

AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

AUG 26 1987

ACTION MEMORANDUM FOR THE ASSISTANT ADMINISTRATOR (LAC)

FROM: LAC/DR, Terrence J. Brown

SUBJECT: El Salvador- CY 1987 ESF Balance of Payments Program
(519-0348) PAAD Program Approval and PAAD Authorization

Action Requested: Your action is required to approve a \$157.0 million Balance of Payments (BOP) program to El Salvador in support of its Revised Economic Plan for CY 1987. You are requested to authorize at this time \$97.0 million in FY 1987 Economic Support Funds (ESF) and \$30.0 million ESF funds provided by the 1987 Supplemental Appropriation. The balance of \$30.0 million will subsequently be authorized from the 1987 ESF account.

Background: The PAAD requests approval of a \$157 million (\$127 FY 1987 ESF and \$30 million in Supplemental funding) ESF BOP program to be implemented with the Government of El Salvador (GOES) during CY 1987. You previously approved \$30 million in FY 1987 ESF funding in support of the overall objectives of the GOES Revised CY 1987 Economic Program. The PAAD, while seeking approval for the additional funds takes a comprehensive view of the GOES program which includes all of A.I.D.'s FY 1987 ESF support.

Dollars made available under this action would be used to provide the GOES with the foreign exchange necessary to help it stabilize the deterioration in the economy that has taken place over the last two years and reduce inflationary pressures and the deterioration in export competitiveness. Program funds will be deposited in separate accounts of the Central Reserve Bank (BCR) of El Salvador at U.S. commercial banks to finance the importation of raw materials, intermediate goods, spare parts, agricultural imports, and capital goods for use primarily by the private sector. The Mission proposes to continue the source eligibility criteria utilized since 1985 which includes eligible items from the United States, CBI-designated CACM countries, except Nicaragua, and petroleum from A.I.D. Geographic Code 941 countries.

Discussion: The 1986 BOP concentrated on actions pertaining to three main areas: (1) economic stabilization; (2) economic diversification; and (3) consolidation of the agrarian reform. While progress was made to diversify the economy and to consolidate agrarian reform, economic stabilization was an elusive goal. In the area of economic stabilization, the GOES was to have established a system for monitoring progress, prepared a comprehensive program

for 1987 before submitting its 1987 budget, and established limits on public sector indebtedness. By the Summer of 1986 the program was at an impasse and the A/AID, Mr. McPherson, visited El Salvador and agreed to go forward with the BOP Program on the basis of fiscal and monetary adjustments. President Duarte agreed to review the exchange rate in late November. The Mission was negotiating the revised targets with the Ministry of Planning when the earthquake struck. This led to a suspension of progress in developing an economic program. The remaining FY 1986 funds were disbursed in April 1987 based upon satisfactory progress towards resolution of the CAESS electric company compensation case, receipt of a satisfactory land reform plan, submission of the 1987 economic program, and replenishment of 25 million colones for A.I.D. OE Trust Fund use.

Progress against the export diversification benchmarks was far better than for stabilization. These included calling for the GOES to pass an export promotion law, and to form two committees with participation from the private sector on exports and the investment climate. The export promotion law passed in March contains provisions for a one-stop export documentation center, private-sector ownership and/or management of free zones, and exemptions from payment of certain taxes on imports and on income. The two export committees were formed, with the second committee, CODEXI (Committee for Export Development and Investment), playing a key role in export promotion policy and implementation, investment promotion, and the coordination of the A.I.D.-financed Industrial Stabilization Project.

Progress against agrarian reform benchmarks was also satisfactory, although the payout of compensation was hindered by GOES differences and the slowness of the generation of local currencies due to the lack of dollar disbursements. Late in 1986, acceptable plans for compensation were worked out and payouts begun. Progress on titling benchmarks was generally at planned levels in spite of the earthquake. However, the earthquake impeded performance on beneficiary rights, which again fell short of expectations.

The basis for the proposed PAAD is the GOES Revised 1987 Economic Program, which is the result of lengthy negotiations between the USG and the GOES. The PAAD maintains that this program if carried out should significantly reduce inflationary pressures, improve public sector finances, and reduce the deterioration of export competitiveness compared with the previous program. It will not result in stabilization or vigorous growth of the economy, but it should stem the deterioration in macroeconomic indicators that has taken place over the last two years. Successful implementation at the macroeconomic level, however, will require consistent monitoring by the GOES, and a willingness to continue to take difficult decisions to keep the program on track.

At the sectoral level, the program includes significant government intervention and "fine tuning" of incentives intended to increase profitability and production. The Mission doubts the efficacy of such measures compared to market forces.

The Mission has not included specific covenants or conditionality in this PAAD, although the PAAD refers to actions in which it is expected that the GOES will take action. The negotiations linked aid to the personal commitment of President Duarte to implement a GOES-designed economic program, combined with non-confrontational policy dialogue to move towards macroeconomic adjustments to restore profitability and competitiveness, stimulate production, rein in inflation and stabilize the balance of payments, and sectoral reforms which could improve economic efficiency and provide tangible evidence to restore private sector confidence in the government.

Disbursements are to be made in tranches in August (\$67.0 million), September (\$60.0 million) and during the first quarter of FY 1988 (\$30.0 million). Disbursement of the first tranche is to proceed relatively automatically, tied to the requirement of normal progress in implementation of the program. The PAAD states that the September disbursement may be subject to delays because it will be contingent on GOES action, as scheduled in its economic program, to increase utility rates, and on the programmed implementation of the monetary program. The December disbursement will require continued meeting of the program targets for monetary and fiscal performance.

The PAAD states that successful implementation of the program will require close cooperation between the GOES and the USG in monitoring the program. The agreement will require that the Mission and the GOES meet quarterly to review performance against targets and to agree on corrective actions. The GOES has agreed to "ample" sharing of economic information. The Agreement will require that the BCR furnish monthly statements of assets and liabilities of the BCR and the depository banks in the detail provided in worksheets for the preparation of the weekly cable to the International Monetary Fund, copies of monetary program data revision, and a monthly foreign exchange flow analysis. The Mission will also attempt to assure that a 1988 monetary program is prepared at the same time as the national budget.

The following points were resolved in the Issues Meeting on July 15, 1987:

The Mission will prepare and submit for inclusion in the PAAD: (1) the statutory checklist and (2) a brief initial environmental determination.

The Administrator has approved grant financing for FY 1987 balance of payments support to El Salvador in the amount of \$157 million. PPC agrees that it is appropriate to interpret the spirit of the Administrator's approval of grant financing of the FY 1987 BOP program as encompassing the ESF grant funds provided by the Supplemental. No additional memorandum requesting approval of grant financing for this PAAD is required.

The following decisions were taken in the DAEC:

The DAEC recommended that the Bureau examine the Mission's method of dealing with the quantities of petroleum going for military use. In internal discussions, and in discussions with the Mission Director, the Bureau decided that the Mission's means of subtracting the amount of petroleum used by the military from the totals applied to the monies in the special account was adequate and sufficient to assure that A.I.D. resources were being used correctly.

The DAEC noted that new guidance on the programming of local currency resources will be issued shortly. Mission local currency priorities appear to be in line with guidance to date. The Bureau is very interested in following the breakout between public and private sector programming of these resources and the degree to which local currencies are being used to support the GOES budget. To this end, the Bureau will include in its cable transmitting your approval of the PAAD a request to the Mission that it keep the Bureau fully informed on the evolution of the GOES 1988 budget and the extent to which it appears that local currency generations will be used for budgetary support.

The Bureau expressed its intent that design and negotiation of the CY 1988 BOP program not be delayed. It was agreed that the Mission should begin ASAP a series of in-depth studies to analyze the reasons for poor economic performance and to prioritize areas where ESF funds could have the most impact. The Mission was requested to provide the Bureau within one month a timetable for development of its FY 1988 BOP program which would provide for the development of the CY 1988 program by the Fall of 1987. This program would include specific targets even though it is assumed that many of those targets might have to be readjusted after the March elections. It is hoped that a more comprehensive BOP program would allow the GOES to successfully acquire substantial support not only from the U.S.G., but from international financial institutions such as the IBRD and IMF as well.

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Congressional Notification: Since the amount requested under this action is less than that shown in the FY 1987 Congressional Presentation, a Congressional Notification is not required.

Recommendation: That you approve the proposed CY 1987 program in the amount of \$157.0 million and sign the attached facesheet authorizing the obligation of \$127.0 million in ESF funds.

Attachment: PAAD Facesheet

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Clearance Page

- 5 -

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(PW)

Attachment: PAAD Facesheet

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drafter: LAC/DR: RWhelden: 07/15/87: Document #30280

Clearances:

LAC/DR: RYoussef	<u>[Signature]</u>	date	<u>7/21/87</u>
LAC/CAP: RNelson	<u>[Signature]</u>	date	<u>7/22/87</u>
LAC/CAP: CCostello	<u>[Signature]</u>	date	<u>7/22/87</u>
LAC/DP: JFox	<u>[Signature]</u>	date	<u>7/23/87</u>
GC/LAC: GDavidson	<u>[Signature]</u>	date	<u>7/23/87</u>
ARA/ECP: Wbarron	<u>[Signature]</u>	date	<u>7/23/87</u>
PPC/PB: DAdams	<u>[Signature]</u>	date	<u>7/23/87</u>
PPC/EA: KKauffman	<u>[Signature]</u>	date	<u>7/24</u>
LAC/DR: ILevy	<u>[Signature]</u>	date	<u>7/24</u>
DAA/LAC: MButler	<u>[Signature]</u>	Date	<u> </u>

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CLASSIFICATION:

A/C 1120-1 PAAD	AGENCY FOR INTERNATIONAL DEVELOPMENT PROGRAM ASSISTANCE APPROVAL DOCUMENT	1. PAAD NO 519-0348	519-K-609A : \$59,554,000.00 519-K-609B : 67,446,000.00
		2. COUNTRY El Salvador	
		3. CATEGORY Cash Transfer	
		4. DATE July 17, 1987	
5. TO AA/LAC, Dwight Ink		6. OYB CHANGE NO N/A	
7. FROM LAC/DR, Terrence J. Brown		8. OYB INCREASE	
9. APPROPRIATION REQUESTED FOR COMMITMENT OF \$ 127,000,000		10. APPROPRIATION	Economic Support Funds (ESF)
11. TYPE FUNDING <input type="checkbox"/> LOAN <input checked="" type="checkbox"/> GRANT <input type="checkbox"/> INFORMAL <input checked="" type="checkbox"/> FORMAL <input type="checkbox"/> NONE	12. LOCAL CURRENCY ARRANGEMENT <input type="checkbox"/> NONE <input checked="" type="checkbox"/> FORMAL <input type="checkbox"/> INFORMAL	13. ESTIMATED DELIVERY PERIOD FY 1987	14. TRANSACTION ELIGIBILITY DATE
15. COMMODITIES FINANCED			

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only: _____	U.S. \$127,000,000
Limited F.W.: _____	Industrialized Countries: _____
Free World: _____	Local: _____
Cash: \$127,000,000	Other: _____

18. SUMMARY DESCRIPTION

The purpose of this program is to provide balance of payments assistance to support the economic stabilization of El Salvador during 1987. This economic program is based on the Government of El Salvador's (GOES) Revised Economic Program for 1987 which addresses the major fiscal and monetary problems that face El Salvador, and should lead to reduction in inflationary pressures as it is implemented.

Program funds will be deposited into a special ESF account or accounts in the U.S. from which payments for eligible foreign exchange transactions will be made. Eligible transactions include the importation of raw materials, intermediate goods, spare parts, agricultural inputs and capital goods from the U.S. and Central American Common Market countries, excluding Nicaragua, and including Panama, and Petroleum from A.I.D. Geographic Code 941 countries (all to the Private Sector). Upon disbursement of the dollars, an equivalent amount of local currency will be deposited by the GOES in a separate Special Account in the Central Bank of El Salvador to be used for mutually agreed upon development purposes consistent with the Foreign Assistance Act, specifically Sections 103 through 106.

19. CLEARANCES	DATE	20. ACTION	
LAC/DP: VWheeler	7/23/87	<input checked="" type="checkbox"/> APPROVED <input type="checkbox"/> DISAPPROVED	
GC/LAC: GDavidson	7/25/87	 AUTHORIZED SIGNATURE	
ARA/ECP: WBarmon	7/23/87		8/26/87
LAC/CAP: CCostello	7/22/87		
PPC/EA: KKauffman	7/24/87		
SER/FM: CChristensen	8/25/87		
DAA/LAC: MButler			
		Assistant Administrator, LAC	
		TITLE	

9:15

01 PAGE 01 STATE 267928 5883 020076 AID1184
02 ORIGIN AID-00

03 -----
04 ORIGIN OFFICE LADR-03
05 INFO PPA-02 AALA-01 LACE-02 LACO-01 LADP-04 AMAD-01 GC-01
06 GCLA-03 PPMF-01 PSC-03 PPR-01 ES-01 RELO-01 PRE-06
07 /031 A0
08 -----

09 INFO LOG-00 EB-00 ARA-00 TRSE-00 /000 R
10

11 DRAFTED BY: AID/LAC/DR:RWWHELDEN:RWW/30970
12 APPROVED BY: AID/LAC/DR:TBROWN
13 LAC/DR:DBOYD LAC/CAP:DNELSON (PHONE)
14 LAC/DP:WWHEELER (INFO)

15 -----062752 272001Z /38
16 O 271946Z AUG 87
17 FM SECSTATE WASHDC
18 TO AMEMBASSY SAN SALVADOR IMMEDIATE
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20 UNCLAS STATE 267928
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22 AIDAC
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24 E.O. 12356: N/A
25 TAGS:

26 SUBJECT: CY 1987 ESF BALANCE OF PAYMENTS PROGRAM
27 (519-0348) PAAD PROGRAM APPROVAL AND PAAD AUTHORIZATION
28

29 1. THE AA/LAC APPROVED SUBJECT BALANCE OF PAYMENTS
30 PROGRAM FOR DOLS 157.0 MILLION AND AUTHORIZED DOLS 127.0
31 MILLION AT THIS TIME. IT IS EXPECTED THAT THE BALANCE
32 OF DOLS 30.0 MILLION WILL BE AUTHORIZED LATER THIS
33 CALENDAR YEAR. MISSION SHOULD PROCEED WITH NEGOTIATION
34 AND OBLIGATION OF THE AUTHORIZED AMOUNT. FOLLOWING
35 GUIDANCE STEMS FROM BUREAU'S REVIEW OF SUBJECT PAAD AND
36 SHOULD BE INCORPORATED INTO MISSION'S PLANNING FOR ITS
37 1988 BOP PROGRAMS.
38

39 2. THE BUREAU IS VERY INTERESTED IN FOLLOWING THE
40 BREAKOUT BETWEEN PUBLIC AND PRIVATE SECTOR PROGRAMMING
41 OF LOCAL CURRENCY RESOURCES AND THE DEGREE TO WHICH
42 LOCAL CURRENCIES ARE BEING USED TO SUPPORT THE GOES
43 BUDGET. TO THIS END, WE REQUEST THE MISSION KEEP THE
44 BUREAU FULLY INFORMED ON THE EVOLUTION OF THE GOES 1988
45 BUDGET AND THE EXTENT TO WHICH IT APPEARS THAT LOCAL
46
47

01 CURRENCY GENERATIONS WILL BE USED FOR BUDGETARY SUPPORT.
02

03 3. THE BUREAU IS ALSO INTERESTED IN ASSURING THAT THE
04 DESIGN AND NEGOTIATION OF THE CY 1988 BOP PROGRAM
05 PROCEED EXPEDITIOUSLY. IT WAS AGREED WITH THE MISSION
06 REPRESENTATIVE AT THE DAEC THAT THE MISSION SHOULD BEGIN
07 ASAP A SERIES OF IN-DEPTH STUDIES TO ANALYZE THE REASONS
08 FOR POOR ECONOMIC PERFORMANCE AND TO PRIORITIZE POLICY
09

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09 AREAS WHERE ESF/BOP FUNDS COULD HAVE THE MOST IMPACT.
10 THE MISSION IS REQUESTED TO PROVIDE THE BUREAU WITHIN
11 ONE MONTH A TIMETABLE FOR DEVELOPMENT OF ITS FY 1988 BOP
12 PROGRAM WHICH WOULD PROVIDE FOR THE DEVELOPMENT OF THE
13 CY 1988 PROGRAM BY THE FALL OF 1987. THIS PROGRAM WOULD
14 INCLUDE SPECIFIC TARGETS EVEN THOUGH IT IS ASSUMED THAT
15 MANY OF THOSE TARGETS MIGHT HAVE TO BE READJUSTED AFTER
16 THE MARCH ELECTIONS. IT IS HOPED THAT A MORE
17 COMPREHENSIVE BOP PROGRAM WOULD ALLOW THE GOES TO
18 SUCCESSFULLY ACQUIRE SUBSTANTIAL SUPPORT FROM
19 INTERNATIONAL FINANCIAL INSTITUTIONS SUCH AS THE IBRD
20 AND IMF.

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22 4. SUBJECT ACTION MEMORANDUM IS BEING SENT TO THE
23 MISSION. PLEASE ADVISE WHEN SUBJECT PROGRAM HAS BEEN
24 OBLIGATED. WHITEHEAD
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