. Table 1 summarizes the FUSADES component budget expenditures through March 31, 1986. Column 1 presents the original FUSADES budget by specific inputs. The original budget has been reprogrammed by approved Project Implementation Letters (PIL's), as shown in Column 2 of the table. Columns 3-6 reflect the distribution of ISRP Grant funds within FUSADES activity centers for the 1984-1987 period. Columns 7-10 summarize expenditures recorded by FUSADES for each program component through March 31, 1986, while Columns 11-14 reflect unexpended budget totals available for the April, 1986 - September, 1987 period. The table indicates that as of March 31, 1986, FUSADES' actual expenditures, on a cash basis, amounted to \$2,258,300 or 33% of the budget.

Table 2 presents total remaining funds available as of March 31, 1986, and estimated requirements for the remainder of CY 1986. While FUSADES' projected expenditures reflect a higher level than achieved in the past, it should be noted that only \$2.0 million would remain to fund 1987 activities.

In a review of the expenditure levels with FUSADES, it was noted that the Association Strengthening Activities (FORTAS) program and the Economic Studies Unit (DES) had been planning and budgeting programs in excess of available funding. FUSADES concurred with the USAID to better focus the role and program definition of those components. As a result, no new grant funds from the PP Amendment for FORTAS or DES are planned in the ISRP beyond the original PACD of September 30, 1987.

Table 3 presents the FUSADES 1987 budget on this basis and reflects a need for \$3,407,000, excluding the Investment Fund and corresponding costs for investment project analysis. As approximately \$2.0 million will be available under the current Grant funding, a shortfall of \$1.4 million remains to be covered. This amount will be reduced by \$565,000 to \$822,000 if FORTAS and DES are justified under another Cooperative Agreement separate from ISRP.

Table 4 presents the FUSADES 1988 projected budget and Table 5 the projected 1989 budget. These amount to \$1,664,000 and \$1,946,000, respectively, again excluding the Investment Fund and investment project analysis.

Table 6 distributes the PP Amendment grant funds (\$5.0 million for program and operating expense support for FUSADES and \$15.0 million for the Investment Fund) by resource use and by year, fully utilizing current funding levels. The 1987 funding does not reflect FORTAS or DES requirements.

A decrease in technical assistance levels in 1988 and 1989 reflects FUSADES' plans to incorporate more local Salvadoran personnel in the PRIDEX program as opposed to expatriate contractor personnel. Given the experience gained thus far by FUSADES and its Salvadoran staff in the implementation of this program, this concept appears realistic and substantially increases PRIDEX local commitment.

Table 7 presents the cost estimates of technical services and Table 8 presents the estimates of goods which were used to justify a source, origin and nationality waiver from Code 000 to Code 899.

TABLE 1

FUSADES COMPONENT BUDGET FOR THE ISRP

(\$000's)

<u>Line Item</u>	<u>Original Budget</u> (1)	<u>PIL Amends.</u> (2)	<u>Budget Distribution</u>				<u>Expenditures through 3/31/86</u>				<u>Original Funds Available</u>			
			<u>PRIDEX</u> (3)	<u>FORTAS</u> (4)	<u>ADMIN</u> (5)	<u>DES</u> (6)	<u>PRIDEX</u> (7)	<u>FORTAS</u> (8)	<u>ADMIN</u> (9)	<u>DES</u> (10)	<u>PRIDEX</u> (11)	<u>FORTAS</u> (12)	<u>ADMIN</u> (13)	<u>DES</u> (14)
L/T Technical Assistance	2,485	2,785	2,555	-	230	-	810.1	-	-	-	1,744.9	-	230.0	-
S/T Technical Assistance	1,409	1,394	989	170	-	235	257.0	-	2.7	23.3	732.0	170.0	(2.7)	211.7
Personnel	919	1,119	258	156	552	153	180.5	41.5	215.9	133.1	77.5	114.5	336.1	19.9
Equipment & Supplies	200	200	90	50	30	30	117.5	14.0	52.1	17.0	(27.5)	36.0	(22.1)	13.0
Invitational Travel	337	100	100	-	-	-	43.2	22.5	2.9	2.3	56.8	(22.5)	(2.9)	(2.3)
Assistance to Associations	250	250	-	250	-	-	-	114.2	-	-	-	135.8	-	-
Program Support	300	232	-	-	232	-	30.1	5.4	18.5	19.2	(30.1)	(5.4)	213.5	(19.2)
Overhead	505	464	-	-	464	-	58.1	12.2	47.8	16.0	(58.1)	(12.2)	416.2	(16.0)
Contingency	495	356	-	-	356	-	-	-	1.2	-	-	-	354.8	-
<b>Total</b>	<b>6,900</b>	<b>6,900</b>	<b>3,992</b>	<b>626</b>	<b>1,864</b>	<b>418</b>	<b>1,496.5</b>	<b>209.8</b>	<b>341.1</b>	<b>210.9</b>	<b>2,495.5</b>	<b>416.2</b>	<b>1,522.9</b>	<b>207.1</b>

Source: Cooperative Agreement, Project Implementation Letters, and FUSADES.

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TABLE 2  
PROJECTED USE OF FUNDS - 1986

(\$000' s)

<u>Line Item</u>	<u>Unexp. Balance 3/31/86</u>	<u>Requirements for 4/1/86 - 12/31/86</u>					<u>Funds Available</u>
		<u>From FUSADES Annual Plan</u>					
		<u>PRIDEX</u>	<u>FORTAS</u>	<u>ADMIN</u>	<u>DES</u>	<u>Total</u>	
L/T Technical Assistance	1,974.9	837.9	-	-	-	837.9	1,137.0
S/T Technical Assistance	1,111.0	731.0	-	38.0	80.0	849.0	262.0
Personnel	548.0	62.6	53.2	234.0	166.6	516.4	31.6
Equipment & Supplies	(0.6)	1.8	-	22.6	-	24.4	(25.0)
Invitational Travel	29.1	33.5	0.0	18.0	6.0	67.5	(38.4)
Assistance to Associations	135.8	-	62.5	-	-	62.5	73.3
Program Support	158.8	105.8	-	19.1	36.0	160.9	(2.1)
Overhead	329.9	24.4	8.9	21.8	17.6	72.7	257.2
Contingency	<u>354.8</u>	<u>7.4</u>	<u>1.5</u>	<u>18.0</u>	<u>3.0</u>	<u>29.9</u>	<u>324.9</u>
Total	4,641.7	1,804.4	136.1	371.5	309.2	2,621.2	2,020.5

Source: FUSADES

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TABLE 3  
FUSADES' ISRP BUDGET - 1987

(In \$000's)

	<u>ADMIN</u>	<u>DES *</u>	<u>PRIDEX</u>	<u>FORTAS **</u>	<u>INVEST. FUND</u>	<u>TOTAL</u>
Technical Assistance	20.0	75.0	1,920.0	-	-	2,015.0
Personnel	390.0	189.0	110.0	28.0	-	717.0
Equipment and Supplies	45.0	7.5	3.7	1.0	-	57.2
Overhead	37.0	25.0	33.0	5.0	-	100.0
Invitational Travel	30.0	7.5	53.0	15.0	-	105.5
Program Support						
A) Advertising & Publications	25.0	34.5	48.0	6.0	-	113.5
B) Seminars & Conferences	2.0	8.5	96.0	8.0	-	114.5
Assistance to Associations	-	-	-	150.0	-	150.0
Contingencies	<u>20.0</u>	<u>3.0</u>	<u>10.0</u>	<u>2.0</u>	<u>-</u>	<u>35.0</u>
Sub-Total	569.0	350.0	2,273.7	215.0	-	3,407.7
Invest. Proj. Unit	-	-	-	-	117.8	117.8
Investment Fund	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>3,000.0</u>	<u>3,000.0</u>
Total-AID	<u>569.0</u>	<u>350.0</u>	<u>2,273.7</u>	<u>215.0</u>	<u>3,117.8</u>	<u>6,525.5</u>
Counterpart Funds Applied	<u>55.4</u>	<u>4.0</u>	<u>12.0</u>	<u>20.0</u>	<u>-</u>	<u>91.4</u>
TOTAL	<u>624.4</u>	<u>354.0</u>	<u>2,285.7</u>	<u>235.0</u>	<u>3,117.8</u>	<u>6,616.9</u>

\* Through 9/30/87.

\*\* One-half of 9/30/87 amount.

TABLE 4  
FUSADES' ISRP BUDGET - 1988

(In \$000's)

	<u>ADMIN</u>	<u>PRIDEX</u>	<u>INVEST. FUND</u>	<u>TOTAL</u>
Technical Assistance	20.0	400.0	-	420.0
Personnel	448.0	360.0	-	808.0
Equipment and Supplies	10.0	5.0	-	15.0
Overhead	44.0	76.0	-	120.0
Invitational Travel	36.0	64.0	-	100.0
Program Support				
A) Advertising & Publications	28.0	56.0	-	84.0
B) Seminars & Conferences	2.0	115.0	-	117.0
Assistance to Associations	-	-	-	-
Sub-Total	588.0	1,076.0	-	1,664.0
Invest. Proj. Unit	-	-	220.0	220.0
Invest. Fund	-	-	5,000.0	5,000.0
Total-AID	588.0	1,076.0	5,220.0	6,884.0
Counterpart Funds Applied	66.0	14.0	-	80.0
<b>TOTAL</b>	<u>654.0</u>	<u>1,090.0</u>	<u>5,220.0</u>	<u>6,964.0</u>

TABLE 5  
FUSADES ISRP BUDGET - 1989

(In \$000's)

	<u>ADMIN</u>	<u>PRIDEX</u>	<u>INVEST. FUND</u>	<u>TOTAL</u>
Technical Assistance	20.0	480.0	-	500.0
Personnel	516.0	414.0	-	930.0
Equipment and Supplies	10.0	5.0	-	15.0
Overhead	51.0	88.0	-	139.0
Invitational Travel	44.0	77.0	-	121.0
Program Support				
A) Advertising & Publications	32.0	68.0	-	100.0
B) Seminars & Conferences	3.0	138.0	-	141.0
Assistance to Associations	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Sub-Total	676.0	1,270.0	-	1,946.0
Invest. Proj. Unit	-	-	230.0	230.0
Invest. Fund	<u>-</u>	<u>-</u>	<u>7,000.0</u>	<u>7,000.0</u>
Total-AID	676.0	1,270.0	7,230.0	9,176.0
Counterpart Funds Applied	<u>80.0</u>	<u>17.0</u>	<u>-</u>	<u>97.0</u>
TOTAL	<u>756.0</u>	<u>1,287.0</u>	<u>7,230.0</u>	<u>9,273.0</u>

TABLE 6

SUPPLEMENT FUNDS ALLOCATION

(In \$000' s)

<u>Line Item</u>	<u>Funds Available For 1987</u>	<u>Contingency Distribution</u>	<u>1987 Requirements</u> *	<u>1987 Supplement</u>	<u>1988 Supplement</u>	<u>1989 Supplement</u>	<u>Total Supplement</u>
Technical Assistance	1,399.0	-	1,940.0	541.0	420.0	500.0	1,461.0
Personnel	31.6	-	500.0	468.4	808.0	930.0	2,206.4
Equipment/Supplies	(25.0)	73.7	48.7	-	15.0	15.0	30.0
Overhead	257.2	-	70.0	-	-	71.8	71.8
Invitational Travel	(38.4)	121.4	83.0	-	100.0	121.0	221.0
Program Support	71.2	99.8	171.0	-	201.0	241.0	442.0
Contingency	<u>324.9</u>	<u>(294.9)</u>	<u>30.0</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
Sub-Total	2,020.5	- 0 -	2,842.7	1,009.4	1,544.0	1,878.8	4,432.2
Invest. Proj. Unit				117.8	220.0	230.0	567.8
Investment Fund				<u>3,000.0</u>	<u>5,000.0</u>	<u>7,000.0</u>	<u>15,000.0</u>
TOTAL Supplement Funds Allocation				<u>4,127.2</u>	<u>6,764.0</u>	<u>9,108.8</u>	<u>20,000.0</u>

\* Excludes FORTAS and DES support.

TABLE 7

PROJECTED REQUIREMENTS FOR PROCUREMENT OF SERVICES  
UNDER CODE 899 WAIVER AUTHORITY

(In US\$)

<u>I. FUSADES Component</u>				
<u>A. PRIDEX</u>				
<u>Technical Assist.</u>	<u>Person/Days/Yr.</u>	<u>Cost/Day</u>	<u>Total</u>	<u>1987-1989</u>
- Short Term	300	350	105,000	315,000
- Long Term	200	300	60,000	180,000
<u>B. ADMIN, DES</u>				
<u>Technical Assist.</u>	<u>Person/Days/Yr.</u>	<u>Cost/Day</u>	<u>Total</u>	<u>1987-1989</u>
- Short Term	60	300	18,000	54,000
<u>Sub-Total, FUSADES</u>				<u>549,000</u>
<u>II. GOES Component</u>				
<u>Technical Assist.</u>	<u>Person/Days/Yr.</u>	<u>Cost/Day</u>	<u>Total</u>	<u>1987-1989</u>
- Short Term	150	350	52,500	157,500
- Long Term	200	300	60,000	180,000
<u>Sub-Total, GOES</u>				<u>337,500</u>
<u>TOTAL PROJECTED WAIVER REQUIREMENTS FOR SERVICES</u>				<u>886,500</u>

TABLE 8

PROJECTED REQUIREMENTS FOR PROCUREMENT OF GOODS  
UNDER CODE 899 WAIVER AUTHORITY

(In US\$000)

<u>Investment Fund</u>	<u>Year 1</u>	<u>Year 2</u>	<u>Year 3</u>	<u>Total</u>
1. <u>Overall Equipment Financing Requirements</u>				
a. Assuming 80% of Investment	2,400	4,000	5,600	12,000
b. Assuming 70% of Investment	2,100	3,500	4,900	10,500
2. <u>Waiver Requirements Assuming 70% of Investment</u>				
a. Assuming 75% of Equipment from Code 899 or 941	1,575	2,625	3,675	7,875
b. Assuming 50% of Equipment from Code 899 or 941	1,050	1,750	2,450	5,250 *
* <u>TOTAL PROJECTED WAIVER REQUIREMENTS FOR GOODS</u>				<u>5,250</u>

Note: In the Credit Demand Analysis, Section VI.C., it was assumed that 80% of the Fund's investments would be for equipment purchases (item 1.a. above). For purposes of justifying a waiver, a more conservative figure of 70% has been assumed (item 1.b.). While 75% of the equipment purchases may be from Code 899 or 941 sources (item 2.a.), a more conservative figure of 50% has been assumed (item 2.b.) in this analysis. Thus, based on these assumptions, the projected waiver requirements for procurement of goods during a three-year period total \$5,250,000.

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U.S. TEXTILE IMPORT PROGRAM FOR CBI COUNTRIES

The fiber, textile, and apparel industry is an important sector of the U.S. domestic economy, employing about two million people (roughly 10% of the total U.S. manufacturing workforce). According to the Department of Commerce, domestic textile and apparel shipments in 1984 totaled \$115 billion, an amount equal to 6% of U.S. manufacturing output. During the past two decades, the U.S. textile and apparel industry has faced increasing foreign competition in the domestic marketplace. The reason for this is that textile production is labor-intensive and requires relatively little capital, hence many developing countries establish textile industries during the early stages of industrialization. For these countries, textile and apparel exports are a chief source of foreign exchange earnings and employment.

The U.S. market is the largest in the world. To deal with disruption in the U.S. market caused by imports, the U.S. has, since 1956, negotiated textile restraint agreements both bilaterally and multilaterally. The U.S. currently is party to bilateral agreements with 36 countries. These agreements, under the Multifiber Arrangement, which will continue in force through July 31, 1986, permit the U.S. to regulate textile and apparel imports by providing for consultation levels, growth rates, and base levels. The U.S. has five bilateral agreements (Costa Rica, Dominican Republic, Guatemala, Haiti, and Panama) and one consultation agreement (Jamaica) with CBI countries. It has no bilateral textile agreement with El Salvador at the present.

Under Item 807 of the Tariff Schedules of the U.S., goods assembled abroad from components fabricated in the U.S. may enter the U.S. subject to import duties which are assessed only on the portion of the article's total value that has been added outside the United States. Hence, under 807, clothing made from fabric cut in the United States can be made into garments abroad with duty paid only on the value added outside the U.S.

Textile products were excluded from the tariff reductions of the CBI, which was approved by the U.S. Congress and became effective on January 1, 1984. Nonetheless, President Reagan had promised to give greater consideration to the textile imports from CBI countries.

On February 20, 1986 President Reagan announced a new textile initiative for CBI countries. In March, 1986, a presentation on the new initiative was made in El Salvador by the U.S. Embassy Economic Counselor and the GOES Minister of Foreign Trade. The Minister reported to the apparel industrialists attending the presentation on his recent meetings in Jamaica with U.S. officials on the new program and explained that U.S. representatives were disposed to make a special effort to assist El Salvador.

Under this new program, informally called 807A, CBI countries will have guaranteed access each year for each category of clothing exported to the U.S., as well as other "made-up" textile goods (such as bed linens). In addition, for clothing made from U.S.-manufactured and U.S.-cut fabrics, there will be separate, higher guaranteed access levels. After receiving a statement of interest from a CBI country, the access levels for individual apparel products will be set in consultation with representatives of the beneficiary government. These access levels will apply to imports in a given year. If the CBI country anticipates that imports of a specific product will exceed the agreed level for that year, it may request an increase. This procedure applies both to the standard access levels and to those for imports made from U.S.-manufactured and U.S.-cut material. These apparel into the U.S. will be subject to normal duty rates on the value-added in the CBI country. Apparel imports that do not use U.S.-made and U.S.-cut fabric will be subject to the normal duties on their full value.

The goals of the new 807A program are to assist the CBI countries to develop their economies by guaranteeing market access for their clothing exports to the U.S. and to help the U.S. industry by making the highest levels of access available only to CBI clothing exports made from material manufactured and cut in the U.S. U.S. clothing manufacturers, which are already investing in the CBI countries, will have greater opportunities to do so because of guaranteed access.

FACTORS TO BE PRESENTED TO THE FUSADES INVESTMENT FUND COMMITTEE  
FOR EVALUATION OF PROJECTS PROPOSED FOR INVESTMENT FUND ASSISTANCE \*

1. Brief Description of Project.
2. Sponsorship, Management and Technical Assistance
  - a. History and business of sponsors, including financial information.
  - b. Proposed management arrangements and list of executive management, with curricula.
  - c. Description of technical arrangements for know-how and other external assistance (management, production, marketing finance, etc.).
3. Market and Sales
  - a. Basic market orientation: export, local national, local regional.
  - b. Projected production volume, sales objectives, and market share of proposed venture.
  - c. Potential users of products and distribution channels to be used.
  - d. Present sources of supply for products. Future competition and possibility that market may be satisfied by substitute products.
  - e. Tariff protection or import restrictions relating to products, if applicable.
  - f. Critical factors that determine market potential.

\* It is intended that the Investment Fund deal only with well-conceived and presented commercial proposals. The information shown here is typical of that required for any commercial project (although it may be altered slightly). It is drawn from the IFC brochure, "Preliminary Project Information Required."

4. Technical Feasibility, Manpower and Raw Material Resources

- a. Brief description of manufacturing process.
- b. Comments on special technical complexities, needs for know-how and special skills.
- c. Possible sources of equipment supply.
- d. Availability of manpower and of infrastructure facilities (transport and communication, power, water, etc.
- e. Sources, costs, and quality of raw material supply and relations with support industries.
- f. Proposed plant location in relation to suppliers, markets, infrastructure and manpower.
- g. Proposed plant size in comparison with other known plants.

5. Investment Requirements, Project Financing and Return

- a. Estimate of total project cost, broken down into land, construction, installed equipment and working capital, indicating foreign exchange component.
- b. Proposed financial structure of venture, indicating expected sources and term of equity and debt financing.
- c. Type of financing: loan, equity or both and amount.
- d. Information of profitability and return on investment.
- e. Critical factors affecting profitability.

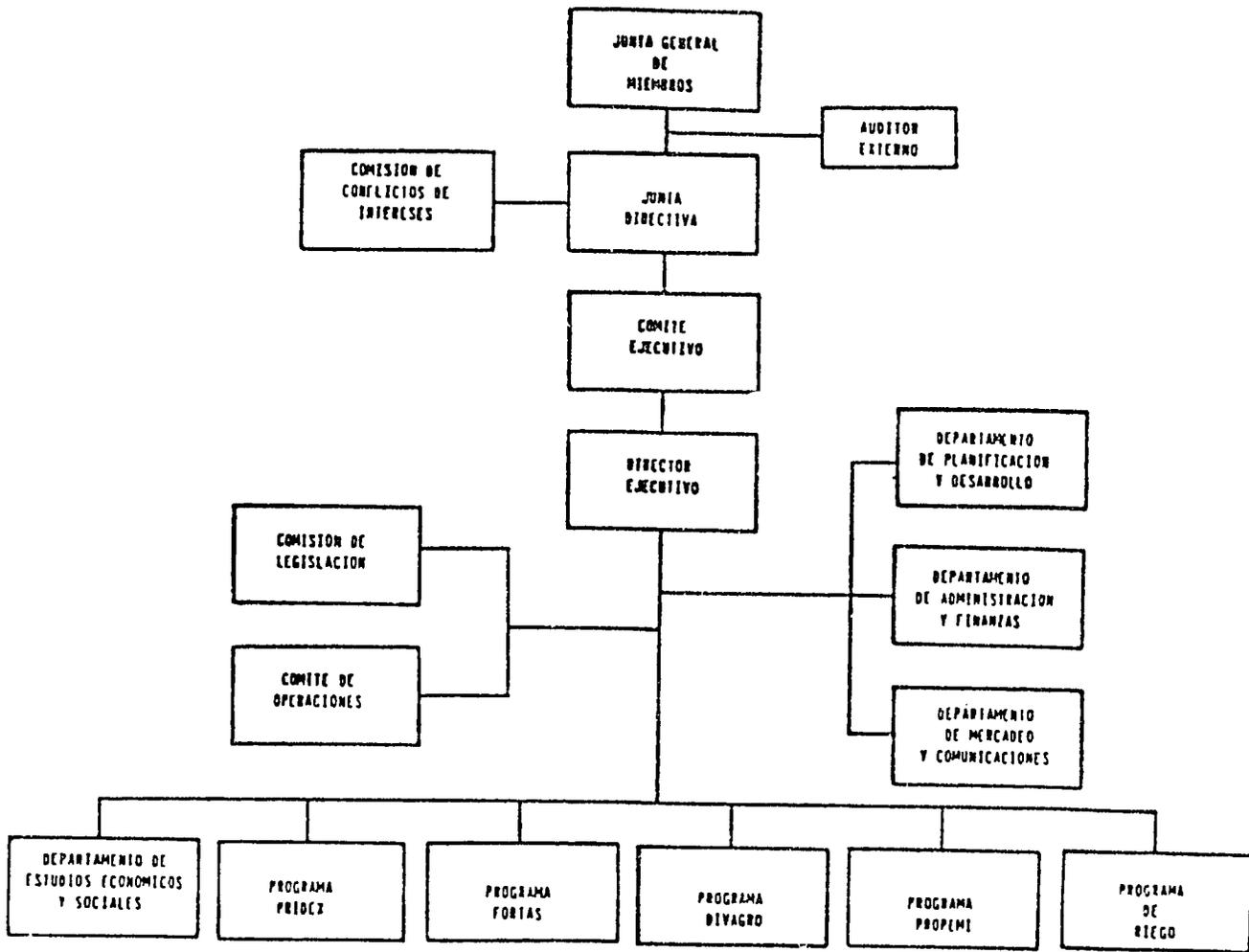
6. Government Support and Regulations

- a. Specific government incentives and support available to project.
- b. Expected contribution of project to employment.

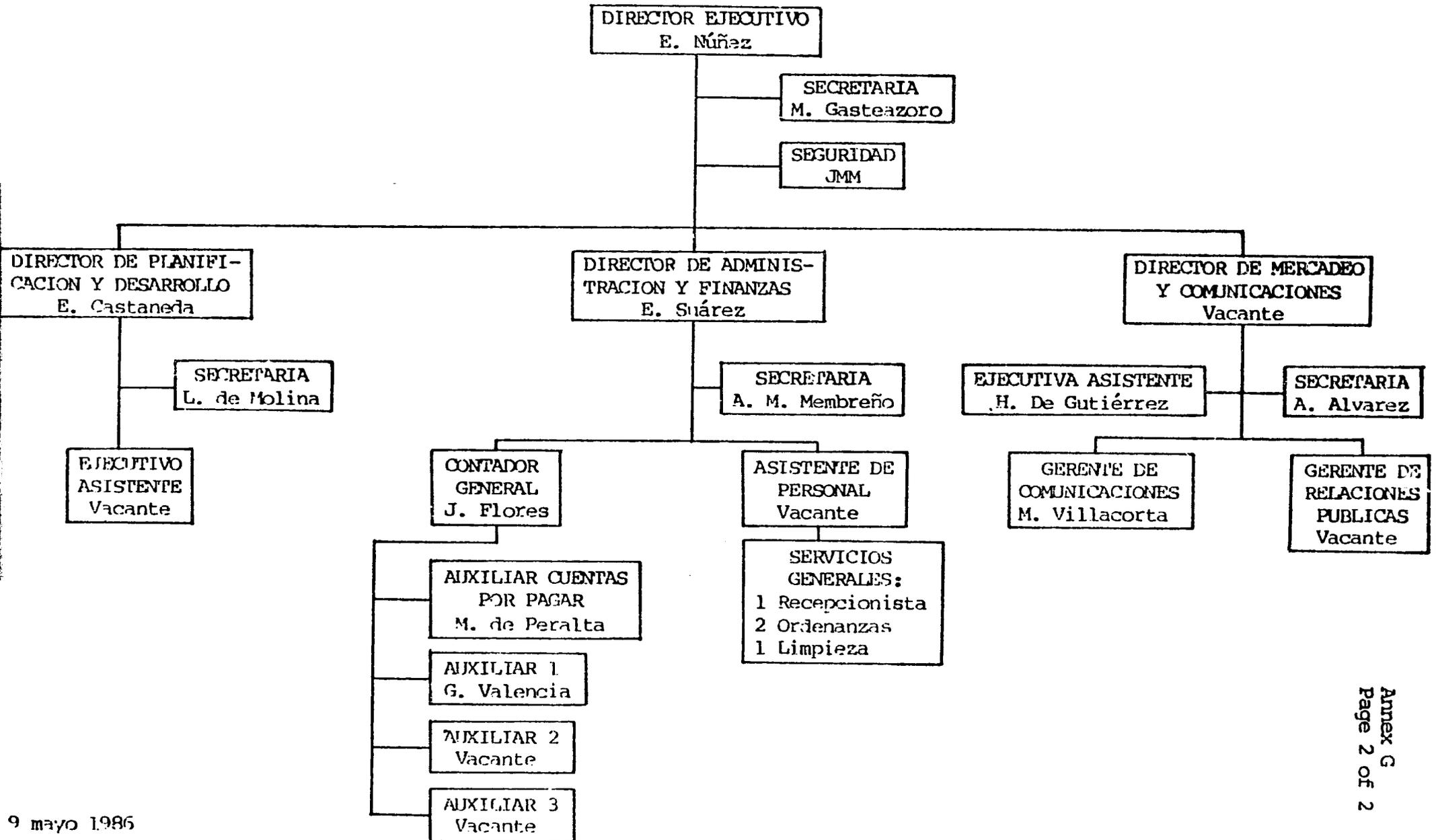
7. Time Scale Envisaged for Project Preparation and Completion.

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ORGANIGRAMA GENERAL DE FUSADES



ADMINISTRACION DE FUSADES



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REF: DE/083-85/ENI/1fm

ATTACHMENT III

MEMORANDUM

PARA: Personal de FUSADES  
 DE: Director Ejecutivo  
 ASUNTO: Política para evitar Conflicto de Intereses  
 FECHA: 20 de agosto de 1985

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Anexo a la presente encontrarán copia de la "Política para evitar Conflicto de Intereses" de FUSADES la cual ha sido recientemente aprobada por la Junta Directiva.

El propósito de enviarla es para que estén perfectamente enterados de sus implicaciones y regulaciones, que comprendan propósitos y sus objetivos, y así se le dé un fiel cumplimiento de parte nuestra

Para fines de archivo y control de esta Dirección, les solicito atentamente me firmen y llenen los espacios correspondientes como constancia de lo anterior.

Atentamente,



Eduardo Viquez I.

\_\_\_\_\_  
FIRMA

\_\_\_\_\_  
FECHA

\_\_\_\_\_  
NOMBRE

POLITICA PARA EVITAR CONFLICTOS DE INTERESESINTRODUCCION

Siendo FUSADES una institución de servicio, responsable de la custodia y manejo de fondos destinados a desarrollar actividades en beneficio de todos los salvadoreños; y teniendo en cuenta que los beneficios de los programas se deben otorgar en igualdad de condiciones y oportunidades dentro del alcance de los mismos; así como también para poder operar eficientemente y con carácter empresarial, es que se crea esta Política destinada a establecer lineamientos generales, alcances y mecánica para evitar conflictos de intereses.

OBJETIVO

El objetivo de la Política de Conflictos de Intereses es el de dictar y regular la conducta que deben guardar todos sus Directores, Miembros de Comités y Comisiones, Funcionarios y demás empleados y contratistas, para evitar cualquier conflicto entre sus propios intereses personales y los intereses y objetivos de FUSADES y de sus programas.

Esta política requiere que todas las personas señaladas eviten cualquier conflicto entre sus propios intereses personales y los intereses de FUSADES y de sus programas con respecto a los siguientes aspectos:

- a) Uso de bienes y recursos de la Fundación.
- b) Los suministros de bienes y servicios a FUSADES.
- c) Uso de la información propiedad de FUSADES.
- d) El secreto o ética profesional con los clientes.

ADMINISTRACION

Por la complejidad de posibilidades, y por la delicadeza en el manejo e implementación de esta política, es que su administración estará bajo la responsabilidad de una Comisión nombrada por la Junta Directiva.

Esta Comisión estará formada por el Presidente, Vice-Presidente y otros cuatro miembros de la Junta Directiva. Se reunirá las veces que lo considere necesario, por convocatoria de cualquiera de sus miembros, y su responsabilidad primordial será la de vigilar el fiel cumplimiento de esta política, la de actuar como órgano de consulta previa y la de conocer, aprobar y/o recomendar procedimientos sobre los posibles casos de conflicto que sucedan a nivel de miembros de la Junta Directiva, Director Ejecutivo, miembros de Comisiones, Miembros Fundadores y Directores Ejecutivos de los Programas.

A criterio de la Comisión y por razones de eficiencia e índole administrativa, ésta podrá delegar en el Presidente y en el Director Ejecutivo de FUSADES el análisis, recomendación y/o aprobación de los casos de conflicto que sucedan a niveles de empleados y otros funcionarios. El Presidente y el Director Ejecutivo tendrán la responsabilidad de informar periódicamente a la Comisión sobre todos estos casos y presentar los casos que le correspondan resolver a la Comisión.

IMPLEMENTACION

Una vez aprobada esta política y en el transcurso de las operaciones de FUSADES, será responsabilidad de todos los Directores, empleados y Miembros observar esta política cuidadosamente.

Para iniciar su implementación, se le solicitará al Director Ejecutivo que lleve a cabo una investigación y que presente a la Comisión un reporte en el que incluya los casos que se consideren de conflicto, o que por el contrario, asegure de que no existe ninguno. Una vez recibido este reporte, la Comisión se reunirá para analizarlo y girar los procedimientos y recomendaciones que considere necesarios.

### LINEAMIENTOS GENERALES

Comprendiendo la naturaleza y objetivos de FUSADES y la necesidad de establecer esta política, pero también considerando la naturaleza y potencial de sus Directores y Miembros en cuanto a los beneficios que éstos pueden generar en favor de los objetivos de los programas, así como la necesidad de que esta política sea flexible y efectiva, se establecen los siguientes principios generales:

1. Debido a la complejidad y gama de posibilidades, será responsabilidad de la Comisión y/o del Presidente y Director Ejecutivo el ampliar, modificar o adoptar principios o procedimientos que refuercen la efectividad de esta política.
2. En todos aquellos casos en que Directores, Miembros de las Comisiones, o empleados, ya sean en forma individual o a través de compañías donde tengan intereses particulares, solicitan participar en los beneficios de alguno de los programas de FUSADES, éstos no podrán, expresamente:
  - a) Estar presentes a la hora de discusión y/o aprobación del caso, haciéndolo constar en las actas o documentos respectivos, y
  - b) Manejar directamente el desarrollo técnico y operativo del programa o proyecto, teniéndose en estos casos que transferir esta responsabilidad a otra persona. Si por limitaciones organizativas no pudiera cumplirse con este requisito, se deberá presentar el caso previamente a la Comisión o al Presidente y Director Ejecutivo, según proceda, para obtener los lineamientos operativos y aprobaciones respectivas.
3. En todos aquellos casos de compañías pertenecientes o asociadas a Directores y/o empleados, y que éstas sean actualmente, o pretendan ser suministrantes de bienes, servicios o contratistas de FUSADES, deberán:
  - a) Como principio, evitar los casos de conflicto de intereses.
  - b) Desarrollar relación comercial con FUSADES, basada en una probada competitividad en calidad y costo, y que éstos representen un beneficio para FUSADES. En estos casos deberá existir un procedimiento escrito de evaluación y bases de escogitación, con el propósito de comprobar plenamente lo anterior, el cual deberá ser aprobado previamente por el Presidente y el Director Ejecutivo.
4. En los casos de documentos e información de carácter confidencial o uso restringido, de propiedad de FUSADES, así como de información confidencial propiedad de beneficiarios o clientes de FUSADES, queda terminantemente prohibido utilizar esa información para beneficio propio de Directores, Miembros o empleados, o de terceras personas.