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LATIN AMERICAN EXPORT BANK (BLADEX) CREDIT DEMAND

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ROCAP/Guatemala
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Submitted by:

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Section 1

INTRODUCTION

The substantial shortfall in export credit extended from the BLADEX/-AID Export Promotion Fund against projections and forecasts has raised questions regarding the premises underlying the project and its administration by BLADEX (Banco Latinoamericano de Exportaciones). The following report represents the results of a study undertaken by Checchi and Company, on behalf of AID/ROCAP, to identify and answer these questions and to consider the future of the project in the context of Central American economic and political conditions. The study and report were prepared for Checchi and Company by Jack C. Corbett and William Loehr.

The report is based on a review of the documentation supporting the project, discussions with responsible ROCAP officials, officers of BLADEX and users of BLADEX/AID credit. A list of institutions visited and individuals interviewed is presented in Appendix 1. All four Central American countries involved in the program were visited; extensive interviews were held with officers of those banks which have made most use of the credit program. Discussions were held with AID officers in country missions, with exporters, with central bank officers and others who might contribute to an understanding of what has happened to the program and what its future might be. The resulting conclusions and recommendations are those of the authors of this report; no responsibility for these can be attributed to the many individuals who assisted in this effort.

The primary questions raised are:

1. Did sources of credit for assisting non-traditional exports exist that were not taken into account?

2. Were the estimates of demand for the facility exaggerated?

3. Were there problems in administration and promotion of the credit in BLADEX? In the local participating banks?

Each of these three areas of concern included a number of sub-concerns. Sections 3, 4 and 5 follow this outline and are followed in Section 6 by reviews of individual countries. Although this report frequently refers to the region of Central America, it should be emphasized that the differences among the countries in terms of economic development are more striking than their similarities.

In spite of the shortfall in expected lending and an even greater lag in the cofinancing performance of BLADEX, there are positive accomplishments as a result of the program. AID in its support of the project has contributed to the building of an institutional facility which will continue to promote the development of non-traditional export loans into the future.

Section 2

EXECUTIVE SUMMARY

This executive summary includes principal findings, conclusions and recommendations.

Principal Findings

1. There was a serious overestimation of the amount of Central American non-traditional exports requiring financing from dollar sources. In particular, the demand for imported goods on the part of Central American exporters was much less than anticipated.

2. The underlying model of the exporter unable to export because of lack of dollars and credit to purchase essential imported components is more often the exception than the rule in non-traditional goods production.

3. The supply of short-term exporter credit (both for pre-exports and exports) has been much greater than assumed or forecast in the project paper, thus undercutting one of the major assumptions of the project.

4. Major economic and political changes in the four countries since the approval of the Export Promotion Fund project all had a negative effect upon the demand for facilities of the BLADEX/AID credit.

5. Exchange rate instability and unrealistic rates have exerted a depressing effect upon exports of non-traditional products in all four countries at some time during the existence of the BLADEX/AID credit line.

6. The present capability of the four Central American countries to expand their non-traditional exports is limited by international market demand, price competition and domestic disincentives to exports.

7. BLADEX has mounted a satisfactory promotional effort and has performed its duty as a credit supplier with professional efficiency.

8. Only some of BLADEX Class B member banks have participated in the use of the line; others have not done so for a variety of reasons, none of which can be attributed to maladministration by BLADEX.

Conclusions

1. The failure of BLADEX to meet its cofinancing commitment under the AID loan is largely beyond its control to correct in the foreseeable future.

2. A continuing effort of BLADEX to increase its cofinancing under present conditions of demand for and supply of export credits is likely to result in a decreased use of the AID revolving fund for such credits.

3. The greatest influence on the development of non-traditional exports from the region will, in the short-run, be exercised by the administration of foreign exchange rates and systems.

4. Political events will continue to exercise an important but unmeasurable effect on the productive capability of the region.

5. Under existing circumstances the BLADEX/AID loan agreements appear to be incapable of fulfillment in all its terms in the near future.

6. The BLADEX/AID line probably faces a period of slow growth which will be uneven due more to developments in each country than to region-wide influences.

7. The BLADEX/AID credit however has institutionalized substantial export credit assistance to non-traditional exports and further positive results can be expected as economic conditions in Central America stabilize and improve.

Recommendations

1. Goals for lending under the BLADEX/AID line should be set country-by-country; monitoring of the program should also be on this basis.

2. More work should be done with local member banks and central banks to facilitate those imports that contribute to extra-regional exports, albeit indirectly. Where linkage cannot be established through an exporter's operations, this must be done through the local banking system.

3. Projects requiring medium-term financing should be considered but should not be actively promoted. Such financing should not be used to re-finance existing borrowers of BLADEX.

4. The cofinancing commitment of BLADEX should not be canceled but should follow the full employment of AID loan advances in short-term financing of non-traditional exports.

5. BLADEX and ROCAP should continue to press central banks to reduce the strictures of exchange controls on the use of the credit.

Section 3

CREDIT SUPPLY

Unique circumstances existing in each country must be understood before statements can be made about relative supply and demand for export credit. However, there are some general statements that can be safely made about all countries of the region and this section does that. A general conclusion can be reached that credit supply has been much larger than originally anticipated in the Project Paper, and demand, smaller. The country by country review (Section 6) reinforces this conclusion.

I. Sources of Export Financing

Dollars or foreign currencies are not essential to direct export financing or bridge financing as it sometimes is called. The process here is to shorten the exporter's waiting period for the proceeds of his sales abroad. The exporter, in general, is required to turn his foreign currency proceeds over to the exchange control authorities and is given an appropriate amount of the local currency in which he normally keeps accounts and does business.

In the ordinary course of events the foreign importer -- through a letter of credit, a banker's acceptance or another form of contract -- agrees to make payment in dollars on a specific date or upon the fulfillment of specific commitments by the exporter. The Central American exporter can wait for this to occur or he can go to his bank and request that the foreign obligation be discounted, giving him his dollar proceeds at once. If the bank has dollars or access to dollars, the transaction can be carried out. In turn, the exporter will deliver the dollars to the authorities, settling his obligations in that regard. In essence this is a summary of the transaction that the BLADEX/AID loan has been carrying out in its export financing.

However, should the exporter simply have a need for the proceeds of his sale before the arrival of the overseas payment, he does not necessarily have to discount the foreign letter of credit. He could obtain a short term loan or advance from his bank, to be settled with the bank when the letter of credit is paid and the dollars delivered to the exchange authorities. If for some reason the exporter must deliver dollars to the authorities before receiving them from abroad, he can use the bank advance to buy them in the open market (parallel, free, black) -- and sell his export earnings in the same market when they eventually become available.

The most important reason why an exporter would use this technique rather than the BLADEX line is the potential for a saving on interest if local interest charges were lower than charges for the BLADEX line. Additionally, the exporter might be able to avoid paper work and other complexities involved in dealing with the international department of his bank. He might find his transaction too small to be worth discounting and his own bank willing to grant an advance against his promise to pay or acceptable collateral.

Thus, the local banking system in each country is a primary alternative source of export credit. Under current conditions it is a preferred source in three of the four countries of the region.

II. Sources of Pre-Export Financing

It is generally accepted that the greatest need for hard-currency-financing is in the field of pre-export financing. Such financing can only be supplied with dollars or other acceptable foreign currencies. A letter of credit cannot be opened without the assurance of the availability of the requisite foreign exchange. Other acceptable instruments likewise require similar assurances.

The more significant aspect of the BLADEX/AID line is the pre-export. rather than export, financing. It was anticipated that the bulk of the BLADEX operations would be concentrated in this type of financing. To finance goods imported into the region for the production of exports, dollars are necessary. Given the shortage of dollar reserves and the unfavorable balances of payments, it seemed logical to expect that a substantial demand for such assistance would exist. In fact, demand for the BLADEX line for this purpose has been relatively small. This is due to both deficiency in demand and the existence of other, more attractive sources of credit. We focus here on the other sources of financing available to countries of the region.

The bulk of the pre-export import financing is provided by the region's commercial banking system. Many imports required by the exporting sector are not linked directly to exports and thus have had some difficulty qualifying under the BLADEX/AID line. In other instances, exporters have procured their import needs by use of their own resources or by buying dollars in the open market. Finally, some importers of intermediate goods have access to supplier credits and therefore do not need bank financing as well. This source has diminished as the Central American countries suffered exchange difficulties which caused delays in meeting such obligations.

As a general rule importers have sought to cover their orders from overseas through their local banks and using local currency. In periods of exchange rate uncertainty through which all four countries are passing, importers make every effort to avoid taking commitments in dollars. While this is basically a demand factor, the supply of local bank credit greatly facilitates the use of this option.

Other sources of financing appear less important than domestic sources.

The Inter-American Development Bank has established lines for pre-export financing in three of the four countries of the region and is on the verge of opening a small line of $1 million in Guatemala. IDB lines with Honduras are $2 million, with El Salvador $5 million and with Costa Rica $3.5 million. These lines have not been heavily used. According to our information, this is largely because of complexities in administration. On the other hand, when a transaction is approved, cash is remitted to the borrower; to some countries this is an attractive feature. Some complaints were heard to the effect that the response of the IDB to an inquiry regarding a transaction was slow compared to the prompt reaction of BLADEX. Additionally, the IDB also does not finance perishable exports such as vegetables and flowers. It does not appear that the IDB has captured much of the market or is a major competitor of BLADEX. An additional facility has recently been instituted. The Export-Import Bank (EXIMBANK) and AID on December 19, 1984 agreed to establish a $300 million Trade Credit Insurance Program for Central America, pursuant to a May, 1984 amendment to the Foreign Assistance Act. Initiative to establish the program in each country is left to interested American banks which would extend credit lines to Central American banks once AID has entered into certain agreements with the Central American Central Banks.

The EXIM Bank will exact its usual insurance fee for political and commercial risks while the participating banks will charge market rates and standard fees. How the ultimate cost of credit to a Central American importer would compare with the cost of a transaction under the BLADEX/AID line cannot be precisely forecast although the EXIM credits will probably be competitively priced.

As of March, 1985 the Export Import Bank had approved the following dollar figures for insurance:

Honduras	$25 million
Costa Rica	25 million
El Salvador	75 million

In Honduras, some 15 local banks have set up 25 separate credit lines totaling $25 million with 8 American or American- based banks.

The credits extended under the EXIM/AID insurance program do not have to be covered by a matching export or a certain future export as is the case in the pre-export credits under the BLADEX/AID line, nor must the imports be related to the country's extra-regional exports. The credits can be for up to 360 days, compared to a 180-day limit imposed by BLADEX.

The principal disadvantage of the Export Import/AID line as compared with the BLADEX/AID line is the fact that it is limited to goods imported from the United States. The high international value of the dollar sometimes results in high prices for U.S. goods vis-a-vis comparable goods from the Far East or Europe. The ability to finance cheaper imports from non-U.S. areas under the BLADEX line may in some cases offset the apparent advantages of financing under the EXIM/AID program.

III. Conclusions

The supply of credit is not like the supply of physical items which exist in precise quantities and are consumed or not consumed. Rather, credit is created or destroyed almost instantaneously. When economic conditions deteriorate rapidly as they did in most countries of the region in 1983, credit is withdrawn. Most credit is in the form of a line of credit. Individuals or banks with a line of credit can draw up to a specified amount with only minimal delay (e.g. 24 hours). If economic conditions deteriorate, lines of credit can be terminated with a telephone call or a Telex. The reverse is of course true when conditions improve. Indeed, in Costa Rica we were told of a "flood" of new credit lines that became available shortly after the rationalization of the exchange rate there in 1983.

Another difference between credit and other commodities is that there are few qualitative differences among credits from different sources, or even for different purposes other than the terms of a loan. Cash is fungible and can be used interchangeably for many purposes. Even tying a loan to specific uses does not address what may be done with the resources released by the loan funds.

For example, if credit is made available to a specific user through the banking system, this could conceivably release a comparable amount of credit already being extended to that user. This credit could thus flow elsewhere in the banking system.

This characteristic of credit markets is important to keep in mind in evaluating the progress of the BLADEX/AID program, especially in assessing the cofinancing provided by BLADEX. Currently, BLADEX is being encouraged by AID to make more loans to non-traditional exporters from BLADEX resources other than from the AID loan. Furthermore, BLADEX is being also encouraged not to reduce loans being made out of the AID loan: this is at a time when the AID loan advances to BLADEX are not yet fully employed in the export assistance program. The situation is similar to the example stated above. Encouraging BLADEX to make loans to non-traditional exporters from non-AID monies, when slack demand is apparent (indicated by low use of the AID funds), implies that BLADEX must increase <u>its share</u> of loans to non-traditional exporters. If the BLADEX share of this market goes up, the share of non-BLADEX sources must go down. BLADEX resources would be used <u>instead of</u> resources from other sources -- not in addition to other resources. BLADEX resources may simply replace financing from other sources. Those other sources would therefore have extra resources to lend as they wish and are under no obligation to direct them to non-traditional exporters. In the end, overly encouraging BLADEX to provide matching cofinancing at a time when there seems to be slack demand, could result in no net addition of funds to non-traditional exporters. Only market shares shift. Indeed, resources of other institutions which are displaced by BLADEX resources can then be lent to any activity, traditional or not.

Within the region, the domestic credit system operating within the confines of a country's foreign exchange market is a primary -- although largely unmeasurable and constantly changing -- supply of export and pre-export financing.

Sources of internationally supplied credit for Central American importers have also been identified. None are exactly comparable in scope, cost or administration yet there is a sufficiently large area of overlap to consider them competitive.

In addition to the two internationally supplied sources of credit for Central American importers -- the lines of credit -- Export-Import/AID program and the IDB there are bilateral AID programs which finance importation of raw materials and intermediate goods into the region. There are also government subsidized exporter assistance programs in Europe and Asia which finance producer goods (although these programs generally concentrate on medium-term capital goods exports).

The combination of these domestic and external sources results in a more than adequate supply of pre-export and export credit, both currently and prospectively, to finance a substantially higher level of non-traditional exports from the region.

In summary, factors other than the supply of credit are controlling the flow of such exports. These factors vary from country to country and are described in Section 6. They can be subsumed under a few broad headings: unrealistic and punitive exchange rate systems which cause high prices and costs relative to competition in foreign markets; a lag in redirecting exports from within to without the region; general unwillingness to make necessary foreign exchange commitments in a period of uncertainty.

Section 4

DEMAND FOR EXPORT CREDIT

I. Estimates of Demand

The BLADEX/AID loan program assumed that a significant credit demand existed from exporters wishing to import intermediate inputs. Therefore, the primary use of the BLADEX/AID line was expected to be the financing of imported goods for incorporation into products to be exported from the region. For practical purposes it was assumed that exporters could demonstrate that they were importing inputs (for which credits were needed) to produce exports for which they already had orders from abroad. This assumption oversimplified the process through which imported goods contribute to extra- regional exports.

The demand for credit for imported inputs to be used for export production was greatly overstated in the original project paper. The paper presumed:

1. The imported input-output relationship is the same for exports of non-traditional items as for all manufacturing.

2. All inputs require formal banking financing.

3. All exporters would qualify for BLADEX/AID credit and would be importers as well.

4. Credit was the key constraint to exporting.

These assumptions were not correct in 1982 and are not correct today.

Table 4.1 compares estimates of the backlog of demand for imported inputs for producing the exports which are targets of the program. Also shown are estimated imported input requirements for 1982. Both sets of numbers are from the project paper. Actual qualifying exports for 1982, as reported by SIECA are shown in the right-hand column. Compared to qualifying exports, the imported input estimates are implausibly high. For example, imported inputs for El Salvador and Nicaragua were put at 84% and 41% of qualifying exports. Also, the fact that Nicaragua was eventually excluded from the plan, contributed to the overestimation of the need for imported inputs.

Table 4.1

COMPARISON OF CENTRAL AMERICAN BACKLOG DEMAND AND REQUIREMENTS FOR IMPORTED INPUTS
(US $ Millions)

	*Estimated Backlog	Estimated Imported Input Requirements 1982	+ Actual Qualifying Exports 1982
Guatemala	60	54	231
El Salvador	50	49.4	59
Honduras	15	15.0	164
Nicaragua	60	31.4	77
Costa Rica	50	54.2	160
	235	204	691

Sources: * Project Paper

\+ SIECA

Our research reveals that, in addition to problems with the original project paper, credit demand has been substantially overestimated for other reasons: These reasons include:

1. Multinational firms (MNCs) are excluded as clients of the BLADEX/AID credits. In many product lines, MNCs are the main exporters of non-traditional items requiring substantial imported content.

2. Firms with established markets abroad are normally already equipped with either supplier credits or with established credit lines and therefore did not have to resort to bank lines involving foreign credits.

3. Small and even medium sized producers do not purchase inputs directly from abroad. Rather, they are most likely to purchase imported inputs, - e.g. steel, packing materials, spare parts, - from distributors in their own countries. There are two reasons for this. First, this type of producer lacks knowledge of foreign sources. Second, these inputs are not used in sufficient quantity to justify a direct order at a favorable price. If such imports were attempted, overly large amounts of working capital would be tied up in inventory*. Unless the exchange and banking system permitted a linkage of these imports to related exports, this demand for the BLADEX/AID line was effectively eliminated.

4. Credits for inputs imported "indirectly" for export purposes were discouraged (i.e. credits to distributors selling inputs in the local market to exporters) by the difficulty of matching importers with related exporters.

5. Some exporters are "self-financing" to the extent that their own resources and overseas connections are sufficient to eliminate recourse to foreign exchange financing.

6. Exports to the CACM are likely to be more import-intensive than exports outside the region. CACM exports are to protected markets and are not based upon comparative advantage. CACM exports are explicitly of the "import- substitution" type, which tend to use more imported inputs than

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* Indeed, in Guatemala and El Salvador there are taxes on excess inventory.

exports outside the region. Thus, import coefficients calculated in the aggregate (i.e. including CACM exports) probably overestimate import coefficients for exports destined to extra-regional markets.

7. Many non-traditional exports from the region have very little, or no, content which is imported. This is especially true of certain agricultural and marine products, processed food and other agro-industrial items.

These factors cause overall demand for the BLADEX/AID credit for imported inputs to be lower than originally anticipated. However, in the next sub-section we will examine the political-economic turmoil affecting the region and the currency overvaluation and exchange controls that have accompanied these developments. These events surely caused demand to be lower still, as many exporters qualifying for credit found little demand for their products, or faced unacceptable risks in entering foreign markets or in undertaking obligations in foreign currency.

II. Economic Environment

Since the time of the original ROCAP evaluation of the BLADEX loan, and the first disbursements in late 1982, changes occurred within Central America which greatly affected the premises upon which the loan was based. Events which are of prime importance in explaining the course of BLADEX lending are:

1. Recessions - Beginning in 1980, and lasting through much of 1983, economic recessions occurred in the developed countries which were to be the markets for BLADEX-supported exports. By 1983, the U.S. was pulling out of its recessionary period while Europe continued its sluggish economic performance. Recessions in the main markets for Central America's traditional and non-traditional exports meant decreased demand for them. Recessions in Central America can in part be associated with reduced demand for exports to the industrialized countries. During the 1980-83 period, Central American GDPs fell by about 7% in real terms, before a

slight recovery (of 2.4%) in 1984. Comparative figures for Central America and the U.S. appear in Table 4.2. Note that recession in the U.S. characterizes the 1979-82 period, before real growth resumed in 1983.

Clearly, at a time when demand for exports has declined, so would the demand for export finance. Now (1985) as the developed countries have experienced about 18 months of growth, the demand for Central American exports again is growing and real GDP growth is again being seen in the region. Along with this change, demand for export credits should grow apace but will vary from country to country.

Table 4.2

REAL GDP IN MILLIONS OF 1978 U.S. DOLLARS FOR CENTRAL AMERICA

	1979	1980	1981	1982	1983	1984
Guatemala	6356	6595	6641	6404	6234	6250
Honduras	2037	2092	2118	2079	2070	2126
El Salvador	3021	2761	2533	2377	2374	2410
Costa Rica	3695	3725	3641	3359	3455	3685
Total	15109	15173	14933	14219	14133	14471
United States GNP (billions)	2640	2632	2698	2641	2738	2925

Source: Saidi & Loehr, Checchi & Co., Research of a Trade Financing Facility, March 1985; and IMF International Financing Statistics, 1984 Yearbook, and June 1985.

2. Political Instability - By the time the AID/BLADEX loan program began, the Nicaraguan revolution had occurred and political violence in El Salvador and Guatemala had begun. Political violence in these countries

continued through the first year of the loan program. Political instability not only reduces the demand for BLADEX-type credits, but can render the granting too risky from a banking standpoint. Political risk was very high, especially in El Salvador and Guatemala through 1983, and continues high today. This instability reduces the volume of lending.

3. Currency Overvaluation - During recession and political upheaval most countries of the region tried to maintain the value of their currencies vis-a-vis the dollar, resulting in severe overvaluation of those currencies by 1984. Only in Costa Rica were steps taken during 1982-83 to adjust to new market conditions, once it had become painfully obvious that the old nominal value of the colon could not be maintained. An earlier study for ROCAP by Checchi and Company revealed that overvaluation was due to two basic factors. First, currencies were tied to the U.S. dollar, and domestic inflation in the Central American countries exceeded that in the U.S. Second, since 1980, the U.S. dollar has appreciated greatly against most of the world's major currencies. For example, since 1980, the dollar has appreciated about 50% against the German mark and 75% against the French franc. As Central American currencies remain tied to the dollar, they appreciated sharply against other major currencies to the detriment of their exports.

Real effective exchange rates for the countries under study are shown in Table 4.3. The numbers shown are index numbers. They show the number of units of local currency, relative to 1978, required to buy a given real quantity of goods and services in a weighted average of the currencies of seven major trade partners. A decline in the index number indicates an appreciation of the currency in question. The only currency of the group to depreciate substantially is the Costa Rican colon. The lempira and El Salvadoran colon have appreciated considerably since 1978, and the quetzal has remained approximately stable.

Table 4.3

REAL EFFECTIVE EXCHANGE RATES - CENTRAL AMERICAN CURRENCIES (1978 = 1.0)

	1979	1980	1981	1982	1983	1984
Guatemala	1.06	1.13	1.04	.95	.96	1.04
Honduras	1.04	1.11	1.07	.97	.85	.84
El Salvador	.98	.93	.79	.70	.67	.67
Costa Rica	.91	.89	1.85	2.06	1.73	1.97

Source: Saidi & Loehr, op. cit.

Given these appreciations, one would expect the demand for Central American exports to decline. Statistical evidence supports this position*. Thus, as the demand for exports declined, the need for export credits also declined. This shift in demand for credit will of course be different for each country depending upon the relative overvaluation of each country's currency.

4. Exchange Controls. Currency overvaluations are accompanied by shortages of foreign exchange. Countries with overvalued currencies must spend whatever foreign exchange they have accumulated or are able to borrow, merely to support the overvalued rate. When foreign exchange becomes scarce most developing countries resort to exchange controls to

* The statistical appendix to the March 1985 Checchi & Co. study presents significant statistical evidence that exports correlate positively with the real exchange rate. The more overvalued the currency the lower exports. Since the March 1985 study, additional statistical work on these data reconfirms this conclusion.

conserve it; the Central American countries have been no exceptions. Management of exchange controls is very difficult and few countries do it well. If not well done, exchange controls can create great difficulties for exporters (and importers). In the region, the exchange control systems of Guatemala and Honduras present major obstacles and disincentives to exporters and to the extension of BLADEX credits to them. El Salvador and Costa Rica are performing better in this regard, with the latter presenting few obstacles.

(Section 6 explores in more detail on a country-by-country basis, exchange controls and the effect that they are likely to have on exporters and the market for the BLADEX/AID credit.) In short, AID and BLADEX should not be overly optimistic about placing credits in Guatemala or Honduras until the exchange situation improves. Costa Rica on the other hand seems ripe for export expansion and the use of short-term export credits.

5. Latin American Debt Crisis and High Interest Rates. The well known debt crisis and interest rates both peaked in 1983. Almost all Latin American countries, Central American included, were required to make special efforts to mobilize capital to service external debts. New debt commitments were discouraged; new flows of capital to the region, already low, were diverted to service foreign debts. Interest rates reached historic highs in some countries, thus discouraging all sorts of borrowing, including borrowing for export finance.

6. Institutional Arrangements. In the Project Paper supporting the BLADEX/AID export promotion fund, pages 19-22 discuss the concept of "compensating" financing. The example is given of a Central American producer-exporter who imports raw materials necessary to fulfill an export order, with payment made directly by BLADEX to the supplier. The producer then owes dollars to BLADEX,, via his commercial bank. When the resulting export is shipped payment is received directly by BLADEX from the foreign exporter, thereby extinguishing the loan. The balance is then remitted to the producer who ultimately receives the local currency equivalent from

his central bank. At that time, ROCAP did not anticipate that there would be any conflict with local exchange control systems.

Unfortunately, almost no transactions take place the way the example in the project paper was constructed. The main deviations from this model are:

a. Few exporters import their inputs directly. Most buy imported inputs from local suppliers and distributors, who are the original importers.

b. Even where firms import inputs directly, few (if any) import transactions are tied directly to exports using those same imports. Usually, loans are made for imported inputs if firms can demonstrate to their commercial bank that they will be exporting something that will eventually cover the original foreign exchange commitment.

c. The central banks in each country do allow the commercial banks and BLADEX to handle the lending and collection procedure as described in the project paper. However, even though loans for inputs and export proceeds may cancel each other dollar for dollar, the exporter is usually debited or credited for each transaction as if each were a totally separate transaction. Each part of every transaction is subject to the rules governing foreign exchange transactions in each country. Thus, while from BLADEX/AID's point of view, transactions balance dollar for dollar, they may not balance for the exporter in units of local currency.

This observation about problems with exchange controls was probably not a "problem" in mid-1982 when the project paper was developed. At that time all countries had uniform exchange rates; transactions that cleared "dollar for dollar", also cleared "local unit for local unit". Since that time all countries but Honduras have created multiple exchange rates, with different rates applying to import and export transactions. Costa Rica has now returned to a unified exchange rate after several years of adjustment. Guatemala and El Salvador still maintain multiple exchange rate systems.

III. Export Performance

Export data for the four countries under study are shown in Table 4.4. All data are expressed in real dollars of 1984. In all cases exports have fallen considerably since 1980 only in Costa Rica was there a recovery in 1984. The table also shows non-traditional exports to areas outside the CACM. In all cases there has been some recovery between 1983 and 1984*. In Costa Rica the recovery in both total exports and non-traditional exports has been very substantial; non-traditional exports are now higher in real terms than 1980. In El Salvador, non-traditional exports outside the region are much lower than in the other countries; an apparent recovery since about 1982 has more or less restored the level of non-traditional exports in real terms to about the 1980 level.

In Guatemala, the data, as shown, indicate a recovery in non-traditional exports. This conclusion is questionable. The Guatemalan data originate with the Central Bank, which has applied the official rate of exchange for the period shown (Q1 = $1). By the end of 1984 when parallel rates were legalized, the quetzal had devalued in the parallel market by about 35%. By applying the official rate of exchange to 1984 data, real exports are overestimated in dollars - perhaps by as much as 35%. It is not likely, therefore, that there has been a true recovery in non-traditional exports, despite the appearance of such a phenomenom in the data.

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* Data for Honduras were not available for 1984.

Table 4.4

CENTRAL AMERICAN EXPORTS 1980-1984
(in Millions of 1984 Dollars)

	1980	1981	1982	1983	1984
Guatemala*					
Total	1703	1175	1132	1127	1122
Non-Traditional	311	220	242	207	257
Costa Rica*					
Total	1158	1068	898	891	965
Non-Traditional	190	200	169	169	221
El Salvador**					
Total	980	634	524	501	510
Non-Traditional	49	43	33	39	47
Honduras+					
Total	814	713	656	626	N/A
Non-Traditional	173	179	165	182	N/A

SOURCES: * Central Banks

** FUSADES from Central Bank data

+ SIECA

Note: Original data for Guatemala, Costa Rica and Honduras were reported in dollars. They were deflated by the U.S. WPI converted to a 1984 base. Data on El Salvador were originally in Colones. Data were deflated by the Salvadoran WPI (excluding coffee) with a 1984 base, then converted at C4=$1.

IV. Summary

The BLADEX/AID program was initially evaluated in 1981-82, using information and data from 1978-1980. Expectations were formed about the demand for credit, based on the information available at that time. Almost from the outset of the BLADEX/AID program, economic events occurred which reduced the demand for export credit -- indeed, the demand for all commercial credit was probably reduced. Considering the economic environment in the region during the period 1980-1984, it would not be reasonable to expect the BLADEX/AID program to reach the levels originally anticipated.

Section 5

INSTITUTIONAL CONSTRAINTS

A principal objective of this study is a determination of the effects of institutional constraints upon the use of the BLADEX/AID credit and upon the prospects for its future use.

In our visits to the commercial and central banks of four Central American countries and in our visit to BLADEX in Panama, we have been alert to any institutional blockages to the effective flow of the BLADEX/-AID credit to the ultimate beneficiaries. Institutional constraints, if any, should be identified in BLADEX administration and promotion of the credit to its participating banks -- matters which can be corrected by BLADEX itself -- and also in the structure of the banking systems and the exchange rate and trade controls in the countries themselves. These conditions can be characterized as structural or institutional and clearly are capable of affecting the use of the BLADEX/AID line of credit.

More detailed comments on banking and exchange problems will be made under the country sections. AID is most concerned with BLADEX performance and therefore our observations will be directed at its organization, staffing and administration as it relates to this credit.

I. BLADEX

A brief description of the structure and operations of BLADEX (Banco Latinoamericano de Exportaciones) is presented here as an aid to appreciating the relative importance of the BLADEX/AID credit to the Bank, and its role in Central America.

The Bank was incorporated in Panama in 1977 and began operations on January 2, 1979. It is the result of an earlier proposal by the Governors of Latin American Central Banks to create a multinational organization to finance exports from the Region.

The shareholders of the bank are divided into four classes:

- Class A - Central Banks or designated government financial institutions;

- Class B - Commercial Banks of the Region;

- Class C - International Commercial Banks; and

- Class D - International organizations (currently the International Finance Corporation).

There is a 10-member board representing these shareholder. As of December 31, 1984, there were 20 Class A stockholders, 201 Class B stockholders, 27 Class C stockholders and one Class D stockholder. There was a total of $62.4 million of capital as of March 31, 1984. BLADEX extends its credit facilities only through Class B stockholders, the local commercial banks and financial institutions. BLADEX has conducted operations under the AID line with:

- 6 Guatemalan banks out of a total of 12 member banks

- 5 Honduran banks out of a total of 11 member banks

- 4 El Salvadoran banks out of a total of 4 member banks

- 2 Costa Rican banks out of a total of 4 member banks

We met with BLADEX officials over a period of two days and engaged in extensive discussions on the background of the loan, experience with its administration and use, and prospects for the future. Before and after the BLADEX meeting, we sought from participating banks their views of BLADEX.

The staff of the Bank with whom we met impressed us with their alertness, preparedness and their desire to make the credit fulfill the original expectations of both AID and BLADEX. The staff admitted its disappointment with results to date. They felt that no entirely satisfactory explanation could be devised for the shortfall in BLADEX cofinancing activities (compared to the AID loan agreement) other than an under-estimation of demand.

The short term financing operations of BLADEX in Central America for all types of exports are set forth below (in thousands of dollars) in Table 5.1.

Table 5.1

BLADEX SHORT-TERM FINANCING

COUNTRY	OUT-STANDING AS OF 12/31/83	GRANTED DURING 1983	OUT-STANDING AS OF 12/31/84	GRANTED DURING 1984	GRANTED DURING 1979-1984
Costa Rica	1,078	1,082	4,626	17,328	46,220
El Salvador	9,216	77,588	14,564	97,942	336,133
Guatemala	15,928	57,785	23,175	68,946	176,731
Honduras	9,146	22,549	10,291	15,729	125,684
Total	35,368	159,004	52,656	199,945	687,768
For all Latin American countries	115,338		145,702		

In the past BLADEX has extended medium term export assistance loans to some of its members but is no longer making such loans. At present such loans represent slightly more than one-half the Bank's total loan portfolio. However, among the Central American countries, only Costa Rica with $10 million and Honduras with $6.0 million have such loans.

Credits granted under the original AID loans and loans from the revolving fund and the original advances from AID amounted to $43.2 million in 1983 and 1984. As can be seen, the credits under the BLADEX/AID line represent a small part - 12 percent - of BLADEX's short term lending operations in 1983 and 1984 in Latin America.

BLADEX has a staff of 106. Its total short term lending in 1984 was $977 million (excluding refinancings) covering 940 loans for an average of slightly more than $1 million per loan. Some 955 loans were made under the BLADEX/AID line between January, 1983 and March, 1985 for an average of $53,000 per loan. Cofinancing loans by BLADEX between September 1984 and March 1985 numbered 70 for a total of $14.6 million or an average of $209,000 per loan.

A BLADEX officer indicated that the Bank may have been incorrectly assuming during the AID loan negotiations that all of its short term financing of exports from Central America would count towards the 2:1 cofinancing commitment. However, the official in no way suggested that at the time of signing the agreement that BLADEX did not share the same understanding as AID in regard to the cofinancing commitment. We feel, given the experience of the past 2 1/2 years, that this background remark should be reported.

BLADEX officials assured us that their handling of credit requests from participating banks has been instantaneous to prompt, a critical feature in the administration of short term trade financing. Some loss of business opportunities were attributed to delays in responses from AID on transactions breaking new ground or involving some unusual financial feature. The incidents have admittedly been rare and BLADEX does not anticipate that future operations will be similarly affected. Banks in the four Central American countries that have had extensive transactions under the BLADEX/AID line expressed themselves as satisfied with the manner in which BLADEX has handled their credit requests, saying the Bank has demonstrated a high degree of professionalism. One bank official stated he preferred BLADEX over other credit sources, terms being approximately equal. Some BLADEX share holder banks have not yet participated in the program. Various reasons have been given for failure to do so but none which would indicate any institutional deficiencies on the part of BLADEX.

BLADEX has financed one transaction of $237 under the program as well as many of less than $10,000. These cannot be considered profitable transactions on an allocated cost basis for a bank with a staff of 106 which carried out almost 1,000 short term trade transactions averaging over $1 million each in 1984. We do not believe that BLADEX has neglected the program or has hampered it through operating or bureaucratic in efficiencies.

A further evidence of the BLADEX reputation in financial circles was the sale on April 15, 1985 in a difficult international market of $50 million in five year floating rate notes at 1% above LIBOR. Given the current credit rating of Latin America, this sale constitutes a favorable independent judgment of BLADEX as an operating institution. Our conclusion is that search must be focused elsewhere for the underlying causes of the shortfall in the projected regional demand for the BLADEX/AID credit.

BLADEX has played an important role in expanding financing for exporters in Central America. Short-term loans outstanding expanded by almost 50% during 1984 (from $35.4 million to $52.7 million). This includes loans under the BLADEX/AID program plus other short-term BLADEX credits - all of which support export activities. Loan disbursements for all purposes during the year 1984, amounted to $207 million. If funds turn over an average rate of 3.64 times per year, the implication is that capitalization should be on the order of $52 to $69 million for all purposes including traditional and non-traditional export lending. In this context, the originally planned $75 million capitalization for non-traditional export financing alone appears excessive.

II. Participating Banks

We could not find evidence that participating banks represented an institutional barrier to the development and increased use of the BLADEX/-AID line.

Some banks have not staffed themselves to make use of the line. It has been suggested that this may be due to the failure of BLADEX to promote the line with shareholding banks. BLADEX is positive that it has spared no reasonable effort in this regard. It therefore seems likely that those banks - especially in Guatemala and Honduras where participation is relatively low - do not consider that their customers need access to the line or that their export financing needs can be adequately met through the bank's own resources. Another possible explanation is the conservative approach of some banks, causing them to specialize in the financing of traditional products. It should be noted that BLADEX shareholder banks undoubtedly make use of BLADEX facilities to handle traditional exports.

BLADEX outlined for us the meetings and visits its officials have made to promote the line with banks and with exporter groups. It appears to us that lack of promotion is not a major reason for failure to make greater use of the line. However, we cannot say with certainty that more promotion by BLADEX would not help.

III. Exchange Controls and Systems

Herein may be the greatest institutional barrier to greater use of the BLADEX/AID line. Wherever exchange rates are used as a means of taxing exports or subsidizing imports, the willingness of banks and exporters to use dollar denominated credits is reduced. The situation is most acute in Guatemala, the most important economic unit in Central America. As a result, only a few banks in that country are currently making use of the line and the number of customers and types of transactions are correspondingly limited.

In Costa Rica, where the exchange rate system is the least burdensome to trade, a multitude of transactions is taking place. Use of the line is further stimulated by a very high (relative to the cost of money under the BLADEX/AID line) rate of interest on local currency borrowing. As explained elsewhere in the report, local currency loans can readily handle most needs of exporters for simple export bridge financing. Thus, where there is an adequate supply of lendable local funds as is the case in Guatemala, Honduras and El Salvador, there is not much pressure to use the BLADEX/AID line. (See Section 6.)

The inability of banks in most countries to link imports to follow-on exports illuminates one of the structural weaknesses in the original project. It was expected that the bulk of the credit would be devoted to imports and that only a minor part would directly finance exports. The reverse has occurred. Indeed, banks have pointed out that import financing is still the greater need; the inability to link imports that are indirectly involved in exports remains one of the more important deficiencies in the program. Some transactions financed under the line show considerable ingenuity. AID has indicated its willingness to approve transactions where a reasonably causal relationship between imports and exports can be demonstrated.

The linkage is easiest in the case of raw materials readily processed for export in the draw-back operations, but there are many manufacturing enterprises which use only small quantities of imported goods to produce exports. Spare parts, specialized fertilizers, herbicides, insecticides and packing materials are examples of indirect exports which may not have qualified for credit from BLADEX/AID under the program as originally conceived. We feel that importers of these products would find it useful to have access to the line on a more comprehensive scale than has yet been achieved.

In all countries we found instances of import financing where such imports subsequently and incidentally form part of exports of non-traditional products. There is reason to believe that communications from

BLADEX to its participating banks might suggest a wider use of the indirect pre-export facilities. This matching of imports only indirectly involved in exports with actual export transactions, is best handled by local banks, although the task is sometimes complicated by exchange controls and regulations.

Section 6

COUNTRY REVIEWS

I. Guatemala

A. Exchange Controls and Systems

Guatemala would be the largest user of BLADEX-AID credit if several major obstacles were removed. The exchange control system in Guatemala is currently so restricted and costly to exporters that exporting is discouraged. To understand how the exchange control system discourages exports an explanation of several aspects of the Guatemalan exchange control system is in order.

Importers have three sources of hard currency purchasing power available to them. First, if importers can arrange a barter transaction, where their imports are covered by an equal- value export they are allowed to do so. This is the cheapest source of foreign exchange, since each dollar earned abroad yields one dollar's worth of imports. Unfortunately, arranging for a barter transaction is rather difficult since both sides of the transaction (import and export) must be simultaneous and it is rare that the Guatemalan exporter/importer would be dealing with only one customer/supplier abroad. Also, there is no standardized procedure established at the Central Bank for approving barter transactions. Each case is handled _ad hoc_. Second, a limited amount of foreign exchange is made available each month (usually $3 million) by the Central Bank. Qualifying firms can bid on that foreign exchange; if their bids are successful they must make use of the exchange within two days. This so called "Licitaciones" market is described in the appendix to this section. The most recent sale through this process brought successful bids averaging Q2.60 = $1.00. Finally, there is the parallel market where importers may simply buy the dollars they need at the going rate, which is currently about Q3.00 = $1.00.

Exporters must sell their foreign exchange to the Central Bank.

Those exporting traditional goods must sell their dollar earnings at the "official" rate of Q1.00 = $1.00. Those exporting "non-traditional" items must sell one half of their dollars to the Central Bank at the official rate, the other half at an "official parallel rate", which is currently about Q2.48 = $1.00. The latter rate is changed weekly and is an average of commercial bank rates over the preceding week.

A major problem for importers and exporters is that even where a loan that is granted for imported inputs is linked to an export credit, the Central Bank considers these two separate transactions. One of the original ideas in the BLADEX-AID loan package was that a producer of non-traditional exports could take a pre-export loan from BLADEX to buy imports, and, when the exports were ready for shipment, BLADEX would also give an export loan. All would be denominated in dollars and the second loan would cover the first loan. Any excess of the second loan over the first would be paid to the exporter, through the central bank, in local currency. Unfortunately, the Guatemala Central Bank considers these two separate loans, each facing different exchange rates when converted to quetzales.

Thus, an importer who must buy his foreign exchange in the parallel market (as most do), must either have quetzales to enter the parallel market at the time he imports or -- if he borrows dollars to import -- he must pay off his loan in quetzales at the parallel rate when the loan is due. If this importer borrows $100 from BLADEX, to effect an import transaction, the loan must be registered at the Central Bank at the time of importation. When the loan matures the Central Bank requires liquidation at the parallel rate. Ignoring interest the imports cost the importer about Q300.

If the same importer now uses those imports to produce and export an item which he sells for $150, upon payment he must exchange his proceeds at the Central Bank, 50% at the official rate and 50% at the "official parallel rate" (assumed here to be Q2.50 = $1). In this case, the transactions yield him about Q262.50. He has lost Q37.50 on the combined transactions. It makes no difference whether he takes payment directly for his exports or receives an advance from BLADEX. The proceeds pass through the Central Bank in the same way in either event. In the example given (still ignoring any interest payment) the importer/exporter must export goods worth $171.43 just to pay for his import requirements of $100!

The original idea behind the BLADEX-AID loan program was that the importer/exporter would come out Q87.50 ahead on the transactions described above. The producer would import $100 worth of imports and this would be covered by a $150 export advance. The extra $50 of export advance would be paid out to the producer via the Central Bank ($25 at the official rate; $25 at "official parallel" rate of Q2.50 = $1).

The multiple exchange rate system being run by the Banco de Guatemala creates a strong incentive for underinvoicing exports. In the above example assume that imports are still $100, paid for at the parallel rate, costing the producer Q300. However, when the producer ships his goods his payment comes in two parts. He still sends a bill to this customer (say in the U.S.) for $150 but payment is to be made to the Guatemalan exporter's bank in Miami. But, the Guatemalan's export documents, which are delivered to the Central Bank, list the goods as worth only $100, to be paid by the Miami bank. Thus, the Guatemalan brings $100 in through the Central Bank and receives Q175. It appears that he has lost Q125 (thereby reducing tax liability) but he has retained $50 in the Miami bank. If that $50 were converted to quetzales at the free parallel rate they are worth about Q150. By underinvoicing exports he is able to earn Q25, rather than losing Q37.50.

Our conversations with Guatemalan business people engaged in export operations reveals that under invoicing is widespread. Overwhelmingly we were told that in the businesses we were discussing and among businessmen with which our sources were familiar, "every one does it".

The exchange controls in Guatemala are compounded by uncertainty. Our sources all complained that they have no assurance that the system is stable and that the rules of the game are now fixed. They fear that changes in the exchange rates within the Central Bank or changes in the proportion of export proceeds which they are allowed to pass through the parallel rate may leave them with obligations denominated in dollars, but which suddenly cost them more in quetzales than they had anticipated.

The fear has some basis. The quetzal has devalued in parallel markets by more than 50% since that market was legalized in November 1984. The devaluation has been accompanied by erratic changes along the downward trend. In addition, exporters of cardamom have become victims of decisions at the Central Bank. Cardamom has recently been reclassified as a "traditional" rather than "non-traditional" export. As a result export proceeds must be exchanged at the official Q1 = $1 rate, rather than exchanging 50% at the "official parallel" rate. The change reduced the exchange earnings of cardamom exporters by about 43% and has contributed to the general uncertainty concerning exchange controls.

In brief, Guatemalans who export, especially those who import as well, are severely penalized by the exchange control system. Simultaneously, the uncertainty associated with the exchange control system in Guatemala acts as an additional deterrent to entering export trade.

B. Guatemalan Exports

Guatemalan exports over the 1980-84 period are shown in current dollars in Table 6.1 and in real dollars of 1984 in Table 6.2. Non-traditional exports that qualify for BLADEX/AID financing fell from $311 million in 1984 dollars to $207 million in 1983. There appears to be a recovery to $257 in 1984, though one should exercise caution in interpreting this figure. Throughout the period the official exchange rate (Q1=$1) has been used for conversion. As we consider more recent periods, the quetzal becomes increasingly overvalued. Major adjustments began after November as the quetzal was allowed to devalue in parallel markets.

Thus, use of the overvalued official rate, especially for 1984, exaggerates the dollar value of exports*. It is probable that, though the data show an increase in real exports, no real change has taken place.

Table 6.1

GUATEMALAN EXPORTS IN CURRENT DOLLARS 1980-1984
(Million $)

	Total	Traditional	Non-Traditional	
			To CACM	Extra Regional
1980	1,473	800	404	269
1981	1,109	546	355	208
1982	1,091	536	322	233
1983	1,100	577	321	202
1984*	1,122	574	291	257

Source: SIECA, Estadisticas Macroeconomicas de Centroamerica 1979-1983 (Junio-84)
* From Central Bank data provided by SIECA.

Table 6.2

GUATEMALAN EXPORTS IN REAL DOLLARS 1980-1984
(Million $)

	Total	Traditional	Non-Traditional	
			To CACM	Extra Regional
1980	1,703	925	467	311
1981	1,175	578	376	220
1982	1,132	556	334	242
1983	1,127	591	331	207
1984	1,122	574	291	257

Note: All figures have been deflated by the U.S. WPI, converted to 1984 base.

* In November, 1984, when the parallel market was first made legal, the exchange rate in that market was about $1.35=$1. If that rate were used, rather than the official rate, real exports in 1984 would have been calculated to be only $190 million.

C. BLADEX/AID Financing Scenarios: Guatemala

To place BLADEX/AID lending in perspective in Guatemala, we have created the scenarios shown in Table 6.3. These are not forecasts but are based upon some simple assumptions about the behavior of exports and the BLADEX/AID share of financing markets.

Lines 1 and 2 (and 4 and 5) separate qualifying exports into two categories, cardamom (line 2) and all other qualifying exports (line 1). Since the preponderance of lending is for cardamom exports it will be retained as a separate category so that perspective on other types of lending is not lost. Lines 1 and 2 represent a "low" scenario. Inflation is assumed to occur at 4% per year. Real exports are assumed to grow at 2%; cardamom is assumed not to grow at all in real terms*. Lines 3.1 and 3.2 assume that BLADEX/AID credits maintain the same relationships to cardamom and other qualifying exports that they had in 1984. In 1984, financing of cardamom amounted to about 50% of cardamom exports. Financing of other exports amounted to about 4% of the value of those items**. Under these assumptions BLADEX/AID lending would amount to about $41 million by 1986.

A second scenario, labeled "high", is shown in lines 4-6. Assume inflation of 6% and that both kinds of qualifying exports grow at 10% in real terms. This real rate of growth would restore the real level of non-cardamom exports to approximately its 1980 level by 1986. Assume further that BLADEX/AID continue to lend to cardamom exporters about 50%

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* Conversion of cardamom export proceeds have recently been moved to the official market. This has the same effect as applying a large tax (of about 43%) on cardamom exports, thus reducing the incentive to export.

** In the first quarter of 1985, BLADEX/AID lending for exports other than cardamom is at greatly reduced levels. See Table 5.13.

of the value of their exports, and that lending for other exports remains at 4% of value in 1985 and 1986 respectively. BLADEX/AID lending would amount to about $51 million by 1986.

Table 6.3

SCENARIOS FOR BLADEX LENDING IN GUATEMALA

		1984	1985	1986
1.	Qualifying Extra Regional Exports	197	209	221
2.	Cardamom	60	62	65
3.1	BLADEX Commitments - Exports	7.9	8.4	8.9
3.2	Cardamom	29.9	31.0	32.5
3.3	Total (Low)	37.8	39.4	41.4
4.	Qualifying Extra Regional Exports	197	229	265
5.	Cardamom	60	70	81
6.1	BLADEX Commitments - Exports	7.9	9.2	10.6
6.2	Cardamom	29.9	35.0	40.5
6.3	Total (High)	37.8	44.2	51.1

II. Costa Rica

A. Exchange Controls

Costa Rica appears to be recovering well from the crisis that gripped the country during 1982-83. Since then the colon has been devalued and continues to be subject to monthly mini- devaluations which, recently, have been extremely small. Differences between "black market" rates and the parallel rates of exchange are only on the order of 3-4%. These signs indicate that the exchange rate is probably near an equilibrium value and that exchange stability should characterize the near term (i.e. one year).

B. Exports

Exports have responded well to the rationalization of economic policy. Table 6.4 (which was pieced together from a combination of AID, IMF and Central Bank information) shows the extremely poor export performance during the crisis years of 1982 and 1983, followed by a sharp rebound in 1984. During 1982 and 1983 exports of all kinds were about 14% below 1981 levels. In 1984 all exports expanded by nearly 11%; non-traditional exports led the way, expanding by about 11.6%. The latter performance was largely based upon rapidly expanding exports outside the region: these grew at 34%. The fact that CACM trade continues to deteriorate in 1984 was more than offset by the orientation that Costa Rica has taken toward non- CACM markets.

Table 6.5 shows Costa Rican exports in millions of 1984 dollars. Real, non-traditional exports outside the CACM rebounded by almost 24% in 1984. They now stand at levels above those of 1980. Prospects seem good that exports of this kind will continue to expand in the near future.

Clearly, one problem for Costa Rica is that her industry was originally based upon serving the CACM. Now that CACM has decreased in importance, industry must make the transition from serving a protected regional market to serving the relatively free markets outside the region. That adjustment may require loans like those offered by BLADEX-AID. It is more likely, however, that loans of a medium term nature will be required.

Table 6.4

COSTA RICAN EXPORTS 1980-1984
(Million Dollars)

	Total Exports	Traditional Exports	Non-Traditional Exports To CACM	Non-Traditional Exports Extra Regional
1980	1001.7	566.8	270.3	164.6
1981	1008.1	580.8	238.0	189.3
1982	865.8	535.8	167.2	162.8
1983	870.2	517.8	187.1	165.3
1984*	965.0	572.0	172.3	221.0

Sources: Prepared by AID from Central Bank data

*FOPEX from Central Bank Data

Table 6.5

COSTA RICAN EXPORTS 1980-1984 in 1984 DOLLARS
(Million $)

	Total Exports	Traditional Exports	Non-Traditional Exports To CACM	Non-Traditional Exports Extra Regional
1980	1158.0	655.3	312.5	190.3
1981	1067.9	615.3	252.1	200.5
1982	898.1	555.8	173.4	168.9
1983	891.6	530.5	191.7	169.4
1984	965.0	572.0	172.3	221.0

Note: All figures deflated by U.S. WPI, converted to 1984 base.

Medium term financing in the Costa Rican context may also find considerable demand for other reasons. First, some Costa Rican firms take advantage of the relatively skilled labor force of the country, producing capital goods destined for export to other Latin American countries. Capital goods are frequently produced over a longer time frame than other goods, and are often produced to special order. For example, a Costa Rican firm, COPESA builds bodies for buses which it exports to the Brazil and Colombia. The turnaround time on filling orders is 1-2 years, which renders BLADEX loans unavailable. Secondly, there are other popular Costa Rican exports which have turn- around times exceeding 180 days. Flower production for example, requires investments of up to $250,000 per hectare. The investment - production - export cycle runs its course in something just under two years.

C. Institutional Developments

Important institutional changes have occurred in Costa Rica since the 1982-83 crisis. A major step forward was the formation of the Fondo para la Promocin de Exportaciones (FOPEX). Founded in October of 1983, FOPEX is an independent affiliate of the Central Bank, dedicated exclusively to the promotion of non-traditional exports. FOPEX provides loans similar to BLADEX and is indeed the heaviest user of the BLADEX- AID credit line in the region. FOPEX not only provides credit but encourages small exporters to enter markets outside the region. Perhaps most importantly, FOPEX works to ensure that exporters have no unnecessary delays in acquiring dollars from the Central Bank when they are needed for importing raw materials*.

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* Normally one must wait up to 45 days after requesting dollars. Meanwhile a deposit of colones is required which has an opportunity cost of about 2% per month. Some sources report receiving dollars in two days with FOPEX assistance.

In evaluating the role of FOPEX and credit expansion, it is useful to keep in mind that:

1. FOPEX was inaugurated only 20 months ago.

2. FOPEX and its staff of five had no experience in export promotion.

3. Not until late 1983 and 1984 was Costa Rica coming out of a period of economic chaos and recession.

4. Large amounts of credit were available immediately. The World Bank loan of $25 million was available when FOPEX began; IDB ($25 million) and BLADEX ($5 million) shortly thereafter.

For these reasons it would be reasonable to expect the disbursal of loans to lag far behind credit availability*. Now, we are told, that with the learning experience of the past year and a half and the economic rationalization that has occurred, the demand for export credit is increasing rapidly.

FOPEX is unique in the region. In no other country is there an export promotion agency so well placed to help non- traditional exporters. Furthermore, in discussions with at least 15 sources, none complained that FOPEX was not functioning well; many had nothing but praise for its work. Unfortunately, the Director of FOPEX thinks that an organization like FOPEX could not work under the types of exchange control systems existing in Guatemala and Honduras and would have difficulty in El Salvador.

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* Most of these factors affected commercial banks as well.

In addition to FOPEX, several other developments are of interest. Trading companies are being formed in Costa Rica. The first, and largest, BANEX TRADING, is a private trading company and serves as a model for the others. BANEX deals exclusively with promoting non- traditional exports. It provides a "provisioning" function by obtaining credit for and buying imported inputs, then making those inputs available to exporters who need them. BANEX then will discount their export documents. Elsewhere in this report we have mentioned the difficulty in making the connection between imported inputs and exports. BANEX provides this function by playing the role of a distributor with an incentive to make sure that the export connection exists.

A second development relates to private banking. The Costa Rican banking system was nationalized in 1948; only four banks performing commercial functions were permitted. Since a 1983 change in the banking law, new commercial banks have been formed. Today there are 14, a number that will probably reach 20 within a year. Each new bank brings with it its own resources, including its lines of credit from outside the country.

The interest rate structure in Costa Rica, unlike Guatemala, is conducive to using BLADEX credits. Loans in colones can be acquired for rates of interest in the 24-32% range. BLADEX-AID monies can be acquired for LIBOR plus 3%, which is about what other dollar denominated loans can be acquired for.

The spread between dollar and colon loans is attributable to a perceived exchange risk. If people have committed themselves to servicing a dollar denominated loan, they expose themselves to the risk that a colon devaluation will cause the loan to be more costly to service. This risk may be more perceived than real. There is no economic reason to believe that major colon devaluations are in the offing. Nevertheless, we listened time and again to expressions of fear that the 1982- 83 episode would be repeated. At that time, people who contracted dollar loans and planned to service them at C8.5 = $1 were forced to service them at up to C65 = $1. People and firms were destroyed financially; fear of a recurrence deters people from taking on dollar denominated debt today.

D. Competing Financing

In Costa Rica a number of alternatives to BLADEX credit exist for exports of non-traditional items. AID's bilateral program has made long-term loans to two institutions, BANEX and COFISA, for this purpose. Both loans are for $10 million, amortized over 20 years at 5% interest. These credits were extended in 1982 and may be used for short, medium or long term lending. Most lending is, however short term, at both institutions.

As a general rule, each institution will lend for imported inputs, up to 50% of the value of exports of client firms, and any loans for imported inputs is supposed to be covered by contracts to export. Cost to client firms for these funds is 2-4% above LIBOR.

In addition to these $20 million in dollars, AID has lent about $65 million in colones to a number of local banks. The project began in 1982. The most recent disbursement of $20 million was made in March. The program will be expanded in future. AID is currently considering an "industrial reactivization credit" of $10 million which will be placed with commercial banks for medium term lending to export-oriented enterprises. This program is "likely" to be funded in the next fiscal year.

In addition to AID programs the World Bank and the IDB have each placed $25 million at the disposition of FOPEX. FOPEX also maintains a credit line of $5 million from BLADEX. FOPEX is currently the most active user of BLADEX credits in all of Central America, and is currently rolling over the BLADEX credit about three times per year. The director of FOPEX noted that while the World Bank and IDB financing can be used for a wider range of activities, the bureaucracy associated with them is too overpowering for most exporters - especially small, new ones. BLADEX, on the other hand, imposes almost no bureaucracy and can reach decisions about extending credit within two or three days (compared to months for the IDB).

In addition to these programs, all of which are dedicated to financing non-traditional exports (except AID's colon lending) and which amount to $75 million, literally all banks maintain lines of credit with banks outside the region. All Costa Rican banks can, and do, provide advances against adequate documentation that an export sale has actually occurred. All banks reported that, as the current stabilization program began to exhibit some success in 1983, many new lines of credit became available from banks outside the country.

Relative costs of credit to end users in Costa Rica, favor BLADEX-type loans. Currently BLADEX credits cost end users LIBOR + 3, which amounts to about 11%. Local loans in colones are acquired for about 28-32%. Most people interviewed agreed upon two important points: first, 28-32% for loans in colones is probably too high, and that given current rates of inflation, interest rates are likely to decline. Second, until May 1986 when a new government will come to power, there is little objective exchange risk. (Though there is a perceived exchange risk). Therefore, there is an incentive to borrow BLADEX - type funds, rather than borrow locally in colones. However, in two major cases - BANEX and COFISA, where BLADEX loans could be made, the institutions involved both have heavily subsidized AID monies available and would naturally choose to draw these down first. Only when the subsidized AID funds are fully occupied would they choose to extend credit by drawing upon their BLADEX lines.

In short, both demand for and supply of credit for non-traditional exports have expanded greatly in Costa Rica. In some cases the BLADEX line is simply not competitive. On balance however, it appears that there will be increases in demand which BLADEX can serve over at least the next year. If political changes in May 1986 are smooth and the exchange regime little affected, greater demand yet would be anticipated on into 1987.

E. BLADEX/AID Financing Scenarios

Two scenarios for BLADEX/AID lending are shown in Table 6.6. These figures do not represent forecasts, but assumptions about the course of Costa Rican exports and BLADEX/AID lending. In line 1, a "low" scenario, assume an inflation rate of 4% and growth in real qualifying exports of 5%. BLADEX/AID lending in 1984 was about 6.3% of the value of these exports. We assumed that BLADEX/AID lending remains at 6.3% of total value in both 1985 and 1986. These assumptions imply that lending would reach almost $16.6 million in 1986.

For a "high" scenario, assume that inflation is at 6%, that real exports grow at 10% and that BLADEX/AID lending amounts to 7% and 8% of export value in 1985 and 1986 respectively. Total lending under this scenario reaches almost $24 million by 1986.

Table 6.6

SCENARIOS FOR BLADEX/AID LENDING IN COSTA RICA
(Million $)

		1984	1985	1986
1.	Qualifying Exports (Low)	221	241	263
2.	BLADEX Commitments (Low)	13.9	15.2	16.6
3.	Qualifying Exports (Low)	221	256	297
4.	BLADEX Commitments (High)	13.9	17.9	23.8

III. El Salvador

A. Exchange Controls and Systems

The Central Bank of El Salvador is pursuing an exchange rate policy which has two important features. First, over time, an increasing proportion of transactions are being shifted to parallel markets. When parallel markets were first legalized in September 1984, a list was published by the Central Bank, stating the proportions of export proceeds which must be exchanged at the official vs. parallel rates. Another list was published in December 1984, which increased the proportions of proceeds that can be exchanged at parallel rates. Since December, the list has been modified, each time shifting increasing proportions of export proceeds into the parallel market. The objective is to eventually shift all transactions into that market. Currently, non-traditional exporters convert most of the export proceeds in parallel markets, and those proportions are growing.

Secondly, the rates at which importers of raw materials can buy foreign exchange, compared to rates at which they must convert their foreign exchange earnings, have been managed so as to eliminate most disincentives to exporting. In general, producers who import inputs acquire greater proportions of their dollar needs at the official rate, while exchanging their dollar earnings at lower proportions in the official "market". For example, a textile producer can buy dollars for imported inputs, 50% at the official rates and 50% at the parallel rate. When the same producer exports, his proceeds are converted 18% at the official rate and 82% at the parallel. Thus, he has incentive to import, process, then export.

Rationalization of El Salvador's exchange rate should begin to pay off in increased exports. Table 6.7 shows export performance, in millions of colones, since 1981. Shrimp is placed in a separate category because shrimp are considered a traditional export in El Salvador, yet qualify under the BLADEX/AID credit line. Shrimp have received more BLADEX/AID export financing than everything else combined. Table 6.8 shows exports converted to constant dollars of 1984. To convert from colones to dollars we first deflate by the wholesale price index (excluding coffee, since we are not particularly interested in coffee), then convert real colones of 1984 into dollars by applying the parallel exchange rate (C4.00 = $1.00).

Table 6.7

EXPORTS OF GOODS FROM EL SALVADOR
(Million Colones at Current Prices)

	Total Goods Exports	Traditional Goods	Shrimp	Non-Traditional CACM	Non-Traditional Extra Regional
1980	2688	1783	32	739	134
1981	1995	1303	40	516	136
1982	1749	1160	45	436	109
1983	1841	1245	34	420	142
1984	2040	1358	41	450	187

Source: FUSADES, "Como Esta Nuestra Economia?", (Dic. 1984) Reproduced from Central Bank data.

Table 6.8

EXPORTS OF GOODS FROM EL SALVADOR
(Real Dollars of 1984, millions)

	Total Goods Exports	Traditional Goods	Shrimp	Non-Traditional CACM	Non-Traditional Extra Regional
1980	980	650	12	269	49
1981	634	414	13	164	43
1982	524	348	13	131	33
1983	501	339	9	114	39
1984	510	341	10	113	47

Source: FUSADES, "Como Esta Nuestra Economia?", (Dic. 1984) Reproduced from Central Bank data.

An interesting feature of the export data is that in almost all categories, export performance has been poor except in non-traditional exports. Traditional goods exports fell after 1981 and have stayed low. Shrimp exports are down, and exports to the CACM are more than 30% below the 1981 level. Non-traditional exports (excluding shrimp) on the other hand have rebounded. They fell by about 25% between 1981 and 1982, but have now expanded beyond the 1981 level, largely on the strength of their performance in 1984.

B. Competing Financing

In El Salvador, there are a number of credit lines which compete directly with lines from BLADEX. Primary sources are the EXIMBANK, World Bank, IDB and private banks.

Credit lines guaranteed by the EXIMBANK are the most extensive. There are two efforts being made by the EXIMBANK. The first has been in existence for some time and offers $10 million each for loans under 360 days and for loans between 1 year and 5 years. A new program by EXIMBANK and AID guarantees lines of credit offered by major US banks. The banks are:

Bank of America
Bank of Miami
Capital Bank (Miami)
Citibank
1st National Bank of Commerce (New Orleans)
Irving Trust
Jefferson Guarantee Bank (New Orleans)
Lloyds Bank

When completed, these banks will have EXIM guarantees on credit lines totaling $75 million. Participating banks must agree that they will offer an additional line of credit, not guaranteed by EXIMBANK, equal to 25% of the funds that are guaranteed. This amounts to $18.7 million.

The Interamerican Development Bank (IDB) has entered into agreement with the Central Bank to set up a "Fondo para la Reactivacion Industrial". This fund is currently composed of $40 million from IDB and $10 million from the Central Bank. These amounts are about to rise to $60 million and $15 million respectively. To qualify to use these funds, firms must export at least 10% of their output. Loans may be for short-term export finance and they are aimed at the industrial sector.

The Central Bank has entered into an agreement with the World Bank to establish a Fondo de Desarrollo Economico. This fund could be used for short-term financing, competing directly with the BLADEX line.

In addition to these lines, Argentina, Colombia and Venezuela have established credit lines of $20, $2 and $5 million, respectively, to support imports from those countries.

Finally, and perhaps most importantly, all sources report that commercial banks in El Salvador have excess liquidity in colones and their own lines of credit with outside banks. All banks stand ready to offer short-term advances against export documents. Indeed, we were told by bankers that "we don't need BLADEX" for export financing since they had plenty of their own resources for that purpose.

Of the sources we have mentioned above, there are credit lines of about $103.7 million currently available which are directly competitive with the BLADEX/AID line, and up to $255.7 which could be used for BLADEX/AID type loans. When the amounts that commercial banks have available to advance against export documents are added to this total, there is a reserve of resources available to support exports.

Most of the resources mentioned above, and the BLADEX resources, are lines of credit which are regulated by the Central Bank. The latter is concerned that commercial banks not overly commit themselves, so banks can only draw upon a line of credit up to an amount approved by the Central Bank. Furthermore, the Central Bank tries to spread the amounts that each commercial bank may borrow across its various credit lines, so as not to overly concentrate debts to a single source. At the present time, the Central Bank is not permitting commercial banks to draw fully upon any particular line of credit that they have established.

The terms available to exporters using the BLADEX/AID credit line offer no special advantages. Currently they pay LIBOR plus 2%. Exporters borrowing on short-term from the Central Bank, drawing upon World Bank resources, pay 10% for export credits destined to markets outside the CACM and 13% for pre-export credits for goods from outside the CACM. Credits originating with the IDB carry interest charges of about 13%. Loans guaranteed by the EXIMBANK for short-term purposes (under 360 days) carry interest rates of the US prime rate; longer term credits add 2% to the prime rate and require a 15% deposit. There is the further restriction of EXIM guaranteed loans that goods imported with them must be imported from the U.S. Loans from local banks in Colones, against export documents currently cost about 12%.

The rate structure in El Salvador suggests that borrowers would be indifferent to using the BLADEX/AID line as against using others*. All cost about the same and all are readily available.

C. BLADEX/AID Financing Scenarios

Table 6.9 shows two different scenarios for BLADEX/AID lending for 1985-1986. The column for 1984 shows actual figures in millions of dollars. Note that BLADEX/AID loan commitments for 1984 were $6.7 million and $9.0 million for non- traditional exports and shrimp respectively in 1984. Thus, BLADEX/AID loan commitments amounted to 8.3% and 90% respectively of non-traditional exports and shrimp.

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* Indeed in one bank's case we were told that customers are not aware of the ultimate source of the credit they are using. Given that rates are all about the same a customer is not interested in where credit originates.

Lines 1 and 2 of the table provide scenarios for qualifying exports and shrimp. Line 1 assumes that there is inflation of 4% and that qualifying exports other than shrimp expand at 3%*. Line 2 assumes that shrimp exports are stagnant at their 1984 level in real terms. Recall that in real terms, shrimp exports have actually declined slightly since 1981. The volume of shrimp exports has been about constant since 1977. Thus, line 2 simply reflects inflation of 4%. Lines 3.1 and 3.2 reflect possible BLADEX/AID loan commitment given the assumptions that commitments to shrimp exports continue at 90% of total exports and that BLADEX/AID commitments to other qualifying exports remains at 14% Total financing commitments are shown in line 3.3 to expand from $15.2 million in 1984 to $18.0 million in 1986.

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* 3% is the rate of expansion 1981-84.

Table 6.9

SCENARIOS FOR BLADEX LENDING IN EL SALVADOR

			1984	1985	1986
(1)	Qualifying Extra Regional Exports		47	50	54
(2)	Shrimp		10	11	11.5
(3.1)	BLADEX Commitments	Exports	6.7	7.0	7.6
(3.2)		Shrimp	9.0	9.9	10.4
(3.3)		Total (Low)	15.7	16.9	18.0
(4)	Qualifying Extra Regional Exports		47	55	63
(5)	Shrimp		10	14	15
(6.1)	BLADEX commitments	Exports	6.7	7.7	8.8
(6.2)		Shrimp	9.0	12.6	13.5
(6.3)		Total (High)	15.7	20.3	22.3

Lines 4-6 show an alternative scenario. Non-Traditional exports expanded from their low point in 1982 by about 20% in real terms in both 1983 and 1984. Two reasons would caution use of that rate to project into the future. First, 1982 was the bottom of the cycle set in motion by El Salvador's political problems, and the 1982-84 recovery was largely a return to something closer to the long run trend. Second, growth at 20% per year in real terms is simply too rapid to sustain for long unless very special circumstances exist. Thus, to generate the figures in line 4, assume that inflation occurs at 6% and that real growth is 10% per year. Line 5 assumes that shrimp exports return to their 1981 level in real terms in 1985 and stay at that level in 1986. They too, of course, escalate in price at 6% per year.

Lines 6.1-6.3 reflect the same assumptions about the BLADEX/AID market share as used in the first set of scenarios. Line 6.3 reveals that under these assumptions BLADEX/AID commitments would rise to about $22.3 million by 1986.

We emphasize that these are not forecasts, but rather scenarios based on <u>assumptions</u>, so that some perspective can be gained on BLADEX/AID lending. We believe that rates of expansion in the BLADEX/AID market shares are not likely to be great given attempts by the Central Bank to administratively spread the use of various lines of credit among different sources. Also, many new lines of credit for purposes similar to BLADEX/-AID are coming on-stream and will gain some market share where they have not in the past. Export growth could be higher than we have assumed in our second scenario, but this is not likely given the continued over-valuation of the colon on average and the perception of instability in the area. Furthermore according to FUSADES, the Central Bank is predicting an overall decline in exports in 1985 in real terms*. Thus, while these figures are merely scenarios, it is unlikely that the actual figures would fall outside the range shown.

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* FUSADES, <u>Boletin Economico y Social</u>, No. 1 (Abril 1985) pag. 3. The Central Bank is reported to have forecast export expansion of only 0.4% in current colones and an inflation rate of "no menor del 15%".

IV. Honduras

Bankers in Tegucigalpa repeated time and again the same points: it is not credit that is lacking but productive capacity and knowledge of foreign markets. Their clients do not know much about export markets and those that have investigated them find that foreign prices for their commodities are too low, and their own prices too high reflecting the overvalued lempira). In short, banks report that they simply don't have clients that can use the BLADEX line.

A. Exchange Controls and Systems

The way in which dollar earnings clear the Central Bank provides a disincentive to local banks to use BLADEX. If BLADEX credit is used (or any other foreign loan in dollars) to finance exports, when dollar payments are finally received from the foreign customer, the commercial bank handling the transaction is allowed to retain 40% of the dollars in its own account, and 60% must be delivered to the Central Bank*. If the commercial bank provides the financing out of its own resources, it can retain 70% of the dollars as its own and deliver only 30% to the Central Bank. Thus, to earn and keep dollars, the commercial banks must use as much of their own resources as possible, rather than those of BLADEX.

Banks are unwilling to bear the exchange risk associated with pre-export financing. All reported difficulty matching an imported input with exported output. They also reported having made loans for pre-export purposes, then having difficulties covering the dollars when export proceeds did not materialize.

There is a concession to BLADEX here. For BLADEX loans these proportions are 40/60. For any other foreign loan the proportions are 30/70.

B. Exports

Honduras has an extremely small export base, and most of that is composed of traditional products. Much of Honduras's non-traditional exports are made to the CACM. Non-traditional exports outside the region are largely wood, metals and ores, and tobacco. None of these have large imported inputs and many already have sources of financing. There is currently considerable overvaluation of the lempira which makes Honduran goods non-competitive in international markets and there is no sign that the lempira is likely to be devalued soon.

Data on Honduran exports are displayed on Tables 6.10 and 6.11. Data on 1984 were not available at the time of this study. In 1984 dollar terms, (Table 6.11) exports qualifying for BLADEX/AID financing have remained almost constant since 1980, with a slight dip in 1982. In real terms, the drop in qualifying exports between 1980 and 1982 was more substantial (about 14.5%) and a slight recovery has occurred in 1983. Given the overvaluation of the Lempira, with no likelihood of adjustment in the near term, it is not likely that qualifying exports will expand rapidly (if at all) in the next two years.

Table 6.10

HONDURAN EXPORTS 1980-83
(Million $)

	Total	Traditional	Non-Traditional To CACM	Non-Traditional Extra-Regional
1980	814	557	84	173
1981	713	468	66	179
1982	656	439	52	165
1983	626	383	61	182

Source: SIECA, Estadisticas Macroeconomicas de Centroamerica 1979-1983 (Junio de 1984)

Table 6.11

HONDURAN EXPORTS 1980-83 IN MILLION DOLLARS OF 1984

	Total	Traditional	Non-Traditional To CACM	Non-Traditional Extra-Regional
1980	941	644	97	200
1981	755	496	70	190
1982	680	455	54	171
1983	641	392	63	186
1984	N/A			

C. Competing Financing

The bilateral AID mission in Honduras is beginning a program which serves almost the same purpose as the BLADEX/AID line, but which is much broader and specifically geared to the needs of Honduran exporters (or potential exporters). AID is establishing letters of commitment with U.S. banks to provide $10 million in dollars, to finance the imported component of exports and with Honduran banks, $40 million in lempiras. Up to $1 million may be borrowed for up to one year, and at prime rates plus 2-3 percent. A special arrangement has been made with the Central Bank so that when dollars are earned, 20% of them can be retained by the exporter. The remaining 80% go into a revolving fund to be used for export promotion in the future. This credit line is being promoted by two private- sector groups funded by AID (FIDE, FEPROEXAH) which are designed to feed technical and marketing assistance to potential non- traditional exporters. In addition to the AID program, $25 million in credit lines is being guaranteed by the EXIM bank for purposes similar to BLADEX/AID.

Given the new AID facility it is unlikely that the BLADEX/AID line will find much activity in Honduras in the next several years. Non-traditional exports are very small and not growing rapidly. The banks report no need for, and indeed, no desire for export financing. The new AID facility for financing imported inputs is better targeted at Honduran needs, and even then, AID officials in Honduras do not believe the new facility will be fully utilized for several years. The only advantage that the BLADEX/AID credit line might bring is that it can be used to import inputs from countries other than the US. Currently this advantage is very small and if the dollar depreciates internationally, it would be even smaller.

D. BLADEX/AID Financing Scenarios

BLADEX/AID lending scenarios for Honduras are not easy to construct and may not be useful. Total lending in 1984 was less than $600,000. Furthermore, qualifying exports are not likely to grow much and bilateral AID funds are likely to provide the bulk of financing where it is needed. Thus one could not expect lending to fall outside the $.5-$1 million range without some major changes in the Honduran situation.

V. Summary

Characteristics of the countries survey indicate great variety. Costa Rica is by far the country with the best prospects for growth in non-traditional exports. New institutions are in place and seem to be working well. Others are developing. Considerable exchange stability has been achieved since 1983 and a unified exchange rate system is in place. Business people and bankers are all optimistic that the country has stabilized following its economic chaos of the 1980-83 period and that many opportunities exist for non- traditional export expansion. Sources of export finance other than BLADEX have materialized in the past two years, but all sources report increased demand for credit.

El Salvador's condition has improved greatly over the past year. The Central Bank has gone a long way toward rationalizing the exchange rate system. Exports are expanding. However, institutions dedicated to non-traditional export expansion have not developed to the point that they have in Costa Rica. Further, the risk of politically related losses is still high and the future is far from secure. Moderate growth in BLADEX/-AID line and competing lines may be anticipated.

In Honduras, low demand for credit for non-traditional exports reflects little export capacity requiring BLADEX type export assistance, and a banking system that has incentives to use means of finance other than BLADEX. The AID bilateral mission in Tegucigalpa has begun a credit program which competes directly with the BLADEX/AID line, but which is better designed to assist Honduran exporters. Over the next two years little demand for BLADEX/AID credit is likely.

Guatemala's situation is very adverse to export expansion. The Central Bank maintains strict but confusing exchange controls, and multiple rates are the rule. Great uncertainty exists about the course of future exchange rate policy and the quetzal has devalued in parallel markets by about 50% in 1985 alone. Business people and bankers are not optimistic about expanding non-traditional exports. Exchange risks and uncertainty are their main concerns and these combine with a rather onerous bureaucracy. There is unlikely to be much demand for export credits in Guatemala until the situation there stabilizes.

Data on the BLADEX/AID loan program reflect, roughly, the prospects for non-traditional exports in each country of the region. If all countries had equal prospects for exports, Guatemalan exporters would borrow most since the Guatemalan economy is by far the largest. Costa Rica and El Salvador would follow, and Honduras borrowing would remain far below the levels elsewhere.

Data from BLADEX reveal that Guatemalan borrowing is considerably below what one would expect it to be if all else were equal across countries. To demonstrate this point we have taken into account a few very large loans that have gone to support cardamom and sesame exports in Guatemala and exports of camarones in El Salvador. Table 6.12 shows that during the first quarter of 1985, over $15 million in loans were committed to these three exports alone, in only eleven transactions. During the

January '85-March '85 period, $11.412 million went to support cardamom and sesame in Guatemala and $4 million for camarones in El Salvador. These loans average well over $1 million each*, and are so large that they should be viewed separately.

Table 6.12

LOAN COMMITMENTS FOR CARDAMON AND SESAME IN GUATEMALA AND CAMARONES IN EL SALVADOR
(Thousands $)

QUARTER	1985:1	1984:4	1984:3	1984:2
Guatemala				
Loan commitments	$11,412	$11,466	$6,800	$177
For Cardamom or Sesame	(9)	(13)	(5)	(1)
Average Loan Size	$1,268	$ 882	$1,360	$177
El Salvador				
Loan Commitments	$ 4,000	0	$5,000	0
For Camarones	(2)		(3)	
Average Loan Size	$ 2,000		$1,667	

Source: BLADEX

* These loans are almost all made from cofinancing and are therefore exempt from the $1 million limit.

To single out loans for cardamom, sesame and camarones should not be taken as an indication that they are not legitimate targets of the BLADEX/AID program. On the contrary, loans for these items should be encouraged. They are segregated only because of their preponderance in the data.

Data in Table 6.13 show loan commitments, for the past year for each country, excluding loans for cardamom and sesame in Guatemala and camarones in El Salvador. One can easily see, that in Costa Rica, where conditions seem best for BLADEX-type loans, the level of lending activity is much greater than anywhere else. Indeed it is almost as large as everywhere else combined.

Table 6.13

TOTAL AMOUNTS OF LOANS COMMITTED EXCLUDING LOANS FOR CARDAMOM AND SESAME IN GUATEMALA AND CAMARONES IN EL SALVADOR. Period is April 1984 - March 31, 1985
(Millions $)

	AID	Co-Financing	Total	Adjustments	Adjusted Total
Costa Rica	13.5	0.4	13.9	0	13.9
El Salvador	5.5	10.2	15.7	-9.0 (shrimp)	6.7
Guatemala	10.7	27.1	37.8	-29.9 (Cardamon & Sesame)	7.9
Honduras	0.4	0.2	.6	0	0.6

In Costa Rica there are not only more commitments in dollars, but there are also many more transactions. Average loan size in Costa Rica (shown in Table 6.14) tends to be smaller than elsewhere. In Guatemala, where lending might otherwise be greatest, lending is actually 1/3 to 1/2 of the level of Costa Rica, and only slightly greater than in El Salvador. Indeed, in the first quarter of 1985, lending in Guatemala fell sharply, probably due to the exchange problems which followed legalization of parallel markets in late November 1984. In El Salvador, the level of lending is modest, but increasing steadily. Honduras has shown almost no lending activity.

Our tour of the four countries of the region reveals that such widely diverse conditions exist in each that it is not wise to set aggregate lending targets for the region without accounting for country-specific idiosyncracies. For example, if aggregate targets are set, while conditions deteriorate in Guatemala, it may mean that unreasonable expectations are implied for lending in other countries. When demand for loans drops in one country (e.g. Guatemala) to meet an aggregate target for the region, loans would have to increase, perhaps unreasonably in other countries (e.g. El Salvador and/or Costa Rica). A better way to form an aggregate target is to establish a target for each country which is consistent with political/institutional conditions and the level of economic activity. In that way the normal ebb and flow of demand for credit in each country can be adequately analyzed and individual country plans designed accordingly. Included in a country plan would not only be targets for lending based upon economic activity and institutional capabilities, but also a "marketing plan", aimed at specific constraints to credit use.

Table 6.14

AVERAGE SIZES OF LOAN COMMITMENTS
(Data exclude loans for Cardamom and Sesame in Guatemala and for Camarones in El Salvador)
(Thousand $)

	1985:1	1984:4	1984:3	1984:2
Costa Rica	35.2	86.1	28.7	17.5
Guatemala	24.2	37.4	30.3	93.4
El Salvador	64.1	54.8	55.0	124.8
Honduras	68.0	45.7	0	0

Source: BLADEX

In our discussions of each country we discussed lending scenarios (and assumptions behind them) in each case. Those scenarios are summarized and aggregated in Table 6.15. Under the low scenario lending would rise to about $80 million in 1986. A high scenario would place total commitments at about $98 million. If we assume that funds turn over about three to four times per year, the low and high scenarios would require capitalization of from $20 to $33 million in 1986.

Readers should keep in mind that these figures do not represent forecasts. Rather, they are based upon a series of assumptions about each case.

Table 6.15

BLADEX/AID LENDING SCENARIOS
(Million $)

	1984	1985		1986	
		Low	High	Low	High
Guatemala	38	39	44	44	51
Costa Rica	14	15	18	16	24
El Salvador	16	17	18	20	22
Honduras	.6	*	1	*	1
Total	69	71	81	80	98

* Less than $.5 million.

Section 7

CONCLUSIONS

1. The original project paper, supporting the establishment of the BLADEX/AID program, overstated the need for export credit assistance. Overstatements stem largely from assumed high growth rates of exports, high import content of non-traditional exports and especially from the assumption that such financing was the bottleneck to export expansion outside the region.

2. Changes since the project paper was written in 1982 have made credit relatively less important as a bottleneck to export expansion than other factors. Some other factors are: exchange controls, overvalued currencies, economic recessions and political turmoil.

3. Each country of the region is unique, and there is no Central American credit market per se. Rather there is a separate credit market in each country, each different from all the others.

4. Prospects for non-traditional export expansion and for credits supporting these exports are very good in Costa Rica and are improving in El Salvador (though these exports are now very small in El Salvador). Prospects are not presently good in Guatemala or in Honduras.

5. Exchange controls, currency overvaluation and exchange instability are the major deterrents to use of export credits in Guatemala and Honduras. In the latter, little capacity currently exists to expand qualifying exports. Guatemala has potential capacity, but few effective measures are being taken to solve economic instability and stimulate exports.

6. Pre-export financing has been used relatively little because the direct link between imported inputs and exports as a requirement of credit has not been easy to make. Many producers use small amounts of imported

inputs, and usually buy them from local distributors. Often imported inputs flow into export production indirectly.

7. Pre-export financing has also been low because many potential users perceive an exchange risk. They do not wish to contract debt denominated in dollars even for short periods.

8. Export credit is generally not needed in dollars. Exporters usually need export credit to cover working capital requirements in local currencies. All countries' banking systems have local currency liquidity to lend against export documents. Compared to the cost of BLADEX/AID credit, loans in local currency have been more favorably priced in Guatemala, are about the same in El Salvador, slightly higher in Honduras and much higher in Costa Rica.

9. Export credits denominated in dollars from sources other than BLADEX/AID are readily available in Costa Rica, El Salvador and Honduras. Costs are roughly the same as they are for BLADEX/AID loans although the use of these other sources may be limited to the products of a single country.

10. Pre-export finance and export financing has developed well and across the board in Costa Rica. This, in our opinion, is attributable primarily to two factors: the high rate of interest prevailing in Costa Rica compared with the cost of money under the BLADEX and other credit lines and the unitary and realistic exchange rate for the colon. Costa Rican industries are turning to export markets and are able to price their products competitively. The growth in exports provides the opportunity to take advantage of relatively low-cost financing in both the pre-export and export transactions.

11. The availability of the BLADEX line has a minor impact on the maintenance and expansion in the volume of exports of non-traditional products outside the region.

12. Services provided by BLADEX to its member banks were praised by all but one bank that was interviewed. It is our opinion that the BLADEX operation is efficient and prudent.

13. Some Class B banks have not used the line. Our conclusion is that demand from their clients has not been sufficient to set up the necessary administrative machinery or they were able to satisfy clients needs without resort to the line. The failure of more banks to make use of the line is not, in our opinion, due to lack of promotion by BLADEX. This does not mean that these non-participating banks do not use BLADEX facilities for traditional export financing.

14. Cofinancing targets required by AID and agreed to by BLADEX are not realistic. Demand for credits, compared to supply from other sources, is not great enough to support the level of lending required to occupy <u>both</u> the $21.6 million provided by AID <u>plus</u> the 2 to 1 matching cofinancing.

15. While the total volume of loans under the BLADEX line has not reached and probably will not reach the levels anticipated for some years, the ROCAP loan has institutionalized a program of pre-export and export assistance for the four Central American countries. It is unlikely that a shortage of such credit will hamper the growth of extra-regional exports for some time to come.

16. BLADEX has given strong evidence of its desire to make the ROCAP credit work. It has devoted considerable staff time to the accommodation of unusual credit transactions and to many small credit requests which are probably not profitable on a cost allocated basis. We doubt that BLADEX would have been inclined to pursue such operating policies in absence of the credit.

17. From the evidence obtained in Costa Rica it can be concluded that, as more rational financial and economic policies are instituted elsewhere in the region, a significant increase in demand for pre-export and export will occur.

18. BLADEX's overall operations in Central America are providing increased credit for export purposes. Short-term loans outstanding (from all BLADEX resources) to the four Central America countries increased by 49% during the course of 1984.

Section 8

RECOMMENDATIONS

1. Goals for lending should be established for each country rather than for the region overall. Conditions differ so much country to country that goals set on a regional basis may in effect place most lending in only one or two countries. If for example, conditions deteriorate in one country and loans decline (e.g. Guatemala) this may force an unreasonable amount of lending to be made in other countries (e.g. Costa Rica) where conditions are better. Country targets would not only ensure that reasonable lending efforts are established for each country (and therefore for the program overall) but would also help to identify reasons for program shortfalls. Also, to the extent that countries differ, different marketing techniques may be called for. Barriers to lending may be more directly identified and dealt with by taking a country by country approach.

2. Promotional and educational efforts should be designed for each country. Since circumstances differ greatly, each country should be dealt with accordingly. The promotional effort should not be done exclusively by the BLADEX staff, but should include an AID-ROCAP involvement. Promotional efforts should take advantage of knowledgeable people in each country, some of whom have been identified by this study. In the final analysis, the self-interest of the exporter will determine his use of the line.

3. Pre-export financing should be broadened to include all imports of intermediate goods and raw materials which can reasonably be expected to be associated with non-traditional exports. It should not be of great concern that some imported inputs "leak" from the imported input-export flow, and end up in products destined for domestic or Central American markets. As long as there is some reasonable connection to extra-regional exports and if both BLADEX and the commercial banks involved are satisfied that the transactions are sound, such imports should be candidates for financing.

In establishing what is a "reasonable" connection between imported inputs and exports, judgment will be required. In making this judgment one should keep in mind the main reason for promoting non-traditional exports: these exports diversify the economy away from a few traditional commodities and providing an additional source of increased economic activity. A close linkage between imported inputs and exports can occur in industries which are not necessarily best for diversification and growth. For example, a typical "drawback" operation has a very large imported component which is very tightly linked to exports. Unfortunately, domestic value added may be only a small proportion of total output. High domestic value added production would be best for general development purposes, diversification and growth, but high domestic value-added operations tend to use few imports. Furthermore, high domestic value-added operations, if they are competitive in export markets, would also be competitive in domestic markets. Therefore, a large portion of any imported inputs would find their way into production for domestic consumers.

This leakage should be of little concern as long as BLADEX and associated banks can service the dollar denominated debt. An example of leakages and debt service may involve two industries. Industry A imports $90 of intermediate goods and exports $100 worth of goods produced with them. Domestic value- added is $10 and net foreign exchange earnings are $10. Industry B also imports $90 worth of intermediate goods, but produced $900 worth of goods, only $100 worth of which is exported. Net foreign exchange earnings are still $10, but domestic value-added is $810. Fully 90% of the imported input in the case of industry B has "leaked" into domestic consumption, yet industry B is a much better investment for AID. With industry B, growth and diversity are much better than in industry A, and foreign exchange earnings are the same in both. Industry B may have additional advantages in that the improved supply to the domestic market increases competition there and reduces pressure for protection. This may also divert products from the domestic market to exports if internal prices drop as supply expands. Clearly, BLADEX-AID resources should support both activities but be especially sensitive to the needs of industry B.

4. The extension of medium term credit (up to 3 years) should be considered now, rather than waiting for some future unspecified date as called for in the project paper. It is not likely that the extension of medium-term credit will expand greatly the number of loans made. Two reasons are evident:

a. Many projects which would apply for medium term credit are very risky and should not be financed. BLADEX and member banks should apply normal criteria for making medium term loans. Currently it is not likely that many medium term loans should be made in Guatemala and Honduras due to extreme exchange risk.

b. Banks and producers frequently stated that medium term financing, in dollars, is not currently attractive to them because they fear the exchange risks.

Nevertheless, from time to time a viable project will present itself for medium-term financing. Several such projects came to our attention in Costa Rica, and if properly structured could spur growth in non-traditional exports. These would probably remain a small part of the overall BLADEX/AID program, but carefully selected projects could improve upon the overall impact of the program.

BLADEX has made medium term loans in the past but is currently not doing so. In fact, medium term loans at the end of 1984 represented about one-half of BLADEX' loan portfolio. If new medium term loans are made from the BLADEX/AID resources, care should be taken by AID to ensure that these loans do not simply refinance those already made by BLADEX.

5. Non-Traditional export items which qualify for financing should be defined to include any activity having a positive impact on the current account of the balance of payments. Services should be considered -- for example, maintenance services to non-national aircraft paid for in dollars.

6. Goals for cofinancing should be dropped or relaxed until all AID-contributed capital is in use. BLADEX and AID should keep in mind that the overall goal of the program is to finance increases in exports and not just to finance non-traditional exports that would occur in any event. Given the current demand and supply of export credits and reasonable expectations for non-traditional export expansion, current cofinancing goals can only be met by BLADEX acquiring a larger market share. BLADEX can expand its share by financing trade that would have been financed by other sources. Overall, for BLADEX this is a reasonable goal in accordance with its profit making objectives, but it is not a reasonable goal for AID. AID should be interested in financing to expand trade and not just financing trade that would have occurred anyway.

Currently it is evident that not enough demand for BLADEX/AID credits exists from expanding non-traditional exports to justify both fully lending the AID-contributed component <u>and</u> twice that amount from BLADEX resources. The fact that only about $9-10 million of the AID-contributed $21.6 million is currently being used for its intended purpose is the first indication of slack demand. Cofinancing has expanded greatly since late 1984, but this has been accomplished largely through the very large new loans to finance exports of cardamom and sesame from Guatemala and camarones from El Salvador. While the program should finance these items, we cannot identify new large items of this sort that could reasonably be expected to expand lending further.

Lending operations which merely expand a market share do not necessarily provide new financing to the target sector. Expanding the share of non-traditional export financing involves financing goods that would have been financed by other means. When BLADEX/AID provides $1 that would have been supplied by another institution, it implies that the other institution then has an extra $1 to finance whatever it sees fit to finance. Since other institutions are usually not limited to financing non-traditional exports it is unlikely that the displaced $1 will end up in the target sector.

Until the monies provided by AID are fully used it may be unproductive to insist upon any cofinancing from BLADEX. Cofinancing under current circumstances would only serve to expand market share and would probably have little or no qualitative effect on the target sector. Also, BLADEX has other lending activities, and when resources are placed with the BLADEX/AID program, they are diverted from other uses. Diversion of BLADEX resources, simply to meet a cofinancing requirement, means that BLADEX may be diverting money from uses which are more productive than the BLADEX/AID loans currently are. A net reduction in economic efficiency could result.

BLADEX should not be relieved of its cofinancing responsibility; rather, the obligation to cofinance non-traditional exports be postponed. Until the $21.6 million of funds provided by AID are fully employed, all other BLADEX lending to Central America should be considered to be cofinancing. When the $ 21.6 million are fully employed, BLADEX and AID should set a reasonable target for BLADEX lending to non-traditional exporters in the region. BLADEX will retain the obligation to provide up to twice the amount of AID funds outstanding for non-traditional export financing. Once reasonable targets are set for lending to non-traditional exporters, the cofinancing may consist of loans for both traditional and non-traditional exports. Targets should be reestablished annually to accurately reflect the financing needs of exporter of non-traditional items.

7. AID should not disburse the remaining funds from the $25 million loan commitment.

8. Policy dialogue should be conducted with each central bank to ensure that the BLADEX/AID credit line can work as designed and provide incentives to the target exporters. This is most important in Guatemala and Honduras where serious obstacles to use of these credits exists.

9. Periodic review of the conditions in each country affecting the use of the BLADEX/AID credit line should be conducted by AID. AID-ROCAP should use the resources of each bilateral AID mission's private sector office to help conduct these surveys. While BLADEX resources may be drawn upon to provide parts of these evaluations, the primary responsibility should rest with AID- ROCAP.

Appendix 1

INSTITUTIONS AND ORGANIZATIONS VISITED and INDIVIDUALS INTERVIEWED

I. Guatemala

Banco del Cafe	Filipe Falla Gerente, Division Internacional
Banco de la Construccion	Mario Gomez Gerente Administrativo
Banco Metropolitano	Rafael Minondo Jefe, Division Internacional
FIGSA	Jose Ortega Sub-Gerente
Banco de Guatemala	Julio Noriega Sub-Director, Depto. International Otto Samayoa Director, Dpto. de Investigacione Agropecuarias e Industriales
Gremial de Exportaciones	Imogen Sieveking* Member, Board of Directors
SIECA/ECID	Enrique Delgado
Parke Davis	Santiago Figueroa
Laboratoreis La Profa Chiclets Addams Warner Chilcott	Tesorero
LAAD de Centroamerica	Tom Monney, President
INTROSA	Owen Smith, President
Non-Traditional Exporters Association	Eric Sperisen**

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* Also an exporter of custom-made ceramics articles.
** Also an exporter of wicker furniture.

II. Costa Rica

FOPEX	Alvaro Mayorga Director
BANCO INTERFIN	Luis Liuerman Gerente General
BANCOOP	Marco Salazar Sub-gerente General
BCT	Leonel La Ranch
BANEX Trading BANCO BANEX	Jamime Pfaefle Gerente
Intertec Trading	Robert Woodbridge Gerente General
American Chamber of Commerce	Frieda Martin

Note: (and approximately 10 non-traditional exporters)

USAID	Vinzenz Schmach Niel Billig

III. Honduras

BANCO Sogerin	Jacobo Kattan Gerente Regional
BANCO Mercantil	Jacobo Atala Gerente Regional Rufino Zelaya Gerente de Operaciones
BANCO Central	Arnulfo Carrasco Jefe de Cambios
Textiles Rio Lindo	Aquiles Izaguirre Gerente Financiero
USAID	Jim Grossman Margaret Mambreno

IV. El Salvador

BANCO Salvadoreno	Jose Ramiro Chavez, Vice President
BANCO de Desarrollo E. Inversion	Blanca de Hernandez Jefe, Dpto. del Exterior
BANCO Central	Francisco Alfaro Lara Director, Dpto, Exterior Cesar Agosto Valladres Dpto. Control de Cambios Mauricio Gallardo Subgerente de Creditos
BANCO Coscatlan	E. Manzano Gerente Dpto. Internnacional
FUSADES	Mario Cantizano, Sub-Director Roberto Hill, Director (and 25 approximately non-traditional exporters)
USAID	David Huezo Ernesto Altshul

V. Panama

Bank of Boston	Ben Mayers, Vice President
BLADEX	Jaime Medina Julio Lastres Armando Nunez Carlos Yap

Appendix 2

GUATEMALA'S "LICITACIONES" MARKET FOR FOREIGN EXCHANGE

The "licitaciones" market for foreign exchange is an attempt by the Central Bank to make a limited amount of foreign exchange available to importers. Currently, about $3 million per month is being made available through this market.

To qualify as a buyer in this market, importers must want to import specific items. The Central Bank determines which items qualify, and publishes a list of the items at the time the exchange sale is announced. To qualify, a firm must in the past have been importing items on the list. If a firm qualifies it can buy enough dollars to buy 50% of the average amount of the items imported in the past four years.

Qualifying importers bid on the foreign exchange that is made available. The Central Bank establishes a minimum bid. The dollars offered go first to the highest bidder until their quota is filled, then to the next higher bidder and so forth until all the foreign exchange is sold. The most recent auction, of $3 million, occurred on May 21, 1985. The highest price bid was Q2.92 = $1; the average was Q2.60 = $1.

Once an importer has acquired dollars in this way he must use them within two days. That is, he must either have an order out for the qualifying item, or place an order within two days, and present the requisite documents to the Central Bank. If he does not commit the dollars within two days, he forfeits them and pay a fine.

Appendix 3

CASE HISTORY OF GUATEMALAN EXPORTER

A small to medium sized exporter of high value consumer goods to the United States was contacted regarding his need for export credits and his experience with the BLADEX line.

He said that when the BLADEX/AID credit line was originally introduced there was much interest in the manufactured goods export community. However, he found the cost to be high relative to interest rates in Guatemala and the procedure seemed complex to him and his bank. He decided his credit needs could be handled more cheaply and conveniently by his bank.

The product of this exporter requires very little imported inputs - some steel and packing material. Consequently he had no need for pre-export financing. As for export financing, when he could not wait for his importer in the States to remit, his bank readily advanced him needed quetzales against his export sale. At other times, he has resorted to such bank credit in order to meet government exchange regulations to deliver his export earnings within 45 days of issuance of the corresponding export license. When this occurs, the exporter goes into the parallel market and buys dollars in order to avoid penalty. When he finally receives payment in dollars, he can convert them at the parallel rate to service his quetzal loan.

The impact of the current Guatemalan exchange system - i.e., the obligation to sell 50 percent of foreign earnings at one quetzal to the dollar and the remainder at the parallel rate - has hurt this exporter. He has had to increase his prices substantially; Taiwanese and Philippine exporters have been making inroads into his market. His monthly shipments are down 58 percent. In his opinion, an export credit system would have no beneficial effects upon his business.