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PROJECT ASSISTANCE COMPLETION REPORT

**REGIONAL ECONOMIC RECOVERY
(No. 596-0114)**

**ROCAP
MAY 1992**

EXECUTIVE SUMMARY

The Regional Economic Recovery Project (596-0114) was signed between ROCAP and the Central American Bank for Economic Integration (CABEI) in September of 1985. The original project grant and loan agreement authorized U.S. \$ 35,000,000 in grant funding and U.S. \$ 12,000,000 in loans. The Project was subsequently amended to increase the loan authorization to U.S. \$15,000,000 and the Project Completion Date (PACD) was extended twice: first to September 1990 and again to December 31, 1991. There was no change in the overall project goal and purpose.

The goal of the project was to mobilize increased levels of external resources to the Central American region and to stimulate growth of extra-regional exports in order to help achieve short term stabilization and longer term growth with equity.

The project purpose was to improve CABEI's financial and administrative viability and to increase the bank's present investment impact on the region while strengthening its private sector development program. The direct beneficiaries under the project were to be those private agribusiness credit recipients, suppliers of agricultural produce and products, laborers directly employed by these businesses and public sector investment programs, and the CABEI and ICI personnel who participated in project training and technical assistance activities.

The objectives of the project were to assist the Central American economies by encouraging a resumption of capital flows to the region; continuing implementation of major public sector investment projects sponsored by the region's governments; and expanding the capacity of CABEI and a wide variety of credit intermediaries throughout the region to more effectively address the investment and financial constraints to agribusiness and export growth.

Of the grant funds, U.S.\$30 million went to improve CABEI's short-term financial viability with loans for public sector infrastructure projects. A \$5 million technical assistance and training component was for institutional strengthening including agribusiness assistance, rehabilitation of the private sector portfolio, development of a management information system, improvement of personnel administration, and training of systems people. A \$15 million loan went for agribusiness loans and non-traditional exports as a means of strengthening CABEI's private sector program. CABEI was to provide a \$48.4 million contribution to the project: \$43.9 million for the public sector investment program; \$2 million for the private sector program and \$2.5 million for agribusiness loans.

During the course of the project, senior management in ROCAP and AID/W became increasingly concerned with the financial viability of CABEI, especially the growing country member debt and the overall liquidity of the bank, and the implications of this on CABEI's ability to service \$280 million in AID and AID-guaranteed debt. During this time a new administration was installed in CABEI which was making progress on institutional and administrative reforms, and which was making serious attempts to restructure the bank and deal with its financial problems.

The project expired in September, 1990 with all funds disbursed to CABEI except \$6.63 million in the agribusiness sub-loans which had been approved by ROCAP and made by CABEI under the terms of the project. However, these funds were not disbursed to CABEI because the conditions set by AID and ROCAP for further disbursements had not been met: member countries had to be current in capital contributions and loan repayments. Subsequently, on advice from AID/W, the project was extended retroactively to December 31, 1991 to allow more time for CABEI to come to compliance with new criteria set for disbursement of the \$6.63 million for agribusiness sub-loans. Final disbursement to CABEI for this amount was made following a RIG audit (August 1992) which confirmed that CABEI had indeed met the criteria set out in PIL no. FY 92-80.

By the Terminal Disbursement Date of the project (September 1992), the new administration had made important progress in restructuring its management and administration (making the bank less a political instrument of the member countries and with more professionals with solid financial and banking credentials in key posts), and had improved its financial position. Extra-regional members (Mexico, Venezuela and Taiwan) were officially incorporated into the bank's directorship which contributed to the liquidity of the bank. A payment plan to improve country contributions and to reduce debt arrears was negotiated among member countries and agreed upon.

TABLE OF CONTENTS

<u>SECTION</u>	<u>PAGE</u>
Executive Summary.....	I
Table of Contents.....	II
Acronyms and Equivalents.....	III
1. Project Overview.....	1
1.1 The ROCAP/CABEI Project.....	3
1.2 Project Goal.....	4
1.3 Project Purpose.....	4
1.4 Project Description.....	4
1.5 Project Elements.....	5
1.6 Evaluations.....	5
2. Project Contributions.....	6
3. Summary of Contributions.....	6
3.1 A.I.D. Contributions.....	6
3.2 CABEI Contributions.....	6
3.3 ICI's Contributions.....	7
4. Project Accomplishments.....	7
5. Progress Towards Achieving Project Purpose.....	7
6. Lessons Learned.....	8
7. Continued A.I.D. Monitoring.....	9
8. Recommendations for Pre-PACD Project Adjustments.....	9
9. Post-PACD Actions.....	9

III

ACRONYMS AND EQUIVALENTS

A.I.D.	Agency for International Development
CABEI	Central American Bank for Economic Integration
ICI's	Intermediate Credit Institutions
PACD	Project Assistance Completion Date
ROCAP	Regional Office for Central American Programs
NBCCA	National Bipartisan Commission on Central America
LOP	Life of Project
T.A.	Technical Assistance

PROJECT ASSISTANCE COMPLETION REPORT

1. Project Overview

From 1979 to 1983, the Central American region suffered through one of the worst --if not the worst-- economic recessions in its history. Between 1979 and 1984, real per capita GDP for the region declined some 16% and unemployment rose sharply. The origins of this crisis included a world-wide recession, increased oil prices, falling commodity prices, political turmoil, a reduction in net capital flows and a near collapse of regional trade. One of the most serious problems in this period was the virtual disappearance of private capital flows from abroad and capital flight from the region. Foreign suppliers ceased to extend short term credits and foreign bankers began to cut back on long term lending. Capital flight encouraged by overvalued exchange rates and political insecurity in the region further diminished stocks of investment capital.

The National Bipartisan Commission on Central America (NBCCA) estimated that to achieve 1980 per capita income levels by 1990, \$21 billion in aggregate external financing would be needed for the region during the 1984 to 1990 period. The NBCCA report recognized that about half of the external financing required would need to be met from sources other than A.I.D. The NBCCA report called for an effort to increase assistance from IBRD, IDB, Mexico, Venezuela, the European countries and Japan. The report also recognized that commercial banks must play an important role in providing external financing, initially by rescheduling part of their existing debt and later by providing fresh capital.

While the \$21 billion estimate for external financing was based on balance of payments analyses (i.e. the sum of the projected current accounts), another way of looking at the need for external financing and investment is that the current economic crisis has precipitated a dramatic decline in the stock of productive and social capital in the region. Foregone investments in agroindustry, manufacturing, agriculture, infrastructure and services must be overcome if the Central American economy is to achieve positive real rates of growth and to diversify the productive sectors into activities that offer the best promise for future growth. Achieving equity within this growth framework will also require very large investments in housing, educational facilities, potable water and other social areas to make up for inadequate investment in the past and to keep pace with rapid population growth.

CABEI has played an important historical role in mobilizing external resources to meet the region's development needs, accounting for almost 20% of the external financing flowing

to the region. These funds have been used primarily to finance high priority infrastructure projects (e.g. regional roads, an interconnecting energy grid, telecommunications, electric power, ports, etc.) where CABEI has had a major role, accounting for 13% of public investment. CABEI has also played an important role in the housing sector using HIG and local resources which have financed more low cost housing than all of the bilateral HIG programs combined. Loans to the productive sectors have been of lower priority under CABEI's past mandate and account for a relatively small part (15%) of CABEI's portfolio. CABEI's experience here has been mixed. Most of CABEI's direct loans to the productive sectors and tourism involve large projects which are experiencing serious problems.

These problems are due mostly to the economic crisis, the collapse of the Central American Common Market and political problems within the region. CABEI's indirect loans, as a second tier lender, to national ICIs under a previous A.I.D. project to assist rural agribusiness are being repaid and the subprojects financed by the ICIs for small and medium sized projects have had important impacts on non-traditional exports, employment and incomes.

While CABEI is still the region's largest and most creditworthy financial institution, it is going through a serious short term liquidity problem which has not permitted the Bank to contribute to increasing the levels of investment needed by the region. In fact, CABEI's net disbursements to the region have been seriously reduced over the past few years and many important public sector investment projects have been delayed or postponed as a result of a lack of financing. CABEI recognizes that it must obtain the resources needed to increase disbursements to the countries for infrastructure projects and that it must continue to play a major role in this area. It also realizes that more of a priority must be given to private sector investment, particularly for projects to increase exports. New initiatives along these lines have been encouraged by CABEI's Board of Governors, composed of the member governments' central bank presidents and ministers of economy, but these as well as efforts to increase disbursements on approved projects have been frustrated by CABEI's liquidity problem and delays in obtaining appropriate levels of external resources.

The project was based on a comprehensive institutional analysis carried out by Price Waterhouse and follow-up design work by the same firm. In essence, the analysis indicates that CABEI's overall strategy and reforms to put the Bank in a position to assist the region's recovery by mobilizing and transferring external resources and again play a significant role in meeting the region's development/investment needs are appropriate and feasible, but that U. S. assistance will be crucial to these efforts.

The project was designed to help CABEI overcome its short term liquidity problems, carried out approved high priority public sector investment projects while at the same starting a new initiative to assist export oriented agribusiness projects in the private sector as a second tier lender. Substantial technical assistance has also been included in key areas to help the Bank continue and consolidate its overall administrative reforms and strengthen its capabilities to rehabilitate its direct loan private sector portfolio as well as to carry out the agribusiness initiative working with ICIs in the region.

1.1 The ROCAP/CABEI Project

From 1979 to 1983, the Central American region suffered through one of the worst, if not the worst, economic recessions in its history. The origins of this crisis are well known. They include a world-wide recession, increased oil prices, falling commodity prices, political turmoil, a reduction in net capital flows and a near collapse of regional trade. One of the most serious of these economic problems were the virtual disappearance of private capital flows from abroad and capital flight from the region. Official capital flows have not offset the reduction in net private capital flows, which have naturally contributed to the deep cut in the stock of productive capital in the region. Foregone investments in infrastructure, agroindustry, manufacturing, agriculture and services were undertaken if the Central American economy was to regain 1978's real level of output, if it was to achieve positive real rates of growth beyond the 1978 level, and, most importantly if it was to diversify the productive sectors into products that offered the best promise for future economic growth. The national Bipartisan Commission on Central America (NBCCA) estimated that to achieve 1980 per capita income levels by 1990, \$21 billion in aggregate external financing would be needed for the region during the 1984 to 1990 period.

This project was designed to improve CABEI's financial viability and administrative capability and increase the Bank's investment impact on the Central American region while strengthening its private sector program development.

On September 30, 1985, AID/ROCAP and CABEI, signed a Project Loan and Grant Agreement for a Regional Economic Recovery Project No. 596-0114. The Conditions Precedent to the initial disbursement were met by CABEI from December 20, 1985 to August 29, 1986. The Project began its formal operations in January 1986.

The Project authorized \$35,000,000 in Grant funds and \$12,000,000 in Loan Funds for a three year period or until September 30, 1988. The Project was subsequently amended to increase the Loan authorization to \$ 15,000,000 and the

Project Completion Date (PACD) extended to September 30, 1990 and again to December 31, 1991. There was no change in the overall project goal and purpose.

The agreement signed between CABEI and ROCAP focused on complementing and augmenting bilateral approaches to the problem of resource mobilization and increasing external investment levels to meet the NBCCA projections by assisting CABEI to (a) overcome its short term liquidity problem, and (b) expand its focus to include a greater emphasis on private sector productive enterprises, especially with respect to extra-regional agribusiness opportunities. This strategy recognizes that (a) CABEI is at a critical turning point; (b) U.S. leadership and support for CABEI's self-help measures in the form of a timely and appropriate level of assistance can make a crucial difference in terms of invigorating the Bank; (c) this in turn will encourage other donors to provide project assistance and new members to join; and (d) CABEI will increase its support of the private sector through intermediate credit institutions in the region.

The Project was directly supportive of CABEI's own strategy, which was developed taking into account recommendations made by Lazard Freres and the World Bank, to resolve its current problems and start to build for the future.

1.2 Project Goal:

The goal of the project was to mobilize increased levels of external resources to the Central American region and to stimulate growth of extra-regional exports in order to help achieve AID's short term stabilization and medium and longer term growth and equity goals.

1.3 Project Purpose:

The purpose of the project was to improve CABEI's financial and administrative viability and increase the Bank's present investment impact on the region while strengthening its private sector program development programs.

1.4 Project Description:

The direct beneficiaries under the project were those private agribusiness credit recipients, suppliers of agricultural produce and products, laborers directly employed by these businesses and public sector investment programs and the CABEI and ICI personnel who participated in project training and technical assistance activities.

1.5 Project Elements:

(a) Improving CABEI's Short Term Financial Viability. This Element or component involves \$30 million of injection of capital for its public sector investment program to complete projects which have already been approved, but delayed in implementation or postponed by CABEI's liquidity problem. CABEI will provide \$48.4 million in counterpart funding for this effort. This component will also involve assistance to CABEI in rehabilitating its private sector direct loan portfolio.

(b) Strengthening CABEI's Organizational Structure. This component financed technical assistance in these areas which will help further strengthen the Bank's organizational structure. In addition, CABEI has indicated an interest in incorporating environmental planning and analysis in anticipation of carrying out expanded lending programs. Technical assistance and training for this purpose were also included in this component.

(c) Strengthening CABEI's Private Sector Program Development. A total of \$15 million in A.I.D. resources plus \$7.5 million in counterpart were made available for agribusiness subblending under this component of the project. A.I.D. funded long and short term technical assistance and training were provided under the project to a) increase CABEI's project review capabilities; b) assist CABEI in strengthening the participating ICI staffs in export-related project identification, promotion and implementation; and c) provide guidance directly to subborrowers in areas such as export marketing, quality standards, production technology and others.

1.6 Evaluations and Audits:

A mid-term evaluation was carried out in March 1988 by Development Associates, Inc. which made an analysis of the short term financial viability of CABEI, the reorganization of the bank, the implementation of the management information system, the personnel system, the environmental advisory services, the private sector program, and a review of the financial and technical assistance inputs to the project. In August 1989, Clapp and Mayne, INC. made an evaluation of the institutional strengthening program. In February 1990, J. Richard Breen of Price Waterhouse made an analysis of the short run financial condition and organizational status of the bank, which was used by the management of ROCAP in a donors/creditors meeting to make recommendations concerning the future financial performance and viability of the bank. A Financial Management Review of the ROCAP/Guatemala Project No. 596-0114, coordinated by CABEI, was carried out by Price Waterhouse for the period September 30, 1985 to February 1990.

From June to August 1992, a RIG close-out audit of the project was carried out by Price Waterhouse. Based on this audit and subsequent evidence provided by the Bank which demonstrated that CABEI had complied with the criteria set by ROCAP in FIL no. FY 92-80, ROCAP disbursed the remaining \$6.63 million in funds for the agribusiness loan program. The audit recommends for future projects with ROCAP or AID that the Bank establish procedures to ensure that project records are centralized in an official file section.

2. Project Contributions

The major contributors in support of the Regional Economic Recovery project are as follows:

- USAID/ROCAP Regional Office of Central America and Panama.
- CABEI Central American Bank for Economic Integration.
- ICIs Intermediate Credit Institutions.

The value of contributions made by each participating institution is summarized below:

<u>Cooperating Institution</u>	<u>Planned Contributions</u>	<u>Value of Contributions</u>	<u>% of Total Contributions</u>
USAID/ROCAP	\$ 50,000,000	\$ 49,910,705	99.82
CABEI	\$ 48,438,900	\$ 47,855,900	98.80
ICI's	\$ 5,000,000	\$ 6,711,300	134.23
TOTAL	\$103,438,900	\$105,677,905	102.10

3. Summary of Contributions by Institution

3.1 A.I.D. Contributions

The total authorized A.I.D. contribution for the 6 year program was U.S. \$ 50,000,000 million. These resources went primarily for public sector infrastructure projects (U.S. \$30,000,000); agribusiness loans (U.S. \$ 15,000,000) and for technical assistance (U.S. \$ 5,000,000).

3.2 CABEI Contributions

CABEI's contributions to the project consisted mainly for the public sector infrastructure projects (U.S. \$ 41.2 million); working capital for the rehabilitation of the private sector (U.S. \$ 1,200,000), and loans for agribusiness (U.S. \$5,455,900). The close-out audit noted the \$2.7 million shortfall in counterpart contribution in the public sector investment program during the life of project. The disbursement of this amount of counterpart was made after the

PACD, due to the fact that several of the public sector projects were delayed beyond CABEI's control.

3.3 ICI's Contributions

ICI's contributions to the project were mainly loans for agribusiness in the amount of U.S. \$ 6,711,300.

4. Project Accomplishments

The Agribusiness component of the Project was successful in that all of the training and technical assistance was completed during the LOP and all of the loan funds, including CABEI's counterpart contribution, have been disbursed to the end borrower by CABEI. CABEI has over the past year made progress in restructuring its management and administration and has improved its financial position. Extra-regional members (Mexico, Venezuela and Taiwan) have been officially incorporated into the Bank's directorship which has contributed to the increase in liquidity of the Bank. Under the Bangkok agreement (March 31, 1991) member countries agreed to negotiate payment plans to improve country contributions and to reduce debt service arrears. Costa Rica has resumed payment of its capital contribution to the Bank.

The various institutional strengthening measures taken under the \$5 million T.A. component have been completed. CABEI has a permanent agribusiness lending unit and the ICIs have received the scheduled training. A mechanism to liquidate private sector debt in arrears has been recently approved by CABEI. CABEI's Personnel Administration has been improved through the implementation of salary surveys, salary scales, job performance ratings, training of supervisors to establish objectives, and a system to judge employees on the fulfillment of objectives. These measures are in response to a number of the recommendations made by A.I.D., World Bank, E.C. and the IDE. Personnel had been reduced by 70 by December of 1991 and the operating budget had been reduced by 34%. Although the Project is now terminated, ROCAP will continue its efforts to help CABEI to solidify its gains and to complete its reforms.

5. Progress towards achieving project purpose

CABEI's administrative and financial and viability have been greatly improved as a result of the financial and technical assistance provided under the project, by the continual policy dialogue undertaken by the USG, the IDB, the World Bank, and other creditors and donors, and most importantly by the strong direction of the new administration of the Bank which is instituting the reforms.

6. Lessons Learned

Any future projects with CABEI should condition disbursements based on actual accomplishments rather than avowed intentions. The performance of the institution depends on the political will of the member countries. During the life of the project there were many disappointments in that stated objectives were not met in the time frames promised. This includes the incorporation of extra-regional members, institutional strengthening reforms such as personnel administration, recovery of private sector loan portfolio etc. much have which has been accomplished PACD extension period and up to the Terminal Disbursement Date. There are indications that these reforms will continue and be solidified under the new administration of the Bank.

Extra-regional membership remains the key for future success of the institution. Extra-regional membership in the Board of Directors reduces the political give and take among the countries and the improves the transparency of decisions made by the Board of Directors.

Even though many improvements have been made in the internal administration such as better professional personnel management, improvements may not become permanent. The President and the members of the Board of Directors (of which the member countries will always maintain a majority) are politically appointed by the ruling party in each country. It is essential that all donors and extra-regional members press the countries to appoint highly qualified Directors. There are indications that this policy is being reversed with the trend in some recent appointments. The quality of the Presidents and of the Directors have been uneven throughout the history of CABEI.

Third tier lending mechanisms such as the agribusiness lending component under project 596-0114 should be avoided. The added layer of the Central Bank introduced another element of unnecessary supervision and regulation. Approval of the mechanisms by the monetary authorities delayed the program many months. Granted the Central Bank mechanism, which lent the funds to the ICIs was used for the convenience of the member countries. The Central Banks would receive some advances in dollars and then relend principally in local currency through the commercial banks. The major advantage for CABEI was that the exchange risk was borne by the Central Banks and the credit risk by the commercial banks.

CABEI should be considered for inclusion in future debt rescheduling agreements between the individual countries and the multi-lateral and bi-lateral donor community. The liquidity of CABEI was affected greatly because CABEI was not included in the most recent debt rescheduling agreement with Honduras. Honduras was bound to honor the commitments first in the debt rescheduling agreement.

7. Continued A.I.D. Monitoring

Given the large exposure of more than \$ 270 million by the United States Government in both direct loans and housing guarantees, more than \$ 60 million in donations over the years, and a large exposure of \$ 138 million by IDB of which the USG has contributed a major share, it is essential that there be continued monitoring of CABEI in all aspects by ROCAP whether or not there is an existing project. In addition to the monitoring function, CABEI, as the largest regional institution in Central America, will continue to have a key role in the economic development of the region. CABEI is the principal conduit of funding for Japan, Mexico and shortly Venezuela. Japan channels considerable loans through CABEI.

8. Recommendations for Pre-PACD Project Adjustments

ROCAP, on the advice of AID/W, retroactively extended the PACD and set new criteria in PIL FY 92-80 to allow time for CABEI to comply so that it could recoup the \$6.63 million in project funds which had been disbursed by the Bank for agribusiness loans already approved by the ROCAP.

9. Post-PACD Actions

CABEI presented evidence by August 1992 that the criteria for final disbursement as stated in PIL No. FY 92-80 had been met.

A close-out RIG audit of the project reviewed the financial status of the project and CABEI's compliance with the criteria set for final disbursement of project funds.

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