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134

CAPITAL ASSISTANCE PAPER

Proposal and Recommendations
For the Review of the
Development Loan Committee

HONDURAS - GRAIN MARKETING

522-104

AID-DLC/P-1052

DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT
Washington, D.C. 20523

UNCLASSIFIED

AID-DLC/P-1052

December 12, 1972

MEMORANDUM FOR THE DEVELOPMENT LOAN COMMITTEE

SUBJECT: Honduras - Grain Marketing

Attached for your review are the recommendations for authorization of a loan in an amount not to exceed $2,000,000 to the National Development Bank, an autonomous agency of the Government of Honduras, to finance the strengthening and expansion of the Bank's grain price stabilization and marketing program.

Please advise us as early as possible but in no event later than close of business on Wednesday, December 20, 1972, if you have a basic policy issue arising out of this proposal.

Rachel R. Agee
Secretary
Development Loan Committee

Attachments:
Summary and Recommendations
Project Analysis
ANNEXES I-III

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AID-DLC/P-1052
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TABLE OF CONTENTS

HONDURAS: GRAIN MARKETING

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HONDURAS: GRAIN MARKETING

PART ONE: SUMMARY AND RECOMMENDATIONS

1. Borrower: The Borrower will be the Banco Nacional de Fomento (National Development Bank) herein referred to as the BNF, an autonomous agency of the Government of Honduras.

2. Guarantor: The Government of Honduras (GOH) acting through the Ministry of Finance and Public Credit.

3. Loan:

A. Amount - not to exceed US $2,000,000
B. Terms - the GOH will be offered the two-step arrangement:

1) Terms to the BNF - 20 year repayment period including a 5 year grace period, with interest of 4% p.a. during the entire 20 years.

2) Terms to the Government - 40 year repayment period, including a 10 year grace period, with interest of 2% during the grace period and 3% thereafter.

C. Local cost component - Up to $1,950,000 of local funds would be made available to the BNF in local currency, with the remaining $50,000 to be available in US dollars.

4. Purpose and Description of Project:

a) The project proposed for A.I.D. loan financing consists of the strengthening and expansion of the BNF's grain price stabilization and marketing program. At present, this program does not have funding sufficient to enable the BNF to operate as effectively as it should in this field. Loan funds would assist in increasing the capitalization of the BNF and would be added to a revolving fund for financing grain purchasing, processing, drying, and storage operations. This working capital, combined with technical assistance and a BNF commitment to finance improvements in its network of rural storage facilities and grain buying stations, will improve the overall effectiveness of the BNF in stimulating production and marketing of basic grains throughout Honduras.

b) The proposed loan would assist in the financing of: (i) Purchases by the BNF of corn, beans and rice produced in Honduras and (ii) training and technical assistance supportive to the BNF's administration of this program.

The basic results desired from this proposed project are:

- The improvement of the BNF as an agency to promote increased and more efficient production and distribution of basic grains, which constitute the most important elements in the diet of the majority of Hondurans.

- More stable price levels for basic grains in the domestic Honduran market in order to prevent the type of large fluctuations that have been experienced in the past.

- Increased exports of corn and beans by Honduras to other countries, both in Central America and elsewhere in order to capitalize on Honduras' comparative advantage in basic grains for the diversification of exports and increased foreign exchange earnings.

- To support the Honduran government's commitment to development of the agricultural sector through the work of the GOH's Agricultural Sector Analysis team now functioning with A.I.D.'s support and encouragement. Two letters have been received from the President of Honduras indicating that the GOH assigns top priority to improving the BNF's grain program through such a loan.

- Extension of the BNF's grain purchasing program farther into the rural areas, enabling small and medium farmers to sell their production at a better price through upgraded rural grain buying stations.

5. <u>Financial Plan</u>: (in thousands)

	Grain Inventory Financing	Upgrading Rural Grain Receiving Stations	Training and Technical Assistance	Total
AID Loan (dollars)	--	--	$ 50	$ 50
AID Loan (local currency)	$ 1,900	--	50	1,950
BNF counterpart	1,700*	200	25	1,925
Central Bank-loan	500	--	--	500
Totals	$ 4,100	$ 200	$ 125	$ 4,425

* Including $1,400,000 of funds already made available

6. <u>Other Sources of Funds</u>:

a) The IBRD and the IDB, in their letters of August 22, and September 26, 1972, respectively, indicated that they were not interested in financing this project. The Exim Bank, in minutes of its September 8, 1972 meeting, indicated that it was not interested. The possibility of obtaining financing for this program through the World Food Program has also been explored and this project could not now be financed through any such arrangement. The MIssion also concluded that the GOH and the Honduran Central Bank cannot provide financing in addition to that already allocated to the program by the Central Bank.

b) Other US or Free World financing is not available for this project.

7. <u>Statutory Criteria</u>:

The statutory criteria for this loan have been met; Annex III contains the statutory checklist.

8. <u>Views of the Country Team</u>:

The Country Team has concluded that this proposed loan, as an integral part of the Mission's top priority Agricultural Sector development strategy with its ultimate focus on bettering the condition of the small rural man, directly contributes to the realization of basic development objectives in Honduras.

9. Issues:

Several basic issues were raised in connection with the project at the time the Intensive Review Request was discussed by the LA/CAEC. Annex I, Exhibit 2 contains a text of the telegram received following the LA/CAEC meeting, together with short paragraphs summarizing how each of those issues has been treated and resolved in this paper.

Section IV of this paper contains a summary of the issues that were raised when this loan was reviewed by the LA/DAEC on November 20 and 21, 1972, together with an explanation of how they were resolved and what modifications were made in the project design as a result.

10. Loan Administration:

This loan will require no unusual disbursement or procurement procedures, and standard A.I.D. regulations will be followed. Disbursements for grains will be made upon presentation by the BNF of proof of purchase from individual Honduran farmers and cooperatives. Training and technical assistance will be procured from countries included in A.I.D. Geographic Code 941, including Central America.

11. Recommendations:

On the basis of the conclusions of the Mission's Capital Assistance Committee that the project is technically, economically, and financially justified, it is recommended that a loan be authorized to the National Development Bank (BNF) for an amount not to exceed $2,000,000 subject to the following terms and conditions:

A. Loan Terms:

Borrower shall repay the loan to A.I.D. within 20 years from the first disbursement under the loan, including a grace period of not to exceed 5 years. Borrower shall pay to A.I.D. in dollars interest of 4% per annum during the grace period and 4% per annum thereafter on the outstanding balance. Should the Government of Honduras elect the two-step payment procedure, the Borrower shall make the above payments in local currency, but with the same amortization and grace periods and at the same interest rates, to the Government of Honduras. The Government would then repay the loan to A.I.D. within 40 years from the first disbursement to the Borrower under the loan, including a grace period of not to exceed 10 years. The Government would pay to A.I.D. in dollars interest of 2% per annum during the 10 year grace period and 3% per annum thereafter on the outstanding balance.

B. Other Terms and Conditions:

1) The loan would be disbursed to the Borrower both in US dollars and Honduran Lempiras, which are freely convertible with dollars and have a value of 1 Lempira $0.50. Up to the equivalent of $1,950,000 would be made available to the Borrower by A.I.D. in Lempiras.

2) Training and technical assistance procured under the loan will have source and origin in countries included in A.I.D. Geographic Code 941, including Central America.

3) Grain purchases financed under loan shall be only for corn, beans and rice produced in Honduras. All other grain purchases financed by the BNF under this program during the life of the loan shall be for grains produced in countries included in A.I.D. Geographic Code 935.

4) The Government of Honduras will be offered a two-step payment agreement arrangement, and the funds available to the GOH through any such arrangement will be used to assist socio-economic development projects mutually acceptable to the GOH and A.I.D.

5) Prior to first disbursement, the BNF shall submit evidence satisfactory to A.I.D. that it has:

a) Established a separate revolving fund in a manner satisfactory to AID, which shall be used exclusively for grain purchases, processing, and for operation of the BNF network of storage facilities during the life of the loan, and that an initial payment into the fund of at least the local currency equivalent of US$1,400,000 in cash and grain inventories has been made by the BNF from its own resources.

b) Made a comprehensive review of all existing grain inventories in BNF storage facilities and that all low-quality grains have been disposed of.

c) Presented evidence satisfactory to AID that the Central Bank will maintain its $500,000 line of credit to the BNF for the basic grains program available for a five-year period.**

6) Prior to the disbursement of loan funds for other than technical assistance and training costs, the BNF shall submit to AID:

a) A Rural Storage Improvement Plan, to include a budget and calendar for implementation, satisfactory to AID, for purchases of equipment and for other physical improvements to its existing network of rural storage facilities and buying stations, with the exception of those facilities which the BNF and AID shall jointly have determined no longer to be economically viable. Prior to such disbursement, the BNF shall also present evidence that progress, satisfactory to AID, towards implementation of the Plan, using its own resources, has been made to insure that all work contemplated under the Plan will be completed during the first 12-month period of loan disbursements.

b) Evidence that it has initiated a comprehensive technical assistance program to aid in improvement of the entire BNF grains operations.

7) Prior to the disbursement of more than $500,000 of loan funds, the BNF shall submit to AID evidence that it has carried out the Rural Storage Improvement Plan approved by AID.

8) The BNF shall covenant with AID that:

a) Loan-funded technical assistance and personnel training required for further improvement of the operations of the BNF grain storage and marketing program will be obtained by the BNF throughout the loan disbursement period on terms and conditions mutually agreed upon by the BNF and AID.

b) The BNF will establish basic grain stabilization prices at the producer level in consultation with the Central American Basic Grains Coordinating Commission.

c) All proceeds from the sale of grains financed hereunder and under the revolving fund mentioned above shall be redeposited in the revolving fund during the life of the loan.

**A Letter was received by the Mission on November 2, 1972 which would satisfy this condition.

d) During each of the first three years of the program, it will make an additional cash contribution to the revolving fund of the local currency equivalent of $100,000.

e) It will negotiate with proper Honduran financial institutions or with the GOH for any and all additional financing that may be necessary for the program during the life of the loan, and that it will make every effort to make the program financially self-sufficient.

12. Composition of the Mission's Capital Assistance Committee:

Chairman: *Harry L. Barr, Capital Development Officer
Members: Harold D. Koone, Rural Development Officer
Ronald V. Curtis, Agricultural Economist
Thomas J. Mehen, Program Officer
Richard Rueda, Embassy Economic Officer
*Robert J. Maushammer, Program Economist
Bernard L. Riedel, Controller
John R. Kahle, ROCAP RLA
Charles R. Connolly, Associate Director
Remo Ray Garufi, Acting Mission Deputy Director
* Robert P. Mathia, International Development Intern

Other Contributors:

*James W. Lemley, ROCAP/PASA consultant, USDA
*Dorn K. Diehl, USDA consultant

Approved: Edward Marasciulo, Mission Director

E. Marasciulo

November 6, 1972

*Drafting Officers

Exchange rate: 1 Lempira = US$ 0.50

PART TWO - Project

Section I: Nature of the Project

A. Description of Activity

1. Definition

This project proposes to strengthen the BNF's program for purchasing, storage and marketing of basic grains by providing additional working capital and by funding technical assistance and training of BNF personnel responsible for its administration. The BNF is the only public sector institution providing agricultural production credit and storage services in Honduras. The grain program has been greatly strengthened with A.I.D. assistance through Loan No. 522-L-018, signed in 1969, which provided $4.5 million for grain and livestock production credit plus $3.0 million to finance about 65% of the total cost of the two new 14,000 ton processing and storage terminals, which became operational in December, 1971.

Together with older facilities in various outlying areas, the BNF now owns 40,000 metric tons of grain storage capacity, as opposed to 12,000 metric tons prior to the completion of the new terminals. A feasibility study will soon be underway, with BNF financing, for some new rural facilities and in connection with this loan, the BNF will undertake certain improvements at existing rural facilities and buying stations. This will increase the effectiveness of its grain program by extending it farther into rural areas.

The BNF has been able to operate the new facilities quite effectively during 1972, and the basic grains program has already begun to improve as a result through increased exports and reduction in variations of prices paid to producers and by consumers. Although the BNF has had difficulty obtaining the approximately $4 million of working capital necessary to make full use of its increased storage capacity, it has been able to come up with about 1/2 of the necessary funds at the expense of certain other programs. Funds would be made available under this loan to the BNF over a three-year period for the purchase of grains produced within Honduras, thus enabling the BNF to buy and store grain in larger quantities. Moreover, exports of Honduran grains can now be increased because the new facilities can prepare and store grain of improved quality. The purpose of this project is not merely to provide capital to operate the new facilities, but it is also aimed at increased utilization and effectiveness of the existing facilities in rural areas.

The project will enable the BNF to improve its grain marketing program which is complementary to the agricultural credit program for corn, beans, rice, and sorghum strengthened through Loan 018. This is designed to have an impact on the small and medium-sized farmers who are as individuals and cooperatives the principal producers of these basic elements of the Honduran diet. The credit program should be combined with one such as this whereby the farmer is assured of being able to sell his grain at a fair price when harvested rather than be subjected to unscrupulous dealers or run the risk of storing it himself. This program will also have a beneficial effect on low-income urban consumers who depend upon corn, beans, and rice for food and to whom wide retail price fluctuations for these grains are particularly harmful since they buy almost daily throughout the year in small quantities in public markets and small stores.

2. <u>Limits of A.I.D. Financing</u>:

It is estimated that the BNF needs to have at its disposal approximately the local currency equivalent of US $4,000,000 (8,000,000 Lempiras) in order to run an effective grain marketing program and to stabilize grain prices in Honduras. This amount will enable the BNF to fill all of its existing grain storage capacity. As of late 1972, the BNF Grains Division had the use of about $3,000,000 but this included a $500,000 180-day note that it had obtained temporarily from a commercial bank and a $500,000 short-term emergency loan from the Central Bank. The remaining $2,000,000 was made up of $1,400,000 of the BNF's own funds which have been permanently assigned to this program, plus a $500,000 renewable 360-day line of credit from the Central Bank.

This A.I.D. loan would supply the local currency equivalent of $1,900,000 in additional working capital to bring the fund up to the $4 million level, and will be added to a revolving fund to be used exclusively for the program. A.I.D. will require that the BNF:

a) Establish the revolving fund for grain purchases and storage operations by making an initial contribution of L. 2,800,000 (equivalent to $1,400,000) in cash and inventories.

b) Contribute an additional L. 600,000 (equivalent to $300,000) to the revolving fund over the first three years of the program.

A commitment has been received from the Central Bank that the existing $500,000 line of credit will be kept open for at least five years, with the funds considered as part of the revolving fund.

The make-up of the revolving fund will thus be as follows:

$ 1,400,000	BNF - existing resources - cash and inventories
300,000	BNF - new money
500,000	Central Bank - renewable line of credit - 5 years
1,900,000	A.I.D. Loan
$ 4,100,000	

The remaining $100,000 of loan funds will be used by the BNF for financing training and technical assistance. The BNF is also to contribute $200,000 of its own funds to upgrade rural storage facilities, as well as some additional funds for technical assistance. Therefore, over 50% of total project funds are coming from local sources. The entire grains program will become financially self-sufficient within a short period of time.

3. Operating Criteria:

In connection with regional grain stabilization efforts made throughout Central America during the late 1960s, the GOH assigned to the BNF responsibility for initiating and operating a grain storage and price stabilization program in Honduras. The direct responsibility for operating this program rests with the BNF Grains Division which is supervised by a Grains Committee composed of the Manager of the BNF's Development Division and certain members of the BNF's own Board of Directors. Please refer to Annex II, Exhibit 1 for an organization chart of the BNF and to Annex II, Exhibit 2 for the organization of the Grains Division.

As a result of the initiation of this new, expanded program, the Grains Division has assumed increased importance within the BNF and the possibility that this activity will be spun off and established as a separate corporation is being studied. Although as yet no formal decision has been made on this, it is the definite intent of BNF top management that this division become financially self-sufficient and have a separate accounting system as a first step in that direction.

A.I.D. Loan Agreement No. 522-L-018 contained a condition precedent to loan disbursements for silo construction requiring the BNF to present a grain price stabilization plan for A.I.D.'s approval. The plan was submitted and approved by A.I.D. on December 22, 1969, and the reorganized BNF Grains Division took responsibility for the start-up of the new facilities in December, 1971. Despite funding problems, substantial improvements have already been made in storage and marketing as compared to the situation which prevailed prior to 1969 when the BNF had neither adequate facilities nor working capital for such a program.

During the past six months, the original stabilization plan has been under constant revision and improvement. It will be discussed in detail below in Section II-C.

In view of the severe historical shortages of corn and beans with corresponding violent and disruptive price increases in the market, the GOH in September, 1971 ordered the prohibition of basic grain exports by the private sector. The BNF was left as the sole exporter but in special cases, the Minister of Finance may grant export permits to others following consultation with the BNF on each case. This action, combined with the completion of the new silos and the entrance of the BNF as a major force in the grain market, has partially stabilized prices of basic grains in Honduras. Moreover, the possibility of a repeat of the July, 1970 situation where Honduras virtually ran out of beans has been sharply reduced. Please refer to Annex II, Exhibit 5, which shows historical grain prices.

Based on the BNF's grain policies, a set of well-defined procedures is followed by the Grains Division in its day-to-day operations. Based on support prices set by the BNF Board of Directors, a schedule of differentials has been set up for calculating actual amounts paid to farmers who deliver grain to various BNF storage facilities. The price differentials depend upon theoretical transport costs from each location to consumption centers, cleanliness, moisture content, and grade.

Managers of the various facilities have the responsibility for receiving grain, determining quality and moisture content, and authorizing payments to farmers by means of vouchers for payment at local BNF branches. Certain facilities also are used for custom cleaning and drying services, and storage space is also rented to private parties. The managers of the new Tegucigalpa and San Pedro Sula facilities have greater responsibilities and have had more training than their counterparts in other facilities. Please see Annex II,

Exhibit 3, for curricula vitae of the BNF personnel most directly involved with this program.

B. Background of the Project

1. Genesis of the Project:

A.I.D. Loan No. 522-L-018 ($9,500,000) signed on April 16, 1969 provided $8,000,000 to the BNF for a "re-lending program designed to help achieve 1969 and 1970 GOH agricultural production goals for the basic food and feed grains of corn, beans, rice and sorghum and for livestock... (and to develop) the physical and administrative capacities necessary for carrying (out) a basic grains price stabilization program, which is carefully and closely coordinated with a regional price stabilization program for Central America... (for) construction and construction supervision of two... grain storage facilities... together with related technical assistance to the BNF in grain storage operation and marketing ..." *
The other $1,500,000 under the loan was allocated to the Honduran cooperative movement for a similar program.

$4.5 million in loan disbursements for the credit program have been completed. The silos were completed at a total cost of about $4.6 million and have been operative since December, 1971. Some funds remaining under this portion of the loan are being used for fabrication of two freight elevators to be installed by mid-1973. No funds for grain marketing were provided under the loan with the assumption that the BNF would be able to come up with the necessary resources. One of the reasons that the BNF has had difficulty mobilizing the needed working capital is that the final cost of the silos was about 40% greater than estimated. The BNF decided to fund the $ 1,534,000 contract for equipping the silos with its own resources rather than request A.I.D. to transfer funds from those allocated to production credit.

* Quotes taken from the Loan 018 CAP-Summary and Recommendations Section - Page i.

The BNF formally applied for this loan in its letter of May 8, 1972 and other letters of support have been received from the President of Honduras and the Economic Planning Council. The Mission is herein proposing a loan for the same amount requested in the IRR, but is recommending that the loan finance a substantial technical assistance and training component as well as provide working capital.

2. Evaluation of Previous A.I.D. Assistance:

$8,000,000 of Loan 018 was made available by the Government to the BNF for three separate purposes in the following amounts:

$4,500,000 -- for BNF sub-loans for production credit for basic grains and livestock, and for the purchase of vehicles for field supervision -- (100% disbursed as of 10/1/72)

$3,000,000 -- for storage facility construction, construction supervision, and technical assistance in grain storage operations and marketing -- (97% disbursed as of 10/1/72)

$ 500,000 -- BNF sub-loans and equity investments in agro-industries -- (11% disbursed as of 10/1/72)

a) BNF Credit Portion: The conditions precedent for this portion of the loan were met on December 22, 1969. Disbursements for sub-loans made began in mid-1970 and were completed in August, 1972. An A.I.D. contract advisor, recently completed an evaluation of the program.

On the first drawdown of loan funds which occured over a two-year period, about 58% of the total number of loans and 36% of the total amount made with both A.I.D. and BNF counterpart funds were for grain production credit, the remainders in both cases being for livestock. The grain loans are broken down as follows:

For production of	Number of loans	Total amount
Corn	4,611	$ 1,837,421
Beans	860	281,235
Rice	592	562,440
Sorghum	32	4,667

Lending levels for corn, beans, and rice production dropped slightly from 1968 to 1969, but increased sharply in 1970 when the program was initiated:
(figures in thousands)

BNF Production Loans for:	1968	1969	1970	1971
Corn	$ 1,245.2	$ 1,220.4	$ 1,094.1	$ 1,773.8
Beans	244.0	198.8	159.3	286.4
Rice	112.6	182.2	127.4	407.4
Sorghum	12.7	14.5	5.2	6.1
	$ 1,614.5	$ 1,615.90	$ 1,386.0	$ 2,473.7

A less tangible achievement was improved coordination between the BNF and the GOH agricultural extension agency, DESARRURAL. In spite of this, efforts to provide increased technical assistance to small farmers under the program were generally unsuccessful for a variety of reasons such as a lack of trained extension agents and the continued reduction of DESARRURAL's operating budget.

Other points noted were:

i) For loans made during the first drawdown under the program there has been a delinquency rate of about 15%.

ii) For the most part, the program served the medium and small farmer groups as intended.

iii) A significant number of new clients were served.

iv) Very significant increases occurred both in numbers of loans and in total amount of loans made for grains and livestock.

v) Improved farming techniques were observed, but to a minimal degree.

vi) Significant increases occurred in levels of production, but with only slight increases in productivity.

vii) The BNF is now able to offer better services to its clients than prior to initiation of the program.

A.I.D. loan funds and BNF counterpart funds assigned to this credit program have been maintained in a separate revolving fund account, as called for in Sections 3.01-B (3) and 4.13-B (1) of the Loan Agreement. The Loan Agreement specifies that these funds must be used for basic grains and livestock credit only through CY1972. However, the BNF is agreeable to continuing this for future years.

b) BNF Storage Portion: All but about $25,000 of these funds were used for construction of the two grain storage terminals completed in December, 1971. Construction work was carried out normally and knowledgable experts who have visited Tegucigalpa and San Pedro Sula have stated that the facilities are very well designed and constructed. Efforts to obtain the services of a grain-marketing advisor under this portion of the loan proved unsuccessful since the individual contracted by the BNF was not able to develop the necessary working relationships with his Honduran counterparts. With A.I.D.'s concurrence, his one-year contract was terminated after five months of work. The Mission and BNF have arrived at a much-improved strategy for obtaining needed technical assistance involving qualified Honduran and US personnel to be financed partly with loan funds under this loan and partly by the BNF. This is discussed in detail below in Section II-C.

c) BNF Agro-Industry Portion: Implementation of this portion of the loan was delayed by the inability of the BNF's Industrial Development Division to develop satisfactory projects. To date, about $65,000 of loan funds have been disbursed for two small projects. This division is in the difficult position of being overshadowed in this field by two very strong institutions, the private Financiera Hondureña, and the industrial department of the Central American Bank (CABEI), both of which have received large amounts of A.I.D. financing.

At present, CABEI's Industrial Department is preparing a plan for a complete reorganization of the BNF Industrial Division. Also under study is the possibility of removing this division from the BNF and setting it up as an autonomous Government development corporation. Nevertheless, the remainder of these funds have been earmarked for two projects: two wood-drying kilns and an African Palm Oil production and extraction plant. Construction of both projects will get underway soon and it is anticipated that these funds will be disbursed within the next 18 months.

d) Compliance of the BNF and the GOH with certain other conditions and covenants: The 018 Loan Agreement contained many conditions and covenants which were intended to insure that the GOH and the BNF would take certain actions designed to improve the BNF's financial position and operations. The most significant of these are:

(i) Section 3.01-A (3):

GOH commitment to "continue to provide contributions to BNF through redemption in cash of BNF-owned bonds of Borrower (GOH)... The said commitment shall include a schedule of the amounts and timing of bond redemption satisfactory to A.I.D."

A.I.D. and the GOH agreed to a schedule of redemptions of the equivalent of $2,000,000 per year through the disbursement period of the loan. The amounts which have been or are to be contributed are: (in millions of dollars)

CY1966	$ 1.0
1967	2.0
1968	2.0
1969	2.0
1970	2.0
1971	2.0
1972	2.0
1973	.5* (contained in GOH 1973 budget as submitted to the Congress)

The 1973 amount will complete the redemption of all bonds now held by the BNF, and future GOH contributions will depend upon the outcome of BNF/GOH negotiations for additional capitalization which are now underway.

(ii) Section 3.01-B (3):

Establishment of a segregated account "revolving fund" with A.I.D. loan disbursements and BNF counterpart contributions for grains and livestock production credit. This requirement has been fulfilled:

	Agreed upon contributions	Amounts as of 5-31-72
BNF	$ 2,800,000	$ 2,915,076
A.I.D.	4,400,000	4,404,780

In addition, the BNF agreed to contribute $300,000 for agro-industrial projects to complement A.I.D.'s $500,000. According to the budgets prepared for projects to be implemented, the BNF should contribute approximately this amount.

(iii) Section 3.02 (1):

A plan for increased technical assistance to

* This is an extra amount the GOH wishes to give to the BNF over and above the original bond grant.

producers.

The amount of technical assistance made available to small and medium income farmers has not been what was envisaged, primarily because of cutbacks in DESARRURAL's budget. This problem has been widely recognized and the GOH is now beginning to focus on the need for improvement in agricultural extension services. The GOH agricultural sector analysis team is looking at this problem in detail, and the IDB has recently made a loan to the GOH for comprehensive improvement of DESARRURAL. The GOH Minister of Natural Resources (agriculture) and the BNF President have been working closely to try to overcome these difficulties and several new pilot supervised agricultural credit programs have been initiated.

(iv) Section 3.02 (2):

A plan for the reduction of total loan delinquencies to a maximum of 10% of the overall BNF loan portfolio by December 31, 1969.

At the time the CAP for Loan 018 was written, it was recognized that the BNF's portfolio contained a significant percentage of delinquent loans, some of which could be collected and others which should be written off as bad debts. Pursuant to this Condition Precedent, the BNF presented a plan, which was approved by AID, for reduction of the total delinquencies to 10% of the current portfolio within about 8 months of the date the Loan Agreement was signed. At that time, total delinquencies amounted to slightly over 30% of the portfolio level, including 10% of the total portfolio that had been refinanced or rescheduled.

The task of implementing this plan proved to be difficult, which in part was due to BNF administrative shortcomings. However, there are numerous other legal and procedural factors involved which prevent rapid and efficient action from being taken on this problem in a comparatively short period of time.

When it became obvious to the USAID that the situation was not improving as had been anticipated, ROCAP financial analysts were requested to come in and reevaluate the situation. Their report, issued in March, 1971, confirmed that these problems did indeed exist but also pointed out several factors which helped to place this issue in proper perspective. The analysts have emphasized the fact that very few loans had ever been written off (only about $416,000, equivalent to 0.3% of all loans made over 20 years of BNF operations). BNF records indicate, however, that an additional amount of about $800,000 has been written off during 1972, thus providing some indication of new efforts to deal with the delinquency problem. However, still to be dealt with is the need to increase reserves for bad debts, to improve collection efforts on past-due loans, and to continue classifying and disposing of uncollectable loans.

The most significant conclusion of the ROCAP analysts was that if appropriate legal procedures were taken and accounting modifications made, the resulting "cleaned-up" portfolio would show bad debts, already written off, of about 3 to 5% of all loans made during the past 20 years (as opposed to .8% currently) and delinquencies of 9 - 11% of the current portfolio (the current figure being about 35%). These levels were judged to be reasonable by normal development banking standards: The calculations of the analysts were based upon reasonable assumptions made on the disposition of various categories of loans now included within the general "delinquent" classification, as well as review of certain larger individual cases.

Nevertheless, until steps are taken to resolve this situation, the current delinquency statistics will remain relatively unchanged. The BNF is now making a renewed effort to deal with this problem through one of the special working groups evaluating all phases of BNF operations. The AID grant-funded technician assigned to the BNF's Credit Department is also involved in this process and is now concentrating his efforts on improvement of the delinquency situation.

In addition, the BNF has agreed, in negotiations with the IDB on a proposed $9.2 agricultural credit loan, to carry out a portfolio improvement plan which should lead to reduction of delinquencies to the 10% level by December 31, 1976. The USAID believes that this is a reasonable approach towards solving this problem and will support this effort through the on-going technical assistance in connection with the agricultural credit program funded under Loan 018. Since the proposed AID loan does not involve the credit program and a reasonable attempt is now being made to resolve the delinquency problem, the USAID is not recommending any further technical assistance or covenants addressed to this recognized problem area.

(in thousands of dollars)

	1967	1968	1969	1970
Cotton	$ 3,838.5	1,945.4	1,239.2	1,364.2
Coffee	1,788.7	1,917.6	2,508.5*	2,652.4*
Tobacco	1,225.7	502.8	517.6	417.6

* Not all of these coffee loans were for production; about $500,000 of short-term export financing is included each year.

(viii) Section 4.13-B (7):

Sale by BNF of its stock in the Sula Milk Plant.

On September 1, 1972, the BNF sold 49% of its stock in the plant to the members of the Sula Valley Farmers' and Cattlemen's Association, and a new corporation was established. The BNF intends to sell additional stock in the near future in order to reduce its ownership to a minority position.

Based on the above results and the Mission's knowledge of BNF operations, the BNF's performance in implementing this project has been satisfactory.

3. Intensive Review and Recommendations of the Country Team

Following an exchange of cables between the Mission and AID/W to determine how Washington would view a proposal for this loan, the Mission prepared a paper which proposed that these funds be made available as an increase to A.I.D. Loan 522-L-018. This paper was submitted to AID/W on May 19, 1972, and was reviewed by the LA/CAEC on May 30. The paper was approved as an IRR. Please see Annex I, Exhibit 2 for a text of the cable which set forth the points upon which the Mission was to concentrate in its intensive review.

The Intensive Review took place during July, August and September, 1972. Negotiations were held with the BNF in order to determine whether or not the funds needed for this program could be generated internally. Meetings were also held with the Central Bank on the same subject. In addition, the Mission analyzed in depth the GOH basic grain pricing policy. Two USDA/PASA consultants visited Honduras during October to assess the BNF's grain marketing program and to help draft this Capital Assistance Paper. This paper reflects their recommendations.

The proposed loan differs from what was set forth in the IRR in the following respects:

a) A comprehensive technical assistance and training program to help improve the BNF's grain marketing program is to be loan-funded ($100,000).

b) The Mission is recommending that these funds be made available as a new loan rather than as an increase to Loan 522-L-018.

c) No funds for the cooperative grain marketing program are being requested.

d) The counterpart contribution to the project has been increased to where over 50% of the total project costs are coming from internal sources.

The Country Team recommends approval of this project for loan financing, and that the loan be authorized under the terms and conditions listed in the Summary.

4. <u>Opinions of Other Institutions</u>:

Please refer to Section II-D-4 below for details on comments by other international lending agencies regarding this project. On the basis of these comments and negotiations which the Mission had concerning possible internal sources of fund, the Mission concluded that no other Free World financing is available for this project at this time.

C. Program Justification:

1. Place of Project in the Country Program:

As agreed upon in the Central American program review for FY73-74 and as the focal point of a regional strategy, the A.I.D. Mission has given first priority to efforts to develop the agricultural sector, with emphasis on projects that will have an effect on small farmers. This loan has been developed in conjunction with these regional programming efforts.

. Because this project will enable the BNF to improve one of its programs dealing with small and medium income farmers by increasing production incentives to the small producer of basic grains, this project directly supports this strategy. The Mission views this loan as the first in a series of loans which will relate to the GOH's agricultural sector analysis. The first exploratory runs of the preliminary linear programming model used in the analysis indicate that marketing of agricultural products constitutes an important part of the major bottleneck to increased efficiency in the use of available resources. This project will respond directly to this.

The BNF, as the single most important agricultural credit and storage institution operating in Honduras, must perform a key role in any agricultural sector development program. The BNF will, with this assistance, be able to further strengthen its operations, improve its reputation, and become a more efficient institution better able to serve Honduras in the many areas of development banking.

2. Project Contribution to Honduran Economic Development:

(Note: Much of the data and analysis presented in this section relate to the discussion of "Alternative Sources of Financing" contained below in Section II-D-4).

a. Budgetary Position

The GOH budgetary position is basically weak, with tax revenues being about 11% of GNP. Although some tax measures have been implemented since Honduras withdrew from the free trade aspects of the CACM and reestablished duties on goods from the region through Decree 97 issued on December 30, 1970, natural growth has accounted for almost all increases in revenue since 1970.

While real total expenditures during the 1961-71 period have grown at a compound rate of 8%, real capital expenditures grew at 12% per year. The following table shows the progress in current account savings and investment in the 1969-71 period and the sharp reversal in 1972. Revenues have been lower than projected in 1972, causing cuts in planned expenditures, mainly on investment. As a result, investment will be a smaller percentage of total expenditures in 1972.

FISCAL OPERATIONS OF CENTRAL GOVERNMENT: 1969-72
(Millions of Lempiras)

	1969	1970	1971	1972(est.)
Current Revenues	155.5	177.4	180.1	190.0
Current Expenditures	146.5	155.6	155.8	171.2
Current Account Savings	9.0	21.8	24.3	18.8
Investment	56.1	66.5	69.0	60.9
Deficit	47.1	44.7	44.7	42.1
Internal Financing	25.8	17.1	13.8	9.9
External Financing	21.3	27.6	30.9	32.2
Investment as % of Expenditures	27.7	29.9	30.7	26.2

(2 Lempiras= 1 US Dollar)

The GOH has borrowed from the Central Bank at a faster rate than in previous years although official statements say that the total projected for the year will not be exceeded. There is, however, a likelihood that it will. In addition to making some budget cuts, efforts to avoid even more serious realignments in expenditures have included slowing down payments and requesting the banana companies to make advance payments of 1973 income taxes.

These measures, of course, provide some relief and may enable the Government to get by this year, but at the expense of 1973 operations. A major tax increase package, currently pending for submission to Congress, seems to be the only way the GOH can put its finances on a stronger footing. Considerable opposition can be expected to any such package, the counterproposal always being that the Government should make more efficient use of presently available resources.

b. Balance of Payments:

Decree 97 was issued in partial response to a rapidly growing trade deficit with other members of the CACM. The disequilibrium, which came after a good overall performance in the mid-1960s, was seriously threatening international reserves built up through trade with non-CACM countries and capital inflows. Since the imposition of Decree 97 and complementary measures, the total value of imports has decreased and exports have increased although trade with the CACM has decreased sharply. A good part of the increase in exports is due to recuperation of banana exports after Hurricane Francelia in 1969, to further investments in banana production and to increasing lumber and meat exports. Major decreases in imports since 1970 have been in food, edible oils and manufactured goods. The following table gives a brief description of balance of payments performance from 1968 to 1972:

HONDURAS BALANCE OF PAYMENTS: 1968-72
(Millions of Dollars)

	1968	1969	1970	1971 3/	1972 4/
Goods and Services					
Exports 1/	204.8	196.8	205.0	223.7	218.6
Imports 2/	-229.4	-227.5	-269.2	-245.7	-258.1
Balance of Trade	- 24.6	- 30.7	- 64.0	- 22.0	- 39.5
Capital Movements	36.7	27.4	50.0	27.6	36.9
Private Sector	27.8	10.0	17.3	5.1	13.9
Public Sector	8.9	17.4	29.5	19.9	19.9
SDR Allocation	--	--	3.2	2.6	3.1
Net Change in Reserves					
Reserves	+ 12.1	- 3.3	- 14.0	+ 5.6	- 2.5

1/ Includes Exports, service receipts and net transfer receipts.
2/ Includes Imports and service payments.
3/ Preliminary
4/ Estimate

The future of the CACM is cloudy, as are the roles of Honduras and, most recently, of Costa Rica in that market. The key to the future of the CACM lies in finding a way to restructure the Market to distribute gains more equitably among trading partners. Pending restructuring of the CACM and resolution of outstanding problems with El Salvador, Honduras has entered into a bilateral trading arrangement with Nicaragua and expects to have similar arrangements with Guatemala and Costa Rica in the future. A complete analysis of the CACM implications of this proposed loan is contained below in Section II-B.

c. GNP

During the 1960-71 period, growth of GNP at current prices in Honduras (4.3%) was the lowest in Central America, as was per capital current GNP (0.9%). The most recent revision of GNP data shows that growth in 1971 was 6.1% in current terms and 6.4% in real terms; on a per capita basis, it was 2.7% and 2.8%, respectively.

As shown in the following table, agriculture accounts for about one third of GNP, which in turn is divided between bananas (one-third) and other activities (two-thirds). At the same time, the rural population is about 70% of total population, and only a small proportion of the rural population with comparatively high wages is engaged in banana production. As a result, the overall per capita GNP figure of $259 masks the much-lower per capita rural output ($131) and the even lower non-banana per capita rural output ($100) which goes to the remaining vast majority of farmers. These data dramatically show the position of the average campesino in Honduras. In addition, it is clear that his welfare, measured in terms of per capita output, has improved very little, if at all, over recent years:

HONDURAS: GROSS NATIONAL-PRODUCT: 1968-71
(Millions of Dollars)

	1969	1970	1971
Current GNP	648.4	680.2	721.9
Agriculture 1/	(216.0)	(225.9)	(239.2)
Excluding bananas	(154.0)	(160.9)	(158.9)
Constant GNP 2/	626.4	649.6	691.3
Agriculture 1/	(215.4)	(224.0)	(244.9) 3/
Excluding bananas	(156.6)	(163.5)	(172.2)
Population (thousands)	2,495	2,582	2,672
Rural population (thousands)	1,772	1,818	1,865
Excluding banana workers	1,622	1,668	1,715
Current GNP per Capita	260	263	270
Rural	122	124	128
Excluding bananas	95	96	93
Real GNP Per Capita	251	252	259
Rural	122	123	131
Excluding bananas	94	98	100

Source: Based on Central Bank Data.

1/ Agriculture's participation in GDP at factor cost. Includes agriculture, forestry, livestock, hunting and fishing.
2/ Based on index 1966 = 100.
3/ Increase due mainly to jumps in physical production of bananas when valued at 1966 prices, which were higher than 1971 prices; real agricultural contribution to GDP is higher than nominal (current) contribution.

d. Monetary and Credit Policy

Monetary policy has traditionally been quite conservative in Honduras, being based on maintenance of exchange rate stability. Such a policy is not unreasonable in light of the strong tendency in Honduras for excess liquidity to show up as increased imports, leading to a loss of international reserves. Up to 1968, the Central Bank actually absorbed Central Government funds in excess of the credit it extended to the Central Government. The year 1969 marked the first reversal of the Central Bank's position, switching from a net debtor of L. 10.7 million in 1968 to a net creditor of L. 5.0 million in 1969. This grew rapidly in 1970 and 1971 so that net Central Bank credit to the Central Government was L. 26.1 million and L. 42.3 million, respectively, at year end. The Central Bank has also been a traditional source of funds for the BNF, net credits being in the area of from L. 9.0 million to L. 12.0 million per year since 1966. In addition, starting with 1970, the Central Bank has been a net creditor to the rest of the public sector (L. 2.8 million in 1970 and L. 7.5 million in 1971).

The above changes are the result of the more active role the Central Bank has been playing in the Honduran financial community. It does not signify that the Central Bank has replaced the goal of exchange rate stability with that of economic expansion, but only that it is willing to work with a lower international reserve position. This change was partially in response to special financing problems engendered by the 1969 conflict but also to a changed concept on the part of the Central Bank of its role in development on a continuing basis. Whereas in the past the Board of Directors was content to let the Central Bank play a passive role, there is now a growing awareness that it can be a much more positive force on the Honduran financial scene. The accompanying table shows the changes in Central Bank accounts over the period 1966-1971.

CENTRAL BANK ACCOUNTS
(Millions of Lempiras)

		1966	1967	1968	1969	1970	1971
I.	Net International Reserves	46.9	49.6	61.5	57.3	39.9	43.7
II.	Domestic Assets	23.7	28.0	23.0	45.0	79.6	89.5
	a) Government (Net)	4.1	6.8	-4.9	12.7	39.3	61.4
	Central Government	-3.1	-1.6	-10.7	5.0	26.1	42.3
	BNF	9.3	9.8	7.6	12.3	10.4	11.6
	Rest of Public Sector	-2.1	-1.4	-1.8	-4.6	2.8	7.5
	b) Banks	6.3	5.1	11.3	18.8	24.7	20.2
	c) Other (Net)	13.3	16.9	16.6	13.5	15.6	7.9
III.	Liabilities	70.6	77.6	84.5	102.3	119.5	133.2
	a) Allocation of SDR's	--	--	--	--	6.4	11.7
	b) Foreign liabilities	0.9	0.9	1.0	1.0	0.8	0.4
	c) Banks	16.9	22.0	23.1	27.4	35.8	41.2
	d) Private Sector	52.8	54.7	60.4	73.9	76.5	79.9
	1. Currency	52.1	53.8	59.6	71.7	75.1	78.4
	2. Sight Deposits	0.1	0.5	0.3	0.4	0.2	0.5
	3. Time & Svgs. Deposits	0.6	0.4	0.5	1.8	1.2	1.0

Source: Central Bank statistics at the end of each year (regrouped by the Mission). (2 Lempiras= 1 US Dollar)

Realizing that it cannot meet all requests for funds and still maintain international reserves and therefore exchange rate stability, the Central Bank prepares a program at the beginning of every year outlining the monetary policy it plans to follow. The total credit it makes available depends in large part on its estimate of the capacity of the economy to absorb resources without provoking large losses of international reserves or threatening price stability.

The plan for 1972 is based on the following propositions:

a) a programmed loss in international reserves of L. 10 million;
b) an increase in resources of the banking system of L. 32.5 million;
c) GNP growth of 5%; and
d) import growth of 7.8%.

The monetary program is essentially a compromise between factors which would call for limiting monetary expansion and stimulating adequate GNP growth. The proposed program, based on the above considerations, called for L. 34.9 million of net new credit to the private sector and L. 15.3 million of net new credit to the public sector (including L. 5 million under a recently-formed Agropecuarial and Industrial Development Fund). Of these amounts, the Central Bank would provide L. 2.1 million in net credit to the banking system and L. 16.2 million to the public sector. The rest of the banking system would receive L. 0.9 million from the public sector (mainly through the operations of the Agropecuarial and Industrial Development Fund). As is evident above and in the discussion of the Balance of Payments, major deviations from this plan of operations could have disastrous results on growth, the balance of payments or prices.

The 1972 program for Central Bank internal credit operations with the public sector and the banking system has been assigned quarterly targets based on expected seasonal requirements. As of the end of September, the actual results in millions of Lempiras were as follows:

Credit to:	Planned	Realized	Difference
Public Sector	53.7	62.6	+8.9
Banking System	35.6	36.3	+0.7
Total	89.3	98.9	+9.6

Within the banking system, the BNF has received L. 11.3 million of the Central Bank's regular resources, plus L. 1.0 million of the funds of the Agropecuarial and Industrial Development Fund for the basic grains program. This total of L. 12.3 million is some L. 0.6 million less than projected, partially due to a drop in the BNF Credit Department's discountable paper but also to a general tightness in credit. Other commercial banks, on the other hand, experienced an increase in credit at the end of September some L. 1.3 million more than projected. This can be traced to a special L. 1.0 million credit the Central Bank made to a commercial bank for extraordinary reasons and to higher than expected drawings of counterpart funds in connection with the Central Bank - administered IBRD Livestock Development loan. In general, the commercial banks are facing a tight credit period. The reason for this and for the radical departure from the monetary program established for the year is the same: the strong pressure from the Central Government on the Central Bank to help deal with liquidity pressures arising from serious short-falls in revenues from projected levels.

The Bank was forced to raise legal reserve requirements by 12% (from 25% to 28%) as a special measure to heed these demands and still meet the basic objectives of monetary policy for the planning period. Another remedial step necessary was a freezing of Central Bank credits to the banking system.

Commercial banks will not be allowed to increase their use of Central Bank credits during the rest of the year. Payment of the L. 1.0 million liquidity advance will lower their total drawings while other Central Bank sources will remain frozen at their September levels.

3. Impact of Proposed Project on Honduran Economy

In general terms this project will make a significant contribution to stimulating the production and efficient marketing of basic grains in Honduras and in establishing an effective system of stabilized prices more closely related to world prices for basic grains. The project will also have more directly measurable effects on economic variables: GNP growth will be increased, additional exports will increase current account earnings, and domestic prices to the consumers of basic grains will decrease in the long run with seasonal fluctuations minimized.

4. Impact on US Economy:

Because this project is involved with the production and marketing of basic grains produced in Honduras, of which practically none are exported to the USA, and because Honduras now does not nor will in the future import these grains from the USA, this project will have little or no effect on the US economy. As far as Honduran grains competing with US grains in the world market, indications are that Honduras will be able to export more corn to certain countries, particularly those in Central America and the Caribbean. However, the volume is not large and most Honduran corn is of the white variety while most of the corn exported from the USA is yellow. The two types do not compete with each other to a great extent. In regards to beans, Honduran black and red beans are also different from US varieties.

5. Building of Democratic Institutions:

The Banco Nacional de Fomento, which was founded in 1950, has just recently been able to begin operating in enough areas and with enough volume to have a significant effect on development efforts in Honduras. Both A.I.D. and the IDB have made large loans to the BNF in the past and the BNF will continue to receive foreign assistance over the next several years. The GOH has made a very substantial contribution towards BNF capitalization as well. This continuing support of the Bank by the international agencies and the role which the GOH sees for it reflect the importance of the BNF to the Honduran development process.

6. Consistency with the CIAP Reviews:

The last CIAP subcommittee meeting on Honduras was held in May of 1970. At that meeting, one of the recommendations was that Honduras continue actions destined to promote productive sectors of the economy, especially export expansion and diversification. This project responds to this recommendation in that it will promote agricultural production by improving the incentive to farmers to increase production, and will expand the potential for increased grain exports.

7. Certification of the USAID Mission Director:

The USAID Mission Director certified on November 6, 1972 as to the satisfactory performance by the BNF with respect to previous A.I.D. loans and to the BNF's capabilities to implement this proposed loan. Annex I, Exhibit I contains a copy of this certification.

SECTION II. Project Analysis

A. Borrower

1. Principal and Participating Entities:

The Borrower will be the Banco Nacional de Fomento (National Development Bank), an autonomous agency of the Government of Honduras having the prime responsibility for development banking activities in Honduras, particularly in agriculture. The BNF was formed in 1950 as an autonomous agency of the Government, with a Board of Directors made up of representatives of the Government and the private sector (see Annex II, Exhibit 1). The Bank's President, appointed by the President of Honduras, takes an active role in bank operations and also functions as General Manager. Under him are two separate departments, the Development Department and the Credit and Operations Department, each of which is responsible for an extensive list of activities and is in turn headed by a Manager. The Grains Division falls under the Development Department.

This loan will be guaranteed by the Government of Honduras, acting through the Ministry of Finance and Public Credit. The Minister of Finance will cosign the Loan Agreement, and the loan will subsequently be ratified prior to first disbursement.

2. Organization and Management:

The BNF, as a government agency with vast responsibilities, many branch offices, and a shortage of trained personnel, has in the past been involved in more activities than it could effectively manage and thus has been affected by many of the problems common to similar banks in other Latin American countries. However there has been a steady trend of improvement in its administrative capabilities during recent years, particularly within the last five years. The bank has been able to attract and hold an increasing number of qualified professionals at high levels, both in managerial and technical positions. The USAID considers the BNF one of the most efficient GOH agencies and the best operating in the agricultural sector. A.I.D. enjoys close working relationships with the bank.

Following the elections in June, 1971, the President of Honduras appointed a new President of the BNF. The new President had worked in the bank several years ago in the Industrial Division, and was one of the private sector representatives on the BNF Board prior to his appointment. With experience including organization of his own industrial development and promotion firm, he had an understanding of BNF problems from both internal and external viewpoints. His appointment was not accompanied by a political "house-cleaning" of personnel and key capable department managers stayed in their jobs. (Please refer to Annex II, Exhibit 3 for biographical data on key BNF personnel involved with this project.) Since his appointment, there has been a visible improvement in attitude of BNF personnel and renewed enthusiasm of the key men who previously had little authority or participation in BNF decision-making.

A significant step which the new President took was to form a series of working groups (12 in total) to diagnose the current problems of all departments and programs of the BNF and to come up with "white papers" containing suggestions for improvements. These groups are formed of bank employees and the BNF President has encouraged each group to conduct interviews among public and private sector organizations that have dealings with the Bank in order to obtain objective opinions. Each group is now preparing its report, and most will be ready by the end of this year. The work of the group concentrating on the grains program is closely related to the analysis carried out by A.I.D. and BNF representatives of the grains division during this intensive review period.

B. Economic Evaluation

1. Setting

Honduras is considered the poorest country in Central America, in terms of both natural and human resources. Nevertheless, the potential for long-term growth exists in Honduras despite serious bottlenecks at present to efficient resource utilization, especially in agriculture.

Land resource utilization is extremely skewed, as the smallest 82% of farms occupy only 23% of farm area, the middle 15% of farms occupy 29% of farm area, and the largest 3% of farms occupy 48% of farm area. While the extent of legitimacy of claims to farm lands is only now beginning to be explored (through the pilot cadaster project on the south coast), it is generally believed that many farms of all sizes are operated without legitimate claims to title.

A high proportion of good agricultural land is not under cultivation at present, whereas some marginal land is intensively worked. Production techniques are relatively primitive, as evidenced to a certain degree by the following data on yields and nutrients used in basic grains production:

CROP YIELDS & NUTRIENTS:
1961-65 and 1968-70

	Honduras		Highest c/		Lowest d/	
	61-65	68-70	61-65	68-70	61-65	68-70
Yields a/						
Corn	0.79	0.94	1.08	1.31	0.86	0.86
Beans	0.44	0.48	0.57	0.78	0.38	0.47
Rice	1.65	1.74	2.34	2.93	1.09	1.29
Plant Nutrients b/						
Nitrogen (N)	8	12	33	50	6	11
Phosphorous (P_2O_5)	1	3	11	23	3	7
Potassium (K_2O)	-	7	11	11	2	2

a/ metric tons/hectare
b/ Kgs./hectare
c/ El Salvador
d/ Yields: Nicaragua
Nutrients: Guatemala

Partially as a result of these factors, the income distribution is also highly skewed. In rural areas, 45% of families earn less than $250 per year, and an additional 26% earn from $250 to $500 per year.

The campesino is a low level producer. He is also a low level consumer. Both aspects of this position constitute limits to spreading the benefits of economic growth over the entire population. This was brought out strongly in AID's FY1974 Development Assistance Program for Central America, and is a major element in designing the Honduran strategy for agricultural sector programs. The object of these programs is the rural man -- more specifically, the small farmer, the corn and beans farmer. (An estimated 80 to 90% of all small farmers produce corn, and an estimated 30 to 35% produce beans). In this specific activity, the urban consumer is also directly benefited. The net impact, then, is to be on the small man, both urban and rural.

The present system of basic grain production and marketing is very fragmented. The great bulk of corn and bean production comes from small farms (up to 10 hectares -- 25 acres). At the same time, however, most small farmers retain a large portion of their production for on-farm consumption and for use as seed and feed. Medium and large farmers sell a relatively larger amount of production. When possible, small farmers withhold a small portion of their crop as a form of temporary savings, to be sold after the harvest season when prices traditionally are higher. In general, the portion of total production that enters the marketing system is negatively influenced by the geographic isolation of the producer and positively influenced by the amount of production credit used.

Before the BNF became active in purchasing grains or in providing small farmer agricultural credit, virtually all small farmer credit came from middleman ("coyotes") buying at low, harvest-season prices. Given the sometimes inflated prices charged for inputs, the high interest rate on cash advances, and the low price paid for outputs, small farmers were charged an effective interest rate of about 40% per year. In addition, weights and qualities of inputs and production were often misrepresented, to the further loss of the farmer.

This system is still strong in Honduras, and is not limited to the more remote rural areas. The reason for its continuance is that it has been the only source of small farmer credit in many areas of the country and has provided other basic services needed by the campesino. Middlemen combined small lots of grain into larger ones and provided inputs on an individual farm basis;; their operations also reduced the marketing risks small farmers otherwise faced.

For the first nineteen years of BNF grain operations, beginning with the construction of a series of rural warehouses in 1952, the overall BNF program was inefficient and ineffective in competing with the coyote system. During this period it made no direct contribution to stabilizing producer prices or wholesale/retail prices in the marketplace.

2. Effects on Producers and Middlemen:

An estimated 75% of basic grain production comes from small farmers. With knowledge of a guaranteed minimum price advertised before planting, and assuming that the BNF has sufficient resources to maintain its schedule of minimum prices, the individual farmer would have an increased incentive to grow and sell more basic grains. This would affect medium and large producers relatively more than small producers, simply because they have more resources to take immediate advantage of changed conditions. Nevertheless, the bulk of the potential benefits eventually will accrue to small farmers due to their preeminent position as producers of basic grains. The fact that BNF buying prices are now well publicized means that the campesino knows the minimum market price which the middleman will get upon selling to the BNF. This will have (and already has had) the effect of forcing the middleman to raise his buying price in the field. Since this increase would be in effect for all sales and not just additional (induced) production, the overall benefit is very large.

A hypothetical example dramatizes the potential this program could have if it were well managed and adequately financed. Assume that total production before the introduction of the new program is 400 units, 300 (or 75%) from small producers and 100 (or 25%) from medium and large producers. Small farmers sell about 40% (120 units) and retain 60% (180 units) of production.

Medium and large producers sell 80% (80 units) and retain 20% (20 units). Total sales are thus 200 units, as are retentions. Prices received by small producers are 3 per unit, and 4 per unit by other producers. Small producers are more often geographically isolated and more likely to produce lower quality grains.

This is the situation before the grain storage and price stabilization program is put into effect. Assume that at this point the BNF announces its intentions to buy all grain offered to it, provided the grain meets certain quality standards, at fixed prices averaging 4.5 per unit. Assume then that because of the wide publicity accorded the announcement, the campesinos know they are in a position to bargain up the prices they receive from 3 per unit to 4 per unit, an increase of 33%. Other producers figure they will receive 4.5 per unit instead of 4.0 per unit, an increase of 13%. Because the BNF pays more for higher quality grains, all producers have an incentive to upgrade the quality of the grains they produce as well as to expand production. Small farmers respond to the 33% jump in price by increasing plantings and eventually harvesting 10% more crop (up to 330 units), retaining 10 units of the increase and marketing 20 units. Other farmers, being in a better financial and technical position, respond to their 13% price rise by increasing production 20% (to 120 units), all of the increase being marketed. Total production has increased from 400 units to 450 units, and marketed grain from 200 units to 240.

The small farmers' cash incomes go up 200 from 360 (120 units sold at 3 per unit) to 560 (140 units sold at 4 per unit); other farmers' incomes increase 130 from 320 (80 units at 4.0 each) to 450 (100 units at 4.5 each). The total increase in incomes is 330, about 60% of which goes to small farmers. The following table summarizes this example:

POTENTIAL OUTPUT AND INCOME EFFECTS OF A GRAIN PURCHASE PROGRAM

A. Before Program

Farm Size	Production	Sales	Retention	Prices	Cash Income
Small	300	120	180	3.0	360
Others	100	80	20	4.0	320
Total	400	200	200		680

B. With Program

Farm Size	Production	Sales	Retention	Prices	Cash Income
Small	330	140	190	4.0	560
Others	120	100	20	4.5	450
Total	450	240	210		1010

C. Net Change

Farm Size	Production	Sales	Retention	Prices	Cash Income
Small	+30	+20	+10	+1.0	200
Others	+20	+20	0	+0.5	130
Total	+50	+40	+10		330

The above table is realistic in its essential aspects. One of the most important assumptions made above relates to the price elasticity of supply. To the Mission's knowledge, no study of this factor has been made in Honduras, but studies for other countries indicate that unless institutional constraints unduly limit small farmer responsiveness, the assumptions used above are valid.

There are many other factors that limit how well small farmers can be accomodated directly by the program in the short run, and this will probably mean that middlemen in many parts of the country will continue in their present role. With the improvement of the programs and particularly of the BNF's rural buying station network, and increased publicizing of prices, these middlemen will become more and more oriented towards providing transportation services exclusively. This has already begun to take place in the San Pedro Sula area where there are indications that profit margins for these dealers are being reduced significantly.

There will be further effects on basic grain producers resulting from this program. In addition to cash income going up dramatically, income in kind will also increase. As production expands per unit costs of production should decrease. This is very important because, assuming buying prices now reflect production costs, it will enable a lowering of minimum buying prices and permit lower prices for internal consumer sales. It would also mean Honduras could become more competitive in world markets.

3. Effects on Basic Grains Consumers:

There are two groups of basic grains consumers -- urban and rural, or more precisely, purchasers and producers, and a basic grains program must consider the needs of both. Producer-consumers have a decision facing them unlike that facing purchaser-consumers. Their major decision is made at harvest time. After that their consumption of basic grains is virtually unaffected by grain price movements throughout the year.

Purchaser-consumers, however, typically buy in small quantities throughout the year and thus are vulnerable to market price fluctuations. Such fluctuations have been significant in the past, as shown in Annex II, Exhibit 5. It is generally recognized that the worst of these price changes were the result of massive exports, due to lack of domestic storage capacity, leading to internal shortages and then re-imports were made at higher prices. These speculative profits were made (above and beyond the value of storage services) to the detriment of the balance of payments.

These purchaser-consumers which constitute about 45%* of the population of Honduras include urban residents and the portion of the rural population which does not produce basic grains. Because of their low incomes and their need to buy throughout the year regardless of price, a doubling in the consumer price of basic grains, which form the major portion of their diet, is a serious hardship. At present

* This is calculated as the sum of 30% of the population that is urban, plus 15% of the population which is rural and does not grow basic grains.

perhaps 40% of average personal income is spent on food, although this percentage varies inversely with income and in many cases may exceed 50%.

About a third of the average food budget goes for basic grains, that is, about one seventh of total consumption expenditures. Therefore, a drop of 15% in the average retail price of basic grains would raise real incomes by 2% for the population as a whole, and over 4% for purchaser-consumers, with the lower-income groups experiencing an even large absolute benefit. The stabilization program, then, has a potential to significantly increase the welfare of the small man in Honduras.

4. Macroeconomic Effects:

a. Expanded Availability of Basic Grains:

One of the effects of this program is expected to be the stimulus it gives to increase production and improve the quality of basic grains available for sale.

As Honduras produces more basic grains and as a larger proportion of these are channeled through BNF facilities, spoilage should be greatly reduced. This will be an additional contribution to increasing the supply of basic grains both for internal consumption and export.

b. Lower Basic Grain Prices:

As production expands, unit production costs will drop, increasing the competitiveness of Honduran grains. At present, accurate cost-of-production data are not available, and probably will not be until sometime in 1974 upon completion of a regional cost study. Even though the magnitude of any reductions is impossible to predict without these data, the direction clearly will be downward. At present, Honduran prices for basic grains are generally competitive within the CACM. This is evident in the volume of export sales Honduras is making:

1972: EXPORTS AND EXPORT CONTRACTS SIGNED
(In hundredweight)

Item	Importer	Quantity
White corn	Nicaragua	195,000
Red beans	Chile	44,000
	Nicaragua	61,000
	Guatemala	5,000
Black beans	Venezuela	25,000
	1972 Possible Exports*	
Yellow corn	Costa Rica	10,000
White corn	Costa Rica	30,000
Black beans	Colombia	22,000
	1973 Possible Exports*	
White corn	Nicaragua	150,000
Red beans	Nicaragua	25,000
	Chile	42,000
	Guatemala	15,000
Black beans	Venezuela	40,000
	Chile	42,000

*Under negotiation in October 1972.

There are two factors to be kept in mind when evaluating basic grains prices. First, prices in and of themselves say nothing about comparative advantage - they reflect only absolute advangage. Theoretically a country's prices for all of a class of products could be higher than those of all other trading partner countries, but it could still be the preferred source of those products. It depends on the amount of production each country obtains through trading relative to what it gives up. This difference is the basis of the theory of <u>comparative</u> advantage.

Second, posted prices do not say that exportable quantities are available. If such quantities are not available, the real export price in economic terms is infinity.

c. <u>Increased Exports to CACM:</u>

Prices received by the BNF for export sales are almost the same as those charged for internal sales, being somewhat higher for red beans and somewhat lower for corn. The BNF has received almost $2 million for its 1972 exports of basic grains, about 50% of total sales. (The beans exported to Chile were of substandard quality, and were sold at reduced prices.) Exports this year were unusually high; the percentage of total sales probably will drop in the future to about 40% as the level of BNF basic grain operations expands. The apparent reason for such high exports this year is that the drought which has affected the prime growing season in Central America has reduced availabilities of basic grains throughout the region. Since other countries seem to have been more affected by the drought than has Honduras, which normally has two and in certain areas three grain crops per year, Honduran grains were available and were priced competitively. There are sufficient supplies this year for internal consumption despite a lower level of production and high exports.

Nevertheless, speculative forces have pushed up wholesale prices of corn and beans in the second half of this year (see Annex II, Exhibit 5) apparently because speculators believe that the BNF will not have sufficient supplies to keep prices stable later in the year -- or that it will not be willing to use these supplies to do so. This is an interesting example of the lingering effects of past BNF failures to effectively stabilize prices. The difference this year will be that with this loan the BNF will have sufficient effective storage capacity to be a strong factor in the marketplace.

A projected cashflow statement for the grains program is shown in Annex II, Exhibit 11 and will be discussed below in detail. The statement makes no specific assumptions about the share of exports in total BNF sales of basic grains. Since one of the objectives of the proposed loan is to increase the comparative advantage Honduras has in basic grain production, the Mission wanted to know if in fact there were sufficient quantities of basic grains available for export. The Mission therefore made a projection for the 1972-1984 period, assuming moderate rates of growth of production and internal consumption. Projections were made for corn and beans, but not rice since there are no prospects for significant rice exports in the near future. While the projections cannot specify the quantities of beans and corn that would be exported, they do indicate what quantities are needed for basic consumption on and off the farm. The remainder would be available for other uses, including use as inputs to higher value added agro-industrial production. For example, corn could be exported after further industrial processing as corn starch or corn meal and can be used as feed to support expanded beef, pork and poultry production.

The projections (see basic tables in Annex II, Exhibits 12 and 13) make the following assumptions:

(1) "Basic" production of corn is now 340,000 metric tons, or 7,480,000 cwt, and will increase at 3.6% per year;

(2) "Basic" production of beans is now 52,000 metric tons, or 1,144,000 cwt, and will increase at 5.5% per year;

(3) Corn buying prices will be dropped from $3.25 to $3.00 in 1975. This will be lower than the present CIF-Honduras price for yellow corn of $3.10 (no comparable data on white corn). Bean buying prices are assumed to remain stationary;

(4) The markup will drop gradually from 20% in 1973 to 11% in 1984, as shown in the projected cash flow statement;

(5) Internal uses of corn currently account for 325,000 metric tons, or 7.15 million cwt, at present;

(6) Internal uses of beans currently account for 47,400 metric tons, or 1.04 million cwt, at present;

(7) "On farm uses" is defined as production minus marketed quantities; and

(8) "Other uses" is defined for the base year (1972) as marketed quantities less exports. Thereafter, "other uses" is assumed to grow at 4.2% per year, the rate of urban population growth.

The basic result of these projections is that increasing quantities of corn and beans will be available for export, industrial uses, or even higher than projected consumption. Valued at BNF sales prices, these availabilities would be worth almost $9.2 million dollars in 1984, up from $2.0 million (actual exports) in 1972. Such availabilities are somewhat sensitive to the rate of growth used in projecting production. The rates used were taken from the guidelines for preparing the 1972-77 GOH five year plan and are considered quite conservative by the Mission. Barring unforeseen climate problems, therefore, total availabilities could well be higher.

On the basis of these projections, one can appreciate why Honduras is so interested, in terms of export markets alone, in the basic grains price stabilization program. While perhaps the above type of analysis was never formally conceived at the time, the recently concluded bilateral trading arrangement with Nicaragua did give basic grains the special status of not being subject to customs duties or quantitative restrictions (except when the two countries so agree), and of being fully coordinated with other Central American countries.

C. Technical Aspects of the Project

1. The GOH/BNF Grain Price Policy:

The GOH has placed with the BNF all responsibility for the initiation and operation of a basic grains production, storage and marketing program, and the BNF has been given a mandate to represent the GOH in meetings of the Central American Grain Marketing and Price Stabilization Coordinating Commission. BNF representatives on the Commission are among the most active. The BNF Board of Directors has responsibility for deciding on implementation of the policies resulting from these regional meetings.

Since the BNF prepared its original grain price stabilization plan three years ago when implementation of A.I.D. Loan 522-L-018 was initiated, the Bank has worked with the Honduran Government in establishing a price policy. In a letter dated November 1, 1972, the BNF set forth a brief historical analysis of grain production and marketing in Honduras and stated the policy. Annex II, Exhibit 4 contains a translation of the substance of the letter.

The Mission believes that the views of the basic grain situation in Honduras, the policy of increasing exports of corn and beans, and the goal of self-sufficiency in rice, all of which are expressed in the letter, are realistic. Honduras is anxious to move ahead with the regional production costs study since the BNF is confident it will show that Honduras does indeed have a significant advantage over the other countries in corn and bean production. Honduras clearly intends to lower its prices in the near future in order to become more competitive both within Central America and in other areas. The BNF strongly feels that the offers received from other countries to buy Honduran grains are evidence of the favorable prospects that exist.

In the second of two letters received from the President of Honduras in support of this loan application, the President reiterates the need for "........ a loan to the BNF in order to provide the funds necessary for the Grains Division to carry out its Basic Grains Minimum Price Stabilization Program, which assists both producers and consumers of these most important food items". He further states that "my government is most interested that this program become a reality as soon as possible which would be of great assistance to the high percentage of the Honduran population producing and consuming corn, rice, and beans...... It is my pleasure to inform you that I will give all support necessary in order that the agencies responsible for agricultural development in the country coordinate their efforts so that consumers can benefit from favorable prices for these important products in the coming years. We are in agreement with the policy which has been recommended by the price stabilization agencies in Central America, as discussed and defined at the last session of the Central American Grain Marketing and Price Stabilization Coordinating Commission, held in Guatemala, and in which one of the points on the agenda was the need to decrease the support prices beginning in 1973!........"

2. <u>USAID Analysis of the Policy:</u>

The A.I.D. Mission is in agreement with these policy statements and believes that they are realistic appraisals of the basic grains situation in Honduras. The importance of basic grains to the Honduran economy from both the standpoints of production and consumption cannot be overemphasized. Corn and beans are the two most important items in the diet of the average Honduran, and if meaningful progress is to be made towards development of the rural areas of Honduras and improvement in the lives of campesinos, these grains must play a significant role. Another factor is the comparative advantage which Honduras enjoys in the production of corn and beans in Central America, which can be exploited much more effectively both regionally and in other countries, to increase and diversify Honduran exports.

Until a coordinated price stabilization program can be developed throughout Central America that can prevent the occurrence of wide price differentials which in turn make speculative buying-selling operations a very profitable undertaking, restriction of exports and internal price stabilization combined with efforts to increase production and efficiency is clearly a reasonable policy. As free trade within Central America is gradually resumed and accurate production cost data is available, Honduras can begin to make adjunstments in prices and thereby fit into a regional stabilization program. Through SIECA, Honduras has informed the other Central American grain stabilization agencies of its application for this loan. The BNF, both verbally during the negotiations for this loan and in its letter of May 24, 1972, has also made known its willingness to modify its grains program and prices in the future in conjunction with renewal of free trade throughout Central America and the reestablishment of a regional price stabilization program. A covenant will be included in the Loan Agreement to the effect that Honduras will continue to coordinate its pricing policies with other Central American countries.

3. Operation of the BNF Program:

Annex II, Exhibit 6 contains a list of purchase prices for grains by geographical location of buying stations, discounts applied for moisture content and grade. Also shown are prices charged by the BNF for processing and storing grains owned by private parties. The USAID, with the assistance of USDA consultants, has studied the prices now paid by the BNF, and they appear to be within a reasonable range compared to historical averages. The same is true of the selling prices. If BNF prices can be made more available to the farmer and to the consumer in the marketplace, the peak high and depressed low prices of the past will be eliminated.

The initiation of the current program and a price publicity campaign have already had an influence throughout the production area. Intermediaries have been forced to make adjustments. The extent to which such desirable changes actually have taken place is not known, but will be evident in the near future as a result of further study of the program to be undertaken in connection with this project. The Mission believes that there are not sufficient statistics or accurate cost data available now to justify price changes. The same is true of the differentials and discounts used for grain moisture content, quality and transport costs, as well as the amounts charged by the BNF to private parties for drying, fumigation and storage rental. Annex II, Exhibit 11 is a projected cashflow statement for the program. The figures shown for 1972 are actual operating results and give an idea of the cost structure of the program. During 1972, the BNF should handle a total of about 330,000 metric tons of grains, approximately 70% corn, 20% beans, and 10% rice.

The two new central grain handling and storage facilities became operative in December, 1971. From the first 10 months' experience, it is apparent that these units will be used to complete capacity with an estimated yearly inventory turnover of 1.5 or more. The old facilities, having a total capacity of about 12,000 metric tons, must also be used to supplement the new facilities. USDA consultants have informed the Mission that the new facilities are ultra-modern in almost every respect. All equipment is working free of problems, and if properly operated and maintained, these terminals will continue to have the capability of conditioning and storing grain in top condition.

These consultants assisted the Mission in reviewing BNF operations in detail in connection wi h preparation of this Capital Assistance Paper. The result was a proposed comprehensive program both for improvements to the network of rural buying stations and storage facilities, as well as technical assistance in many aspects of grain storage and marketing management.

These points have been discussed at length by Mission personnel with BNF representatives, who have concurred in them and suggested methods in which they can be most effectively implemented. The BNF President has made a verbal commitment that the Bank will make the money available for those portions of the program to be financed by the BNF as a counterpart contribution (approximately $225,000 for technical assistance and improvement of the rural facilities).

Following are details of the recommended improvements which have been agreed to by the BNF and will be reflected by covenants in the Loan Agreement.

a) During the review of existing operations and inventories, grain of poor quality was identified. BNF-owned beans now in storage at the Comayagua buying station include beans of poor quality. Some corn stored in the old facility at San Pedro Sula was declared unfit for human consumption by a BNF representative. It is possible that there are other BNF inventories in similar condition.

Such grains will be sold and any losses documented prior to A.I.D. loan funds being put into the revolving fund. BNF will make a condition and quality assessment of all existing BNF grain inventories and will dispose of all low-quality grain at the best price available prior to any drawdown of A.I.D. loan funds.

b) The BNF presently has 12 rural buying stations. Two or three are being operated only sporadically because they are located in areas of a minimum amount of production. Others are in areas where production levels warrant operation and therefore are needed to bring the price stabilization program to producers.

In general,the buying stations are not operating at anywhere near the effectiveness that is needed principally because of antiquated grain cleaning and drying equipment. As a typical example, the Comayagua facility could be improved through the installation of three small holding bins with a capacity of approximately 500 bushels each. These could be constructed with local lumber. Two such bins would require aeration for maintaining the condition of the grain prior to cleaning and drying, and three small augers are needed to move the grain through the conditioning system. The conditioning system would include a small cleaner and a 250 or 500 bushel dryer. The new equipment and bins would be of a type that could be moved to other facilities in the future if necessary.

Certain other improvements are possible at some stations, such as modifying existing storage buildings, fumigation chambers, and steel silos. With a very minimal investment, significant improvements can be realized in a short time, especially if accompanied by improved use of the facilities through technical assistance. The Mission and the BNF have agreed that the BNF will receive the assistance of a qualified engineer who will help recommend the improvements needed to make the rural facilities more operative and effective in a short period of time. The BNF should move ahead as rapidly as possible in making these improvements. Grain now handled in these facilities is a source of significant financial losses to the BNF due to deterioration. As a result, the BNF has agreed to make such improvements, estimated to cost $200,000, with its own funds. This will also have the important effect of bringing the true market to the producer as well as a source of supply of high quality grains to the consumer.

4. Technical Assistance:

A substantial technical assistance and training program has been formulated by A.I.D. and the BNF for implementation in conjunction with this loan. Part will be financed under the loan, and part out of BNF counterpart funds.

The Mission's policy on this matter is to allow the BNF to take the lead in making the necessary arrangements. Through this involvement, some of the difficulties which hampered technical assistance work under Loan 018 can be avoided. The people involved will be closely related to the GOH's agricultural sector analysis. The BNF is a key institution in agricultural sector development efforts, and these technical assistance efforts will be coordinated and made compatible with the analysis so as to have a greater impact on sector development.

a) Evaluation of BNF Program and Feasibility Study for new rural grain facilities:

The BNF, prior to the initiation of the intensive review for this loan, was in the process of negotiating a contract for a study of improvement of the basic grains program with a local Honduran team of economists and engineers, to be headed by Lic. J. Mario Ponce and Ing. Julio Flores. Both Mr. Ponce and Mr. Flores are well-qualified to perform this study.

The scope of work, which has been negotiated with this group, is partially the outgrowth of a dialogue between the BNF and A.I.D. on what type of assistance is necessary. The scope of work for this study includes the following:

a) Determination of the principal marketing channels which are used to move grain to the principal consumption centers;

b) Determination of the price differentials between farms, wholesale and retail markets in order to determine the relative efficiency of the various channels used;

c) Recommendations to the BNF on improved operating procedures for the grain price stabilization program; and

d) Determination of where additional outlying BNF grain receiving stations and facilities should be located and what type of construction and equipment would be most appropriate for them.

This contract is to be signed in early November. The estimated cost is $25,000, financed with BNF funds.

(Note: The possibility of a technical assistance contract grant funded by A.I.D. with the Instituto Centroamericano de Investigación y Tecnología Industrial (ICAITI), had been discussed by the BNF and the Mission. ICAITI has attempted to find qualified personnel to take on this work, but thus far has been unable to propose candidates who were well-qualified. Negotiations are continuing.)

b) Other Technical Assistance and Training:

During the intensive review, certain other technical assistance needs were identified and discussed with BNF personnel. As a result, the Mission is recommending that $100,000 of loan funds be reserved for additional technical assistance and training of BNF personnel involved with the program as may be appropriate during loan implementation. The areas to be included are listed below:

i) Grain handling, conditioning and storage technician

This consultant must have the ability and knowledge of operations and management of a grain storage facility - including operation of equipment, minor repair work, drying techniques, etc. (especially for rice, corn, beans and sorghum). He also must have the ability to supervise insect control through the proper use of fumigants, grain protectants, and aeration and be able to recognize when reconditioning or corrective action is necessary to maintain grain quality. He should work with and help train the managers of the grain storage facilities throughout Honduras with special emphasis on training a counterpart who will be capable of supervising these activities at all BNF facilities in the future. Although he need not be a highly skilled grain quality laboratory technician he should be able to operate such equipment, to make acceptable quality determinations and to assist in the normal buying and selling activity at the various facilities. This consultant should be available for an initial period of at least 90 days and should return for follow-up visits at various intervals over at least a two-year period in order to cover problems that arise from holding grain in storage for an extended period of time.

ii) Redesign Engineer:

This technician will assist the BNF in assessing the older rural facilities and make recommendations on modifications and investments needed to improve them in the short run. The initial survey should include size of holding bins, define aeration system needs, type and capacity of cleaners, grain auger conveying needs and the type and capacity of dryers. He also will work with the local consulting firm in preparing its study of the new buying stations. The Mission has already identified several possible candidates for this position, and it is estimated that this work will take from six months to one year.

iii) Grain marketing expert:

The US Department of Agriculture, through a PASA arrangement with AID/ROCAP, is assisting the Mission in identifying a highly-qualified expert in grain marketing with experience in export markets and price fluctuations for short-term assistance. He may also work along with the local Honduran firm referred to above. An initial 60-day visit, with follow-up visits, is contemplated.

iv) Improvement of accounting and budgeting systems of the BNF Grains Division:

For some time, the Mission has been discussing with the BNF the need to overhaul its accounting and budgeting system. Although computerization of the accounting system has recently been initiated, the methods still used are antiquated and inefficient and the system is not able to produce meaningful data on a timely basis which can be used for decision-making. A complete revision of this system all at once would not be practical and A.I.D. has concluded that it could be done on a gradual basis.

Because of A.I.D.'s direct involvement with the Grains Division, the current plan is to begin there with improvements in budgeting and accounting, both through the revolving fund being established in connection with this loan and other improvements which will, in effect, set up a separate management accounting system for this division. The specific work contemplated with this assistance is a review of the current system, with recommendations on improvements on the flow of documentation from the rural buying stations and terminals to a new system at the BNF's main office. This should result in the elimination of unnecessary record keeping and the development of needed cost information. The establishment of a detailed cost accounting system is of top priority and must cover every operation involved with grain handling and marketing. It is estimated that this work will take at least 12 man-months.

5. Training:

To complement technical assistance, A.I.D. is now developing with the BNF a preliminary training program for Grain Division personnel in order to upgrade the staff directly involved with this project. Some in-service training may also be utilized. This will also involve observation trips, possibly in some cases of outside technicians and their BNF counterparts, to grain storage facilities in the United States.

6. Conclusions:

In order to insure that all technical assistance in grain marketing and operations of the program is initiated promptly, the Loan Agreement will contain a condition precedent to initial disbursement to the effect that A.I.D. shall approve the plan made by the BNF for this assistance prior to first disbursement. A covenant will also be included to the effect that technical assistance and training will be obtained throughout the loan disbursement period.

On the basis of the above analysis, the Mission has concluded that this project is technically sound and feasible and that the BNF has the capabilities needed to implement it effectively.

D. Financial Analysis

1. Funding Requirements:

The total funding requirements for this project are as follows:

	Grain Inventory Financing	Upgrading Rural Grain Receiving Stations	Training and Technical Assistance	Total
AID Loan (dollars)	--	--	$ 50	$ 50
AID Loan (local currency)	$ 1,900	--	50	1,950
BNF counterpart	1,700	200	25	1,925
Central Bank-loan	500	--	--	500
Totals	$ 4,100	$ 200	$ 125	$ 4,425

Following the completion of A.I.D. loan disbursements and of the BNF counterpart contribution to the project, the total amount in the revolving fund for grain inventory financing will be $4,100,000, which will be sufficient to allow the BNF to operate its grain program effectively.and make full use of its storage facilities. Of the total $1,700,000 BNF counterpart for grain inventories, AID will require, as a condition precedent to initial disbursement, that the BNF pay into the fund to formally establish it, the equivalent in cash and grain inventories of $1,400,000. The additional $300,000 BNF contribution is to be paid in cash at the rate of $100,000 per year during the 3-year loan disbursement period. An appropriate covenant will be included in the Loan Agreement.

The Mission is confident that the BNF will be able to make these counterpart contributions in a timely manner. As a result of negotiations between the USAID and the BNF, the BNF approached the Central Bank and has been able to obtain a commitment guarantying that the existing 1-year line of credit for $500,000 assigned to the grains program will be renewed each year during the next five years.

2. Financial Position of the BNF:

Annex II, Exhibit 7 contains a comparative balance sheet for the BNF covering the years 1968-1971, giving a general idea of the size of the Bank and the type of operations in which it is engaged. (Note: A.I.D. Loan 522-L-018 does not appear as a liability on the Balance Sheet since the loan was made to and is being repaid by the GOH.)

In 1964, the GOH took action to eliminate the BNF's dependence on annual appropriations from the Honduran Congress for funding through a plan to capitalize the Bank. GOH bonds in the amount of $17,500,000 were given to the BNF to hold and to be cashed in at the rate of $1,000,000 during the first five years and $1,250,000 during the remaining 10 years. However, in connection with Loan 018, the GOH agreed to increase the rate of these redemptions to $2,000,000 during the A.I.D. Loan disbursement period, with redemptions of $1,000,000 thereafter until completion. Also, $4,500,000 of A.I.D. funds were to be counted as part of the GOH's $17,500,000 commitment. The actual contributions made by the GOH with its own funds through this mechanism were discussed above on page 18 and as of 12/31/72, all of the bonds will have been cashed in. The BNF has also received three loans from the IDB totalling $16.3 million and is about to receive another for about $10,000,000 for use in livestock, industrial and other credit activities.

The BNF has built up a stable financial structure over its 22 years of operations. It has obtained loans, both long and short-term, at concessionary and commercial terms, from many sources, both foreign and domestic and is considered a good credit risk. In fact, as CABEI has pointed out in its current study of the BNF, its financial structure is very conservative by development banking standards, since it has a debt/equity ratio of about 1 1/2:1, whereas an acceptable ratio for most development banks would be 4 or even 5:1. Therefore, CABEI has estimated that the BNF potentially could absorb up to as much as $100 million in new loans, once it has increased the human resources and organizational capabilities needed to utilize such a large amount.

As shown in the BNF organization chart (Annex II, Exhibit 1), the BNF is divided into two distinct departments, Development and Credit/Operations. The Development Department has traditionally been in charge of all new projects, programs and investments which the BNF undertakes in an effort to stimulate agropecuarial and industrial development activities. The Credit Department does not have responsibilities for this type of promotional work, but is only an operating department responsible for making and supervising loans (including those made for activities initiated by the Development Department).

The Grains Division currently falls under the Development Department. The two departments have separate accounting systems, which are linked by means of an informal line of credit that Development has with Credit, but on which Development is to draw only in extraordinary circumstances.

The BNF"s policy is for the Credit Department to operate close to the breakeven point, and to obtain most of its new capital through loans from international agencies as well as from the Central Bank through a rediscount agreement. Short-term loans from commercial banks are used temporarily and only as a last resort. The Credit Department has also received $12,500,000 of the $17,500,000 GOH contribution, the remainder having gone to the Development Department. Annex II, Exhibit 8 contains a cash flow projection for the Credit and Operations Department for the years 1972-1977.

Although the Development Department is also supposed to operate near the break-even point, this has not been the case. The $5,000,000 received by this Department from the GOH has to a significant extent been drained away by losses. The BNF does not assign funds from foreign assistance loans to the Development Department since all such funds received thus far have been for relending. A direct, grant subsidy from the GOH has always been needed to help the Division continue investing in new projects. Annex II, Exhibit 9 contains a cash flow statement for this division similar to that shown for the Credit Department in Exhibit 8, and Exhibit 10 contains a listing of BNF investments in various enterprises, almost all of which are a result of past and present activities of the Development Department.

Contrary to BNF policy, the Development Department has, in the recent past, accumulated a sizable overdraft with the Credit Department. This reached a peak in mid-1970 and a close analysis of the situation reveals that it was a direct result of the start-up of the new grains program. It was at that time that the BNF decided to finance the $1,534,000 equipment procurement and installation contract for the new silos with its own funds and there were no funds in the budget of the Development Department for this. It was decided that the funds would be taken from the Credit Department. Moreover, after the silos were completed, working capital was needed. The BNF then decided that Development should negotiate for outside financing.

These financial statements give a general idea of the types of activities in which the BNF is engaged and also show the various sources of funds that are available to it. However, to a certain degree, they are also indicative of inefficiencies in management, budgeting and control which have been characteristic of the BNF in the past. This inefficiency is gradually being overcome as management improves, and if a significant amount of additional resources are ever to be used effectively, BNF financial management and planning must continue to be improved. As this is accomplished, the BNF will be able to do much more with the funds that it already has at its disposal. The Mission's continual objective is to assist and encourage the BNF to push harder in the area of financial management and budgeting on all projects.

3. Financial Analysis of the Basic Grains Program:

The present funds available to finance inventories are not sufficient. If the BNF is not able to operate this program on a consistent and continuing basis, the producer and the consumer will again be subjected to wide price fluctuations. Such slippage would justifiably cause the public to lose faith in the ability of BNF and the GOH to be effective in the field of grain price stabilization.

Annex II, Exhibit 11 contains projected cashflow and profit/loss statements for the grains program, and it is designed to show approximately how the revolving fund might operate under the A.I.D. loan. Included in it are grain purchases and sales, rentals and services to private parties, operating expenses, and financial obligations.

Because 1972 has been the first year of operations of the new facilities, and also because performance in prior years cannot really be used to predict what will happen in the future, this statement cannot be considered a definitive picture of future performance. However, it does give a general idea of what the factors are that will determine this performance. It also provides certain insights as to the relative importance of each of these factors.

Administrative costs are assumed to increase at 6% per year.

Also shown in 1972, 1973, and 1974 are the extra resources that the BNF has obtained temporarily from other sources, and the BNF credit program in order to be able to continue, during the first years of expanded operations, to buy grains at the $3,000,000 level. The statement reflects the continued abailability of the $500,000 Central Bank line of credit and the $300,000 additional contribution to the fund discussed above. The A.I.D. loan figures are based upon 20-year, 4% terms including a 5-year grace period and a 3-year disbursement period.

Three basic characteristics of the program have been assumed in preparing this statement:

a) The initial grain inventory fund level of $3,000,000 will be increased gradually over the 12-year period shown, reflecting gradually increasing storage capacity, additional BNF contributions to the revolving fund and reinvested operating profits. Storage capacity will be increased as a result of new construction and upgrading of existing facilities.

b) In operating the program, the BNF will become more efficient in the use of storage capacity and working capital, thereby the raising yearly turnover, i.e. the number of times the silos can be filled during one year. A turnover of 2.0 is perhaps a realistic goal for the 12-year period shown.

c) The differences between BNF purchase and sales prices for grains will be reduced from the current overall level of about 20% to at least 15% during the first 12 years of the program, reflecting either reduced prices to consumers or increased prices to producers. As explained above, because of uncertainties now surrounding production costs and future changes in sales prices, it is not possible to specify exactly what prices will change, by how much, or when. In this case, it is assumed only that the gross profit will and should be reduced gradually.

Given these assumptions, the statement shows that over the medium term, 15% markup can be considered as a rough break-even point, which means that the BNF can indeed reduce its margin from current levels and still maintain self-sufficiency with respect to grain operations. The assumed 20-year, 4% A.I.D. loan terms are a factor in this. If a shorter repayment period were granted, consumer price reductions or increased incentives to producers would be postponed. By making the loan funds available at these terms, A.I.D. is enabling the BNF to pass on at an earlier date more of the benefits of the marketing program to those who are most directly affected by it. Moreover, if the program turns out to be more profitable than indicated by the projection, even further reductions in the BNF's margin can be made.

In view of the cost studies and technical assistance described above which are to be initiated together with improvement of the accounting system, the Mission is recommending that no changes be made in grain purchase or sales prices, nor in the charges for services, discounts or mark-up at this time. If accurate cost figures collected do indeed provide evidence that the spread between buying prices and selling prices is excessive and that the program is operating at a disadvantage to the producer or the consumer, the same figures will help identify those charges that are out of line. It is preferable to operate temporarily within a profitable framework and be able to pass those advantages to the public later on than to operate at a loss and be forced to make adjustments that would be politically difficult.

In making any adjustments in the margin, several factors must be considered:

a) Adjustments should be through changes of the charges and discounts that are excessive, as well as by reducing the mark-up to cover overhead, depreciation and financing costs. However, a sufficient level must be maintained to assure full recovery of BNF costs.

b) Every effort must be made to provide a price that provides incentives to the producer and makes food available to the consumer at a price within his ability to pay, but this should not be applied with such vigor that direct government subsidies are required. Price adjustments must be made within reasonable and logical limits.

c) Adjustments must take into consideration Honduras' position relative to world market prices.

d) Prices paid for grains by the low-income consumer should be reduced in the long run.

e) Price adjustments must take into consideration the need to encourage the use of grains for animal feed as well as raw material for agro-industries.

4. Alternative Sources of Financing:

In response to the instructions of AID/Washington contained in State 110687 (Annex I, Exhibit 2) which approved the IRR for this loan and indicated areas to be discussed in detail in the Capital Assistance Paper, the Mission has looked at possible other sources of financing for this project, including the Honduran Central Bank, commercial banks, and other international lending agencies. The possibility of obtaining these funds from the GOH budget or from within the BNF itself has also been investigated. The Central Bank has officially informed the BNF that no further increase in the $500,000 line of credit already being utilized is possible. The reasons for this determination have been discussed in detail above in Section II-B. Similarly, it is obvious that the GOH cannot make the needed additional resources available.

The IBRD and the IDB, in their letters of August 22, and September 26, 1972, respectively, indicated that they were not interested in financing this project. The Exim Bank, in minutes of its September 8, 1972 meeting indicated that it was not interested in this project. The IDB, however, has informed AID that it is considering a possible grain storage loan for Guatemala, El Salvador, and Honduras for CY73 or CY74, which would be complementary to this proposed loan through construction of additional storage facilities. Over the past few years, the possibility of obtaining funds for this purpose through the World Food Program has also been explored by the BNF as well as by regional organizations and it has been conluded that no satisfactory arrangement can be made at this time. CABEI presently does not have capital resources for this type of program. Such a program, on a regional basis, is contemplated in the future with financing from A.I.D., in accordance with the strategy outlined in planning documents for the A.I.D. development assistance program in Central America for FY74 and future years.

The BNF could continue to finance this program to a limited degree with internal funding but only at the expense of other projects. Many of these projects are of an experimental nature and are important if Honduras is to diversify its agricultural production and exports. The BNF has already had to cut back its programs for sesame seed and melon production and has postponed the implementation of other agro-industry projects now being planned such as a feed concentrate plant, refrigerated storage facilities, a fertilizer mixing plant, and a large-scale poultry raising project. The cashflow projection of the BNF's Credit Department shown in Annex II, Exhibit 8 prepared in connection with the BNF's $10,000,000 loan application to the IDB shows that lending levels can only be slightly increased from 1972 through 1974 from $21,150,000 to $22,025,000 and must then drop unless additional financing, such as the IDB is providing is obtained. Even with the new IDB loan, the BNF will have difficulty increasing its lending operations at the 15%-20% annual rate attained in recent years. Part of the problem is that the BNF must repay IDB about $9,000,000 in interest and principal from previous loans during the period 1972-1977. Also, more and more BNF resources are being channeled into medium-to-long term loans for investments in fixed assets, thus tying up additional funds. The BNF estimates that the demand for agricultural credit in Honduras is growing at a rate of perhaps 25% per year, and the GOH Economic Planning Council has recognized that the demand is much greater than the BNF can attend. The Mission thus concurs in the BNF's judgement that no more resources should be diverted from the credit program.

With regard to possible commercial bank financing, even though a loan has been obtained on one occasion, the Mission does not believe that the banks would prove to be a viable source of financing in the long run, especially for the large amount of money needed. Although the loan previously received was at reasonable terms (6 1/4% interest, 180-day maturity), the going real rate of interest for loans from banks in Honduras is between 8% to 12% per year, with maturities of one or two years. Honduran banks traditionally do not make loans for such projects. Nevertheless, if the BNF were to press the banks, the Mission believes that some might be willing to participate through some sort of a consortium arrangement, but the BNF would need either a medium or long-term loan or else a commitment that the loan would be renewed on a normal basis in order to insure the continuity of the program. The BNF strongly believes that since the price stabilization and grain program is of a social interest and should be administered so as to benefit low-income rural farmers and urban consumers, it should not be hampered by having to depend on financing from commercial sources.

The Mission has concluded that it is unreasonable to expect that additional funding for this program could be obtained at this time from any of the above sources in the amounts and on the terms needed, and that an AID loan at concessionary terms to the BNF is justified. The BNF is a development institution whose total program includes substantial activities which are not commercially bankable. Therefore it is appropriate that loan funds be made available to the BNF at such terms. The Mission is recommending that this loan be authorized with an amortization period of 20 years, including a grace period of 5 years and with interest of 4% per annum during both the grace period and the amortization period.

5. Local Cost Financing:

The proposed breakdown between dollar and local cost financing is shown in the above table. All but $100,000 of loan funds are to be made available for purchases of grain in Honduras. Of this $100,000 reserved for training and technical assistance, $50,000 is to be disbursed in dollars and $50,000 in local currency.

6. Prospects for Loan Repayment:

The BNF has a stable financial position and should have no difficulties meeting its interest and principal obligations on this loan in a timely manner. The IDB has made four previous loans to the BNF and as of the end of CY72, the outstanding balance on these loans was almost $11,000,000.

The Government of Honduras, as the guarantor of this loan, has been meeting its AID interest and principal obligations in a timely matter and is not delinquent or in default on any loan repayments to AID. To the best of the Mission's knowledge, the GOH has a similar excellent record with the other international lenders as well as its loans from private sources.

7. Financial Conclusions:

Based on the above analysis, the Mission concludes that the project is financially sound, there are no alternative sources of financing for this project, the BNF's contributions to the project will be made available in the amounts and with the timing consistent with the needs of the project, the level of local cost financing under the AID loan is justified, and that the prospects for loan repayment are good.

SECTION III: Loan Administration and Evaluation

A. Project Execution

1. Execution Plan and Responsibility for Action:

Following the signature of the Loan Agreement by BNF, GOH and AID representatives and ratification, this loan will be ready for disbursement, which perhaps may begin by February, 1973 at the time of the second, smaller harvest season in Honduras. Because the new BNF silos will by then have been operational for over one year, many of the start-up problems customarily associated with projects of this nature will already have been overcome. Similarly, by that time, the BNF-funded technical assistance will be well underway.

The prime day-to-day responsibilities for implementation of this loan will rest with the BNF's Grain Division, under the direct supervision of the Manager of the Development Department, the Grains Committee and the BNF President. These individuals have already had experience in working in this program and thus no break-in period will be required. The Manager of the Development Department will be the principal officer involved with supervision of the technical assistance program for the Bank, while the Chief of the Grains Department will have prime responsibility for the day-to-day program operations.

AID will continue to have close daily contacts with all of these people in connection with both loan and grant activities. The technical assistance personnel will be brought more and more into the activities of the GOH agricultural sector analysis team.

2. USAID Monitoring Responsibilities:

The USAID staff will perform the close monitoring of this project that is common to other loan projects in Honduras, and which involves daily contact with implementing agencies. The USAID Rural Development Officer, who is also attached to the agricultural sector team, will be the Project Coordinator for this loan, and will be assisted as necessary by the Capital Development Officer, who has general responsibilities for supervision of the entire loan portfolio. The Mission anticipates no problems in carrying out these monitoring functions, which will be similar to those already being performed in connection with AID Loan 522-L-018.

3. Technical Assistance:

The types of technical assistance for this project and scopes of work for various consultants who will be needed have been discussed above. The BNF-funded portion of the technical assistance is already underway. The Mission anticipates that the other consultants can be on board by early 1973, as soon after signature of the Loan Agreement as possible. The majority of the assistance will be provided by individuals, who will be placed under loan-funded personal services contract with the BNF. The Mission has already been in contact with several individuals who have good qualifications for this work.

With respect to the assistance in accounting and budgeting, it is likely that these services will be obtained from a consulting firm, possibly a Honduran or a third country firm, or a local branch of a US firm. Procurement of these services will be carried out according to standard AID regulations.

B. Evaluation Criteria

In order to measure the effectiveness of this loan, the Mission proposes below a number of evaluation criteria which it feels are relevant from managerial and economic viewpoints. In effect, these criteria are designed to judge the effectiveness of both the loan and the basic grains program, even though some are based on events not under the control of the program. Good management practices should allow for periodic review of these measures with readjustments if necessary. Some specific objectives are not fixed as yet, pending the results of research planned or already in progress. The Mission would appreciate the concurrence of AID/W in programming small amounts of Technical Support funds (around $10,000) to develop some baseline data and specific objectives. These indicators are:

INDICATOR	OBJECTIVE	DATA SOURCE
1. Seasonal fluctuations in wholesale and retail prices of basic grains.	In general, price swings should be less than in 1972, except where climatic conditions clearly hamper the effectiveness of the program. Rice prices are further conditioned on the degree of production stimuli given.	BNF, DESARRURAL and SIECA data files.
2. Volume of BNF purchases and sales of basic grains.	These should be at levels which allow substantial coincidence of projected and realized turnovers of the basic fund (see Annex II, Exhibit 11, Cashflow).	BNF data files.
3. Utilization of rural facilities.	Utilization of present capacities should increase. Evaluation should take into account changes from present capacities resulting from improvements made in conjunction with this loan. A more specific objective to be set by Technical Assistance hired under loan.	BNF data files.
4. Utilization of central facilities (Tegucigalpa and San Pedro Sula).	Should increase to rate implicit in capital turnover rates. Objective should be from 1.5 to 2.0 per year.	BNF data files.
5. Levels of deterioration or spoilage of basic grains received at BNF rural grain facilities.	Specific objective to be determined; lower levels should result from better enforcement of quality standards and higher proportion of improved quality grains.	Baseline data to be developed.

INDICATOR	OBJECTIVE	DATA SOURCE
6. Sale of drying and cleaning services at BNF rural grain facilities.	Such sales should increase faster than general BNF grain purchases, partially as a result of using better equipment at these facilities.	BNF data files.
7. Volume of export sales.	Exports should increase in absolute terms. Futher, exports outside the CACM should increase relatively faster.	Export data from BNF data files.
8. Farm gate prices.	Nominal prices received by farmers should increase at first and then level off. No spedific objectives set.	Baseline data to be developed.
9. BNF buying prices.	Should move in direction indicated in regional cost study to be undertaken.	BNF and SIECA data files.
10. Basic grain production	Should increase. No specific objective set.	Baseline data from estimates and agricultural census.
11. Percentage and trend of grain purchases from small farmers.	Increased participation of small farmers in the program.	BNF purchase records

C. Implementation Procedures:

1. Target Dates:

The following target dates have been established for this loan, and are based upon a three-year disbursement period:

-- Loan Authorized	November, 1972
-- BNF-funded technical assistance contract signed.	November, 1972
-- Loan Agreement and two-step Payment Agreement signed	December, 1972
-- Loan Agreement Ratified by GOH	February, 1973
Disbursements initiated for grain purchase	February, 1973
-- Disbursements initiated for Loan-funded technical assistance	April, 1973
-- Loan Terminal Disbursement Date	June 30, 1976

2. Disbursement Procedures:

A 3-year disbursement period for this loan should be sufficient to allow the BNF to draw down all funds for grain marketing, and for the completion of the technical assistance programs.

Disbursement documents will be processed by the USAID Controller's Office, with disbursements authorized upon the presentation of reimbursement documentation in accordance with AID regulations. Most of the disbursements will be in local currency for the purchase of grains in Honduras. The remainder, including the portion for dollar-funded technical assistance, will be made in accordance with contracts approved by AID. Disbursements for training costs will also be on a basis of reimbursement for actual expenses or signed contracts. All local currency for this project will be generated in a manner satisfactory to A.I.D. No need for an advance of funds is contemplated since the BNF already has a sufficient amount of cash to finance initial reimbursement vouchers. In conclusion, no problems are foreseen and no deviations from standard A.I.D. procedures are anticipated.

3. Procurement Procedures:

Procurement financed under this loan will be of one of two types, either for the purchase of grain produced within Honduras or for technical assistance and training of BNF personnel. Technical assistance and training financed under the loan shall be procured in countries included in A.I.D. Geographic Code 941. Grain procurement financed directly under this loan will be restricted to the purchase of corn, beans and rice produced in Honduras. However, it is important to point out that under the revolving fund, the BNF during certain times of the year will import grains, principally rice, from Central America or the United States in order to satisfy internal demand. These imports will not be loan-funded. The Loan Agreement will contain a provision to the effect that any imports of grains by the BNF, under its revolving fund, will be carried out in Free-World countries. The Mission, therefore, does not foresee any departures from standard A.I.D. procurement procedures.

D. Conditions and Covenants:

In addition to the standard clauses, the Mission's Capital Assistance Committee is recommending that the Loan Agreement contain the following conditions and covenants:

1) Grain purchases financed under loan shall be only for corn, beans and rice produced in Honduras. All other grain purchases financed by the BNF under this program during the life of the loan shall be for grains produced in countries included in A.I.D. Geographic Code 935.

2) The Government of Honduras will be offered a two-step payment agreement arrangement, and the funds available to the GOH through any such arrangement will be used to assist socio-economic development projects mutually acceptable to the GOH and A.I.D.

3) Prior to first disbursement, the BNF shall submit evidence satisfactory to A.I.D. that it has:

a) Established a separate revolving fund in a manner satisfactory to AID, which shall be used exclusively for grain purchases, processing and for operation of the BNF network of storage facilities during the life of the loan, and that an initial payment into the fund of at least the local currency equivalent of US$1,400,000 in cash and grain inventories has been made by the BNF from its own resources.

b) Made a comprehensive review of all existing grain inventories in BNF storage facilities and that all low-quality grains have been disposed of.

c) Presented evidence satisfactory to AID that the Central Bank will maintain its $500,000 line of credit to the BNF for the basic grains program available for a five-year period.

4) Prior to the disbursement of loan funds for other than technical assistance and training costs, the BNF shall submit to AID:

a) A Rural Storage Improvement Plan, to include a budget and calendar for implementation, satisfactory to AID, for purchases of equipment and other physical improvements to its existing network of rural storage facilities and buying stations, with the exception of those facilities which the BNF and AID shall jointly have determined no longer to be economically viable. Prior to such disbursement, the BNF shall also present evidence that progress, satisfactory to AID, towards implementation of the Plan, using its own resources, has been made to insure that all work contemplated under the Plan will be completed during the first 12-month period of loan disbursements.

b) Evidence that it has initiated a comprehensive technical assistance program to aid in improvement of the entire BNF grains operations.

5) Prior to the disbursement of more than $500,000 of loan funds, the BNF shall submit to AID evidence that it has carried out the Rural Storage Improvement Plan approved by AID.

6) The BNF shall covenant with AID that:

a) Loan-funded technical assistance and personnel training required for further improvement of the operations of the BNF grain storage and marketing program will be obtained by the BNF throughout the loan disbursement period on terms and conditions mutually agreed upon by the BNF and AID.

b) The BNF will establish basic grain stabilization prices at the producer level in consultation with the Central American Basic Grains Coordinating Commission.

c) All proceeds from the sale of grains financed hereunder and under the revolving fund mentioned above shall be redeposited in the revolving fund during the life of the loan.

d) During each of the first three years of the program, it will make an additional cash contribution to the revolving fund of the local currency equivalent of $100,000.

e) It will negotiate with proper Honduran financial institutions or with the GOH for any and all additional financing that may be necessary for the program during the life of the loan, and that it will make every effort to make the program financially self-sufficient.

Section IV: Issues

The three major issues are:

1. Should loan funds be made available for BNF purchases of Honduran rice?

2. Whether an interest rate of 4% or 6% would be more appropriate considering the possibility of a CABEI loan in the future as well as the factors involved with the proposed two-step arrangement and whether the additional benefits resulting from the interest spread should be made available to the Government of Honduras or the National Development Bank (BNF).

3. Timing of Improvements to Rural BNF Buying Stations

Furthermore, concern has been expressed as to the degree to which benefits of this project will flow down to the small and medium grains farmer. Reflecting this concern, the Project Description to appear in the Loan Agreement will make specific reference to the desireability of incorporating more small and medium farmers and grains producers in the project. The basic Implementation Letter will describe the reporting and evaluation scheme to be used in ascertaining the BNF's compliance with this goal

1. Rice:

Considerable attention has been focused on whether AID, by providing these loan funds, would be encouraging the relativly inefficient production of rice in Honduras. Should the Loan Agreement not allow loan funds to be used for rice purchases, or should a covenant be included that would discourage this production or attempt to force Honduras to reduce the market price of rice over the period of AID loan disbursements? It was decided that at this time, AID does not have enough information to be able to make a specific judgement on the potential of rice for Honduras, but that AID wishes to convey to the Hondurans our concern that the stabilization prices of grains be set in conformity with prices in other Central American countries, also taking into account the long run comparative advantages between the countries in various commodities. It was also determined that this loan is not an appropriate vehicle with which to deal directly with production priorities in general or rice cultivation in particular. Instead, AID should use the Loan Authorization and Loan Agreement as a means to express our concern in these areas, with the hope that influence directed at adjustments of these and other prices, as well as production priorities, can be brought to bear in the future through the efforts of ROCAP and the agricultural sector analyses now being done in Central America. Furthermore, it was decided that any covenant to be included in the agreement should not cover only rice, but should be applicable to the other basic grains as well. Therefore, it is proposed that the Loan Authorization contain the following covenant:

> "The BNF/ will establish basic grain stabilization prices at the producer level in consultation with the Central American Basic Grains Coordinating Commission."

It is further recommended that the Loan Authorization contain no restriction against the purchases of rice by the BNF with loan funds.

2. Interest Rate:

The issue concerning any possible difference between the interest rate to be charged on this loan (4% p.a.) and the rate which AID might charge on a future loan to CABEI (probably over 6% p.a.) for grain marketing in Central America has been raised.

It was felt that, as the ROCAP loan is still in a preliminary discussion stage and has a major issue to resolve (e.g. a regional grains policy), it is not possible to judge at this time with any fair degree of certainty that (a) a loan will in fact be forthcoming and (b) on what terms. Also, the reason for attempting to link the interest rate of this loan to a possible future loan (namely; a lower rate now would act as a disincentive for the Central American countries to approach CABEI for future financing) does not appear valid. Should the C.A. countries desire additional funds at a future date, the determining factors will be the terms and conditions on alternative sources of funds on that date not on what was obtainable in the past.

It was then decided that the interest rate should be determined on the basis of what was appropriate for this project and not in relation to future rates. The cash flow indicates explicitly that the BNF can service a 4% p.a. rate of interest and implicitly that it would have difficulty with a 6% rate in the later years of the cash flow period. The argument for an appropriate rate also turns on the answer to the question of where AID would prefer to see the difference in interest rates invested. Under the two-step arrangement, the GOH will receive standard Development Loan terms (i.e., 2% p.a. during the grace period, 3% p.a. thereafter). If the terms to the BNF were 6% instead of 4%, the GOH would receive from the Bank an additional amount of interest payments of over $300,000 over the 10 year AID grace period. This additional amount would be deposited in a development fund to be utilized for socio-economic projects mutually agreed upon between the GOH and AID. On the other hand, if this addition remains with the BNF, it must be reinvested in the grains marketing program- a program which AID has reviewed in detail and would prefer to see strengthened over future unknown projects. Consequently, the USAID is recommending that the interest rate for this loan remain at 4% p.a.

3. Rural Buying Stations:

To assure the timely improvement of the rural BNF buying stations, the Loan Agreement will include the following condition precedent to disbursements for other than technical assistance and training costs ($100,000):

"Prior to the disbursement of loan funds for other than technical assistance and training, the BNF shall present a Rural Storage Improvement Plan, to include a budget and calendar for implementation, satisfactory to AID, for purchases of equipment and for other physical improvements of its existing network of rural storage facilities and buying stations, with the exception of those facilities which the BNF and AID jointly shall have determined no longer to be economically viable. Prior to such disbursement, the BNF shall also present evidence that progress, satisfactory to AID, towards implementation of the Plan, using its own resources, has been made to insure that all work contemplated under the Plan will be completed during the first 12-month period of loan disbursements."

To emphasize the urgency of executing the Plan rapidly, the Loan Agreement will also contain the following condition:

"Prior to the disbursement of more than $500,000 of loan funds, the BNF shall submit evidence satisfactory to AID that it has carried out the Rural Storage Improvement Plan approved by AID."

Honduras - BNF Grain Marketing Project

CERTIFICATION PURSUANT TO SECTION 611 (e) OF THE FOREIGN ASSISTANCE ACT OF 1961, AS AMENDED

I, Edward Marasciulo, the principal officer of the Agency for International Development in Honduras, having taken into account, among other things, the maintenance and utilization of projects in Honduras previously financed or assisted by the United States, do hereby certify that in my judgement, the National Development Bank - BNF has both the financial and human resources capabilities to effectively maintain and utilize the capital assistance project consisting of the BNF's grain marketing program being financed in part by this proposed loan entitled Honduras: BNF Basic Grain Marketing Project.

This judgement is also based on the BNF's satisfactory performance and execution of its portion of the Agricultural Credit and Storage Project financed under A.I.D. Loan No. 522-L-018, and that it has the ability to satisfactorily manage the grain purchasing, storage, and marketing fund for which additional capital is being provided by this proposed loan.

Edward Marasciulo
Mission Director

November 6, 1972
Date

CAEC Comments on Mission's Intensive Review Request

Below is the text of State 110687 received on June 21, 1972 and following each paragraph is a short explanation of the Mission's response to each point raised.

"1. Subject IRR was considered by CAEC on 30 May and approved subject to recommendations set below. These recommendations should be considered during intensive review and appropriate conclusions discussed in loan paper."

"2. Considerable discussion focussed on GOH and BNF commitments under L-018. Specifically, Section 3.03 (7) asked for plan to assure effectiveness of basic grain price program including sources of financing of crop purchase and procedures for use of warehouse receipts. Inasmuch as subject loan request is for partial financing for such program loan paper should present detailed analysis of plan approved by USAID, circumstances preventing GOH and/or BNF from meeting financial commitments under that plan, and justification for such A.I.D. financing. Furthermore, warehouse receipt system should be described and conclusions presented as to effectiveness and arrangements for refinements including commitment to enact basic warehouse laws, if necessary. Finally, analysis should also include detailed evaluation of all aspects of L-018."

<u>Response</u>: The original price stabilization plan that was submitted by the BNF and approved by A.I.D. formed the basis for the effective BNF grains operations during 1972. This plan has been continually revised over the past year. The circumstances preventing the GOH and the BNF from financing the plan have been explored in relation to the Mission's analysis of possible Alternative Sources of Financing for the project. It was acknowledged at the time the CAP for Loan 018 was prepared that the BNF would have difficulty obtaining the necessary working capital financing. The GOH price policy has been discussed in

Honduras - BNF Grain Marketing Project

CERTIFICATION PURSUANT TO SECTION 611 (e) OF THE FOREIGN ASSISTANCE ACT OF 1961, AS AMENDED

I, Edward Marasciulo, the principal officer of the Agency for International Development in Honduras, having taken into account, among other things, the maintenance and utilization of projects in Honduras previously financed or assisted by the United States, do hereby certify that in my judgement, the National Development Bank - BNF has both the financial and human resources capabilities to effectively maintain and utilize the capital assistance project consisting of the BNF's grain marketing program being financed in part by this proposed loan entitled Honduras: BNF Basic Grain Marketing Project.

This judgement is also based on the BNF's satisfactory performance and execution of its portion of the Agricultural Credit and Storage Project financed under A.I.D. Loan No. 522-L-018, and that it has the ability to satisfactorily manage the grain purchasing, storage, and marketing fund for which additional capital is being provided by this proposed loan.

Edward Marasciulo
Mission Director

November 6, 1972
Date

CAEC Comments on Mission's Intensive Review Request

Below is the text of State 110687 received on June 21, 1972 and following each paragraph is a short explanation of the Mission's response to each point raised.

"1. Subject IRR was considered by CAEC on 30 May and approved subject to recommendations set below. These recommendations should be considered during intensive review and appropriate conclusions discussed in loan paper."

"2. Considerable discussion focussed on GOH and BNF commitments under L-018. Specifically, Section 3.03 (7) asked for plan to assure effectiveness of basic grain price program including sources of financing of crop purchase and procedures for use of warehouse receipts. Inasmuch as subject loan request is for partial financing for such program loan paper should present detailed analysis of plan approved by USAID, circumstances preventing GOH and/or BNF from meeting financial commitments under that plan, and justification for such A.I.D. financing. Furthermore, warehouse receipt system should be described and conclusions presented as to effectiveness and arrangements for refinements including commitment to enact basic warehouse laws, if necessary. Finally, analysis should also include detailed evaluation of all aspects of L-018."

Response: The original price stabilization plan that was submitted by the BNF and approved by A.I.D. formed the basis for the effective BNF grains operations during 1972. This plan has been continually revised over the past year. The circumstances preventing the GOH and the BNF from financing the plan have been explored in relation to the Mission's analysis of possible Alternative Sources of Financing for the project. It was acknowledged at the time the CAP for Loan 018 was prepared that the BNF would have difficulty obtaining the necessary working capital financing. The GOH price policy has been discussed in detail in Section II-C. No viable warehouse receipt system is operating at the present time basically due to a lack of adequate storage facilities which could be effectively controlled by parties other than the BNF. ROCAP is now initiating work on a regional study of public warehouses. In connection with that study, the possibilities of developing such a system in Honduras will be explored. The other important aspects of Loan 018 have been discussed in detail in Section I.

"3. With regard to alternative sources of financing, questions raised as to possibility of Central Bank providing line of credit which would cover need in whole or in part. Even though this would most likely lead to temporary monetary expansion, inflationary effects would appear to be reduced by short term nature of credit requirements. Thus, requested that USAID discuss this possibility with Central Bank including how such financing might affect understanding with IMF. In addition to Central Bank alternative USAID should prepare fiscal and monetary analysis to determine whether GOH or other sources of financing are available. In this regard, recommended that Mission explore if funding already obtained for program not be reduced even if A.I.D. approves loan. Thus, total additional A.I.D. assistance request in CAP might be reduced by some $400,000 from amount requested in IRR. In any event, loan paper should address question of source of future working capital as production and storage facilities expand."

Response: The Mission has made an intensive analysis for the possibility of obtaining funds for this project from the GOH, the Central Bank or the BNF itself. The Central Bank has agreed to maintain available for the project its existing $500,000 line of credit to the BNF for the next 5 years. An intensive fiscal and monitoring analysis is included in the paper in Section I-C. The projected cash flow statement for the program contained in Annex II, Exhibit 11 shows that the future working capital for the program will be obtained through the BNF's future contribution of $300,000 and through the profitability of the program itself, which will become self-sufficient in a short time and will operate above the breakeven point. In making this cash flow projection certain assumptions have been made about the future expansion of the project, including increased turnover of inventories, additional storage capacity, and more working capital. The Mission has recommended that the loan be authorized at the amount suggested in the IRR, because the $2 million proposed is needed to give the BNF enough working capital to make full use of its present facilities and to finance needed technical assistance and training.

"4. Loan request should be supported by analysis of self-help measures of GOH in agricultural sector. Adequate self-help must show that GOH agricultural funding levels increasing and, with regard this project, any A.I.D. financing would not serve to replace existing GOH contributions to BNF."

Response: The GOH has recently undertaken a comprehensive agricultural sector analysis with the support and encouragement of A.I.D. At the same time the share of the national budget allocated to the Ministry of Natural Resources (includes agriculture) has been increased from 1969 levels, as was agreed to by A.I.D. and the GOH as a covenant in Loan Agreement 522-L-018. These figures are shown on page 20 of the paper. The Mission has determined that A.I.D. financing will not replace GOH contributions to the BNF. The rate of GOH contributions to the BNF has actually exceeded slightly the amounts anticipated at the time the 018 CAP was prepared.

"5. Fundamental part of program should be clear statement of objectives of GOH price policy on principal grains and this should be analyzed in depth during intensive review. Adequacy of proposed GOH pricing formula and analysis of like operational effects as a means for reaching this basic goal should be studied. For A.I.D. support basic goal should be pricing policy leading toward world market price levels in order encourage exports and lowest possible price to low income consumer in Central America. This analysis should also address implication of GOH grain pricing policies for CACM.

Response: The GOH/BNF grain price policy has been analyzed in detail by the Mission and a lengthy letter has been received from the BNF which sets forth this policy. A translation of that letter is included in Annex II, Exhibit 4 . The BNF and the GOH have committed themselves to lowering the sales prices in the future in order to make Honduran grains more competitive in world markets. The GOH has informed SIECA, who will advise the grain stabilization institutes of the other 4 countries in Central America of its application for this A.I.D. loan. The CACM implications of the GOH policy are discussed in Section II-B.

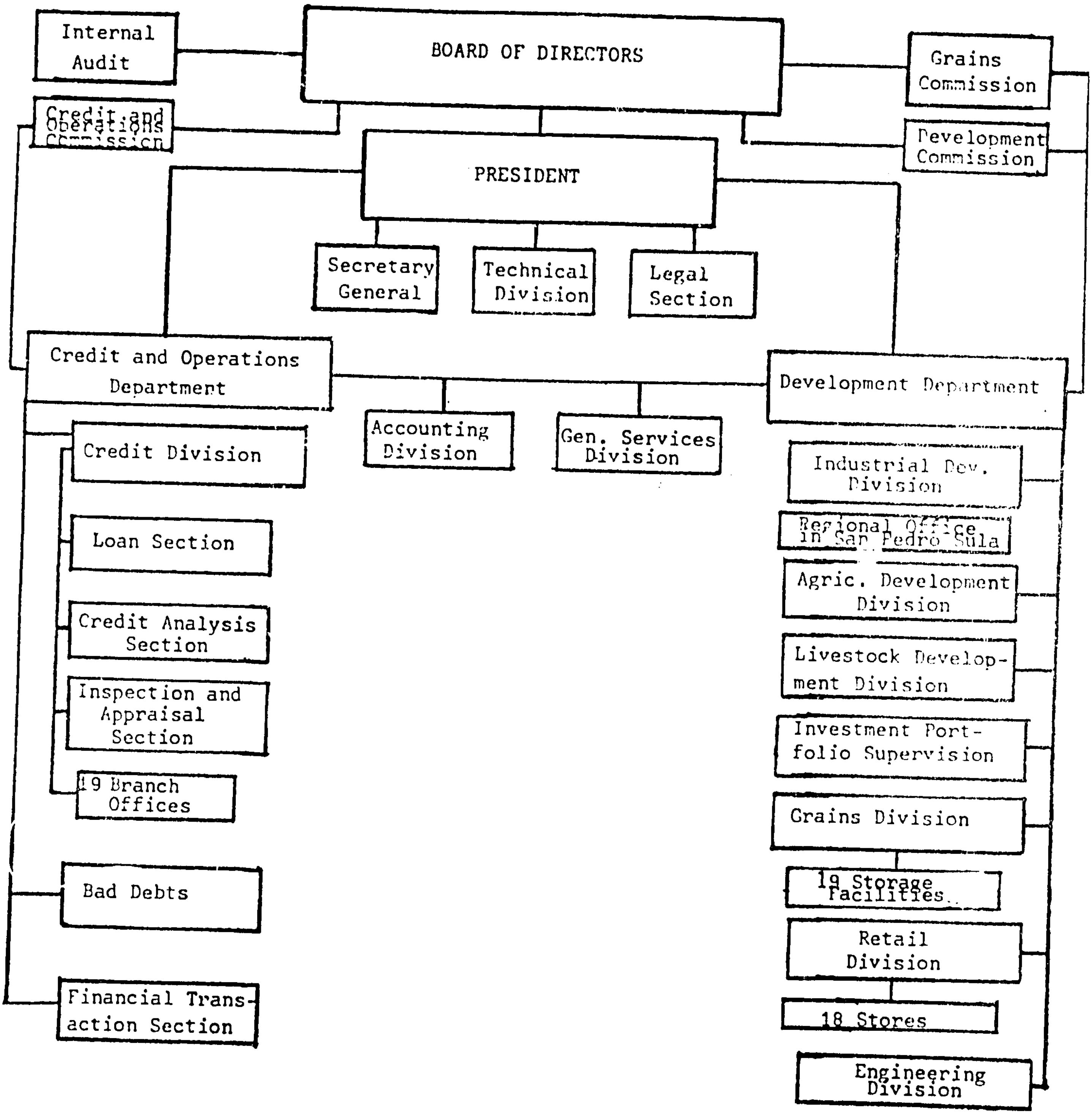
"6. Loan paper should also treat in greater detail commodity flow through storage system."

Response: A discussion of grain movements through the system is included in Section II-C of the CAP.

"7. Technical assistance needs discussed and questions raised as to whether ICAITI was appropriate source in view its limited experience in grain marketing and pricing policy. Thus, either technical assistance should come from other source or ICAITI should be strengthened in this area. USAID should emphasize to GOH difficulty in administering sound program and need for advisors with considerable operating experience in grain marketing. Loan paper should contain scope of work for technical assistance requirements."

Response: A detailed technical assistance plan for the program is set forth in Section II-C. The Mission and the BNF have both concluded that the possibilities of obtaining the needed assistance from ICAITI are remote. A local Honduran consulting firm has already signed a contract with the BNF, financed with BNF funds, to initiate an evaluation of the BNF program at the farmer level, and has made suggestions to improve the rural grain storage network. A.I.D. loan funds will be used to finance personal services contracts with qualified individuals to assist in grain handling, grain marketing and other areas. Scopes of work for these advisors are contained in the CAP.

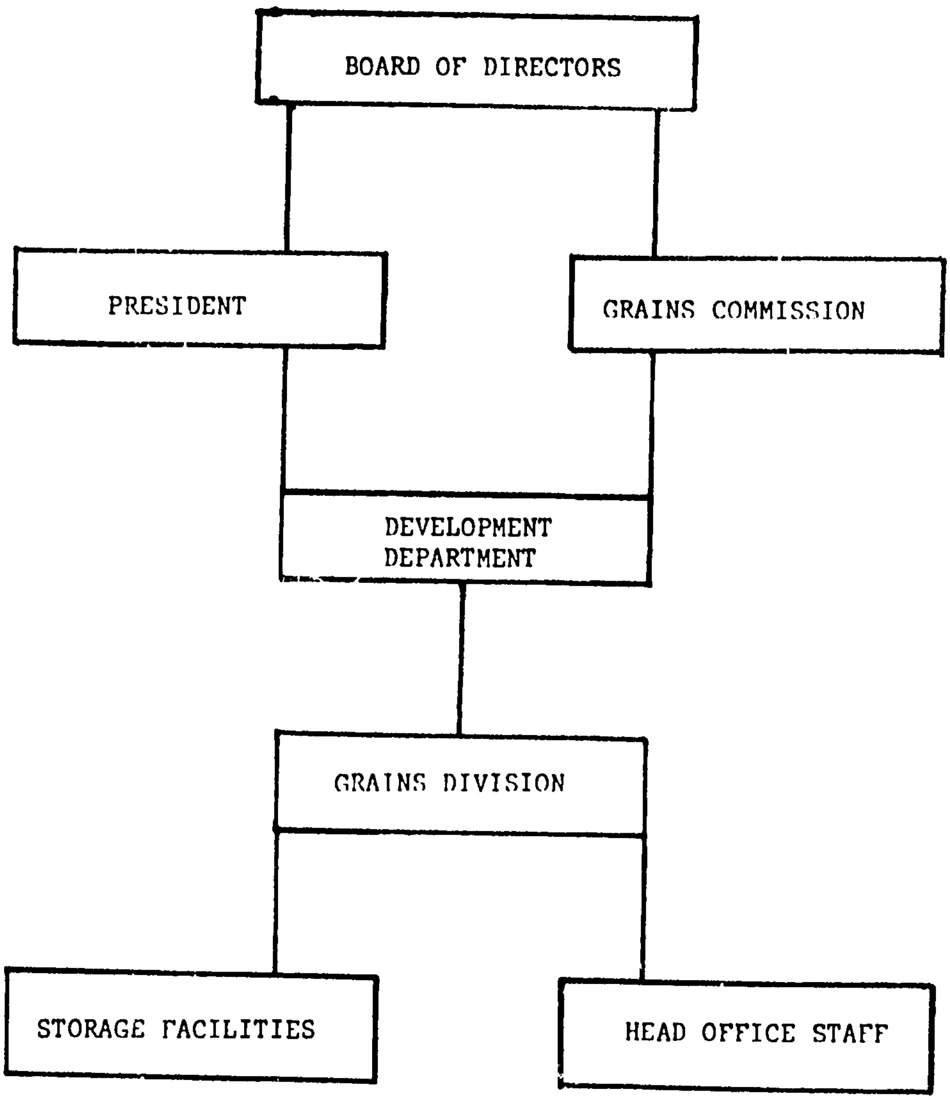
ORGANIZATION CHART OF THE B.N.F.



MEMBERS OF THE BOARD OF DIRECTORS

Position	Name
President, BNF	Guillermo Medina Santos
Government Representatives	
	Elio Ynestroza M. Minister of Finance Ruben Mondragon C. Minister of Economy Edgardo Sevilla I. Minister of Natural Resources Roberto Cantero R. Minister of Communications and Transportation
Private Banking Representative	Coronado Rivera
Central Bank Representative	Roberto Ramírez
Private Sector Representatives	
	Jorge Coello Henry Holtz Sergio Salinas Arturo Bendaña René Sagastume

ORGANIZATION CHART OF THE B.N.F. GRAINS DIVISION



MEMBERS OF THE GRAINS COMMISSION

Position	Name
President, BNF	Guillermo Medina Santos
Government Representatives	
	Ruben Mondragon C. Minister of Economy
	Edgardo Sevilla I. Minister of Natural Resources
Private Sector Representatives	
	Henry Holtz Sergio Salinas
Manager of the BNF Development Department	Raul Edgardo Escoto D.

BIO-DATA OF KEY BNF PERSONNEL

1. **President:** Guillermo Medina Santos Age: 37

Studies: Degree in Economics from the National University of Honduras

Various courses in management, production, human relations, civil service, industrial processing, and administration within the firm.

Recent Experience:

1963 - 1966	Assistant manager of the Development Department
1964 - 1966	Chief of the Industrial Development Division
1966 - 1971	President of Industrial Projects of Honduras Inc.
1966 - 1971	Member of Board of Directors of Chamber of Commerce and Industries of Tegucigalpa
1966 - 1971	Secretary of "Hotels of Honduras" Inc.
1966 - 1971	Member of Board of Directors of Rio Lindo Textiles Inc.
1966 - 1971	Member of Board of Directors of the BNF
1966 - 1971	General Manager of "Fomento Internacional" Inc.
1971	Became President of the BNF

2. **Manager of the Development Department:**

Raul Edgardo Escoto D. Age: 41

Studies: Gradute of the Panamerican Agricultural School (Zamorano)

Bachellor of Science Degree in Agronomy from Mississippi State University

Completed a 15 month special course sponsored by the Rockefeller Foundation on improving intensive agriculture

Completed a one year course at Texas A & M University in seed technology

Recent Experience:

1965 - 1967	Agricultural Engineer of the Division of Agricultural Development within the BNF
1967 - 1972	Assistant manager of the Development Department of the BNF
April 7, 1972	Became Manager of the Development Department

3. Chief of BNF Grains Division:

Antonio Puerto M. Age: 36

Studies: Degree in Economics from the National University of Honduras

Recent Experience:

1965 - 1966	Assistant economist in the Coffee Division of the BNF
1966 - 1971	Assistant manager of the Coffee Division
1971 - 1972	Chief of the Operation and Control Section, BNF Grains Division
April 21, 1972	Became Chief of the BNF Grains Division

4. Market Analyst of the BNF Grains Division:

Manuel C. Cambar C. Age: 35

Studies:	Degree in Economics from the National University of Honduras

Recent Experience:

1963 - 1966	Assistant economist in the BNF Technical Division
1966 - 1968	Economist in the BNF Coffee Division
1968 - 1971	Chief of the Technical and Agricultural Section of the Coffee Division
1971	Became market analyst of the BNF Grains Division

5. Administrator of the Tegucigalpa Silos:

Othoniel Viera A. Age: 38

Studies:

Obtained an instructorship in agriculture from the Escuela Normal Agrícola in Colombia

Received a certificate in general agriculture from the University of Puerto Rico

Earned a Bachellor of Science degree in agriculture from Mississippi State University

Recent Experience:

1958 - 1971	Various assignments with the GOH agricultural extension service (DESARRURAL)
1971	Became administrator of the Tegucigalpa Silos

6. Administrator of the San Pedro Sula Silos:

Hector Lardizabal D. Age: 40

Studies:	Graduated from the Panamerican Agricultural School (Zamorano)

Completed a course in corn improvement conducted by the Rockefeller Foundation in Mexico during 1955-56

Completed a course in soil and water conservation at the Rural University of Brazil. 1969-61

Completed a course on intensive cultivation at Florida University. 1961-62

Completed a course on grain technology At Mississippi State University in 1962

Recent Experience:

1962 - 1966	Technician in charge of seed production DESARRURAL
1966 - 1970	Employed as an agricultural technician by the ALCASA cornstarch factory
1970	Became administrator of the San Pedro Sula silos.

SUBSTANCE OF LETTER FROM BNF PRESIDENT TO USAID MISSION DIRECTOR, DATED NOVEMBER 1, 1972 SETTING FORTH GOH BASIC GRAIN POLICY

"......We hereby offer a review of the history of grain prices and their effect on the stabilization of prices paid both to the producer and by the consumer, in order to show the problems that have affected the price stabilization program and influenced decisions on purchase price levels from 1965/1966 through 1972/1973. Corn, beans, and rice are in fact the principal elements of the Honduran diet.

In the past, the policy for price stabilization in Honduras and other Central American countries has not been well-defined due to a lack of statistical information which would give price stabilization agencies the facts necessary for formulation of a firm price regulation policy for these grains. The prices set during the period 1965/1966 through 1971/1972 have had the following effects on grain production and price stabilization:

1. Beans: Support prices for beans set by the BNF as part of its stabilization program have affected consumer prices, especially in the Tegucigalpa and San Pedro Sula markets. When a support purchase price of $5.00 per cwt was set in 1969/70, market prices paid by the consumer rose to an average annual figure of $8.75 per cwt and the BNF purchased only 4,387 cwt during that year. However, for the 1971/72 harvest, the purchase price was set at $7.00 per cwt, which had a positive effect on stabilization since average annual market prices rose to only $7.16 per cwt in Tegucigalpa and San Pedro Sula. This reduced the average price to the consumer by $1.59 and the BNF purchased 157,495 cwt during the 1969/70 harvest. The BNF was thus able to guaranty an adequate supply to the consumer as well as develop a well ordered plan for exports. During the 1971-72 harvest, more than 44,000 cwt of beans were exported to countries outside of Central America at favorable prices. *

* See figures on Page of CAP

2. Rice: Honduras in the past has had a chronic deficit in rice production and although the situation has improved in recent years, production is still less than internal consumption. This deficit persists because of high production costs in Honduras due to traditional farming methods. Other Central American countries (especially Nicaragua) and the United States have been able to offer rice at better prices than these prevailing for internal production. The support price set by the BNF for the 1970/71 harvest was \$3.30 per cwt for rough rice, which was much lower than the average prices prevailing in the private sector. In addition this price had no effect on stabilizing prices. In fact, the average annual prices in the Tegucigalpa and San Pedro Sula markets rose abruptly to \$10.07 per cwt in 1970 and to \$13.89 in 1971, an increase of \$3.82 per cwt. Taking into account the fact that low prices in past years have contributed to low production in Honduras, the support purchase prices have been slightly increased for the 1972/73 harvest. At the same time, differentials have been established in accordance with yields after milling, in order to increase internal production and stimulate the cultivation of higher-yield, better quality rice with more modern methods.

3. Corn: The positive effects of the grain program, especially in the stabilization of corn prices beginning with the 1971/72 harvest, were made possible by the BNF's installation, through A.I.D. financing, of new processing and storage plants in Tegucigalpa and San Pedro Sula. These silos increased the storage capacity of the BNF, enabling increased amounts to be purchased and provided an adequate internal supply as well as an organized system for exporting surpluses to other CACM countries. All these factors contributed to the stabilization of the price paid by the consumer.

Support prices paid for corn have been maintained at an almost constant level from 1965/66 through 1972/73 of

$3.25 per cwt, with only a slight drop during the 1969/70 and 1970/71 harvests when the price was set at $3.00. During the 1969/70 season, only 52,685 cwt of corn were purchased. This figure significantly increased in 1971/72, when the price was again raised to $3.25 with purchases of 362,981 cwt. This represented an increase of 310,296 cwt, which enabled the BNF to regulate effectively the price paid by the consumer, and simultaneously to export surpluses to other Central American countries. The exported corn was channeled through the various price stabilization organizations, principally the Instituto Nacional de Comercio Exterior e Interior, of Nicaragua.

The guidelines of the BNF's price policy are not only to increase production and stabilize prices internally but also to coordinate grain prices on a regional level within Central America. An analysis of all factors which influence grain prices is to be carried out, for the purpose of relating, as closely as possible, prices to production costs plus a normal profit for the producer. With this in mind, the Central American Grain Marketing and Price Stabilization Commission, in Resolution #35, Act No. 14 of the Session held in Guatemala, (May, 1972) decided to carry out a study of the different factors which influence basic grain marketing, including marketing channels used by the various Central American stabilization agencies, volumes of grain moving through these channels, storage facilities, differences in consumption patterns according to income levels in rural and urban populations, use of basic grains as raw material for industry, and above all, a detailed investigation of production costs and incomes of producers. Data on production costs and income will be broken down by farm size, farming methods, and technology, in order to obtain basic information upon which support prices can be set on a coordinated basis throughout Central America. This study should result in an ordered flow of these products throughout the region.

Even though we are conscious of the importance of such a survey to determine production costs and income to producers and of its impact on the development figures for the first harvest of the 1972/73 season reflects losses as a consequence of the prolonged drought. This type of study, if it were carried out under these adverse conditions, would not reflect accurate cost and income figures; on the contrary it would show low yields and high production costs. On the other hand, such a survey should not be carried out for the second harvest since the BNF is making an effort to compensate with the second planting for losses suffered during the first harvest. This would show up in increased yields in relation to national production under normal conditions and, therefore, lower costs because of improved techniques which are being used in the area where the BNF is supporting this special program.

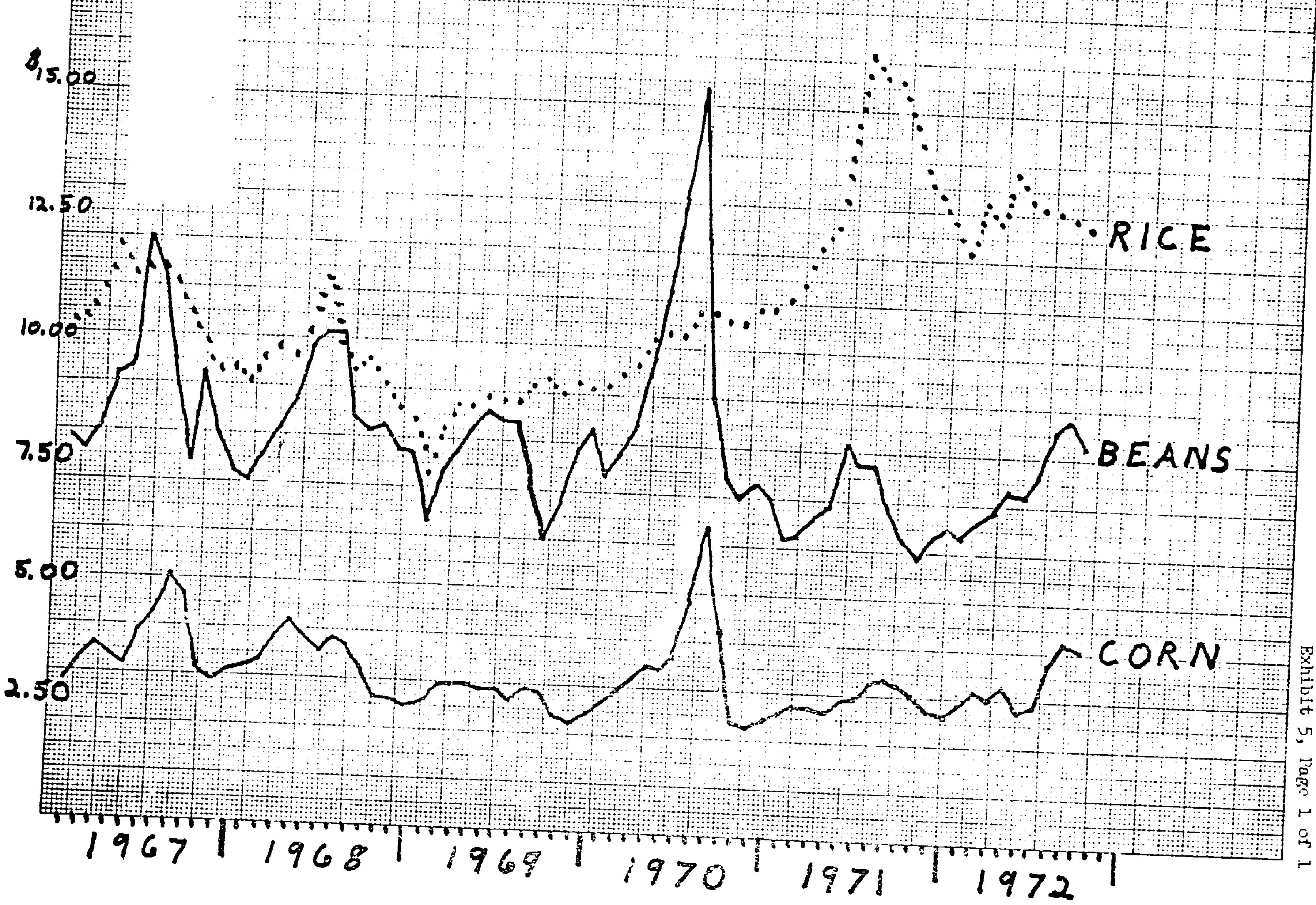
For the above reasons, the BNF has decided, as have the majority of the other Central American countries, to postpone the collection of data in order to carry out the study under more normal conditions, since information then obtained would reflect the real situation of costs and income to the producers.

Taking into account the need for accurate basic data in order to adopt a price policy, the pricing policies of the BNF must be conditioned upon the study to be carried out in the future.

Nevertheless, a general analysis indicates that the current price levels for basic grains in Honduras have reached maximum levels. It would be very difficult to exceed these levels since this would cause consumer price increases. In effect, support prices should be reduced in the future in accordance with the results of the study.

Traditionally Honduras has supplied basic grains to the majority of the Central American countries, because of its ideal ecological conditions and competitive advantage."

Average Monthly Price of Grain Per Hundredweight



Annex II, Page 13 of 26
Exhibit 5, Page 1 of 1

BNF GRAIN PURCHASE PRICES PER HUNDRED WEIGHT

1972/73 Growing Season

Location	Corn	Red Beans	Black Beans	Rough Rice with a Mill Yield of: 50-59%	60-64%	65% or more
Tegucigalpa	$ 3.25	$ 7.25	$ 6.75	$4.50	$5.00	$ 5.50
Choluteca	3.00	--	--	4.25	4.75	5.25
Danlí	2.93	6.93	6.43	4.18	4.68	5.18
Juticalpa	2.83	6.83	6.33	4.08	4.58	5.08
Catacamas	2.75	6.75	6.25	4.00	4.50	5.00
El Porvenir	2.88	6.88	6.38	4.13	4.63	5.13
San Pedro Sula	3.25	7.25	6.75	4.50	5.00	5.50
Puerto Cortés	3.13	--	--	4.38	4.88	5.38
Tela	2.88	--	--	4.13	4.63	5.13
Olanchito	2.75	--	--	4.00	4.50	5.00
Comayagua	3.00	7.00	6.50	--	--	--
El Negrito	2.88	--	--	--	--	--
La Entrada	2.88	6.88	6.38	--	--	--
Cuyamel	2.88	--	--	4.13	4.63	5.13

(Price differentials are based on transportation costs from granary location to the central silo facilities in Tegucigalpa and San Pedro Sula.)

BNF PRICES FOR GRAIN PROCESSING SERVICES

Service	Price per CWT	Comments
A. CORN AND SORGHUM - ALL LOCATIONS		
Drying	$ 0.0175	for grain with an initial moisture content of more than 18%
	0.0125	for grain with an initial moisture content of 18% or less
Cleaning	0.075	
Storage	0.025 per month	
Fumigation	0.05 per application	
B. RICE AND BEANS - ALL LOCATIONS EXCEPT SAN PEDRO SULA		
Drying	$ 0.075	for grain with an initial moisture content of 12.01% to 14.50%
	0.125	for grain with an initial moisture content of 14.51% to 16.50%
	0.175	for grain with an initial moisture content of 16.51% to 18.50%
	0.225	for grain with an initial moisture content of 18.51% to 20.50%
	0.25	for grain with an initial moisture content of more than 20.51%
Cleaning	0.10	
Storage	0.05 per month	
Fumigation	0.05 per application	
C. RICE AND BEANS - SAN PEDRO SULA		
Drying	$ 0.225	for grain with an initial moisture content of more than 18%
	0.175	for grain with an initial moisture content of 18% or less
Cleaning	0.075	
Storage	0.04 per month	
Fumigation	0.05 per application	

BNF GRAIN SALES PRICES - 1972/73 GROWING SEASON

Tegucigalpa and San Pedro Sula Warehouses

	Domestic	Export
Corn	$4.00	$3.90
Rice	6.00 rough 12.50 polished	--
Red Beans	9.00	9.50 to 9.00
Black Beans	8.50	8.50

BNF BALANCE SHEET

(In Thousands)

ASSETS	1968	1969	1970	1971
Cash, bank deposits, and government bonds	$ 2,100	$ 2,143	$ 1,721	$ 2,437
Accounts receivable, loans, and interest due	28,828	34,933	36,291	37,552
Stocks, equity investments, inventory and development project investments	3,777	4,277	4,825	5,459
Fixed assets	2,907	3,191	4,691	5,312
Totals Assets	$37,612	44,544	47,528	50,760

LIABILITIES	1968	1969	1970	1971
Current				
Savings deposits, term deposits, and short term borrowings	5,742	6,636	6,964	9,272
Foreign bank liabilities	1,204	--	2,022	2,090
Central Bank of Honduras	4,421	5,746	5,171	6,186
Interamerican Development Bank/ current portion	381	906	1,024	1,035
Coffee Institute	--	--	--	195
Building Mortgage - Central Bank/ current portion	92	92	92	92
Others	578	4,610	1,986	2,472
Current Liabilities	12,418	17,990	17,259	21,340
Medium and Long Term				
Coffee Institute	1,262	1,300	1,365	964
Mortgages and Bonds	214	144	72	-
Reserve for fringe benefits	260	244	230	173
Building Mortgage - remainder	1,072	980	888	796
Inter American Development Bank	11,316	11,843	12,161	10,950
Agency for International Development*	1,493	1,929	1,929	--
Medium and Long Term Liabilities	15,617	16,440	16,645	12,883

Capital Account

Department of Credit and Operations	$ 5,653	$ 5,933	$ 9,087	$10,905
Department of Development	3,924	4,181	4,537	5,632
Total Capital	9,577	10,114	13,624	16,537
Total Liabilities & Capital	37,612	44,544	47,528	50,760

*Loan 522-H-011 transferred to FEHCOVIL in Implementation Letter No. 16 dated March 14, 1972.

BANCO NACIONAL DE FOMENTO
Department of Credit and Operations
Source and Use of Funds
(In thousands)

	1972	1973	1974	1975	1976	1977
SOURCES	$35,590	$36,698	$37,620	$38,186	$38,686	$39,339
Initial cash and bank deposit balances	3,368	1,873	2,023	2,226	2,475	2,810
Capital recovery (Loan repayments)	17,004	18,612	19,184	19,382	18,986	18,656
Interest received on loans	2,600	2,849	3,055	3,226	3,377	3,531
Profits from commercial banking operations	221	237	253	269	286	302
Rediscounts from the Central Bank	6,826	7,288	7,749	8,210	8,672	9,133
Increase of deposits	1,414	1,415	1,417	1,419	1,420	1,422
GOH Contribution	--	1,500	1,500	1,500	1,500	1,500
Loans from foreign banks	2,000	1,750	1,750	1,750	1,750	1,750
Loan from A.I.D.	1,000	--	--	--	--	--
Interest from commercial banks - export loans	108	121	133	145	157	168
Interest on investments	11	13	14	15	17	19
Time deposits	1,000	1,000	500	--	--	--
Other inflows	38	40	42	44	46	48
USES	33,717	34,675	35,394	35,711	35,876	36,129
Loans extended	21,150	21,800	22,025	21,575	21,200	20,975
Ordinary service costs	938	942	946	983	987	991
Personnel costs	718	723	728	772	777	782
Operating costs	350	379	407	436	465	494
Payments to the Central Bank						
a. Rediscounts	6,366	6,537	6,748	7,209	7,671	8,133
b. Building mortgage (including interest)	106	107	108	109	111	112
c. Interest on rediscounts	360	394	428	462	496	529

	1972	1973	1974	1975	1976	1977
Payments to foreign banks						
a. Principal	$ 1,750	$ 1,750	$ 1,750	$ 1,750	$ 1,750	$ 1,750
b. Interest	118	123	123	123	123	123
Payments to BID						
a. Loan 20-SF	500	500	600	700	700	700
b. Loan 42-TF	137	156	163	169	175	175
c. Loan 115-SF-HO-1	253	253	253	253	253	253
d. Loan 115-SF-HO-11	160	159	159	159	159	159
e. Interest and Commissions	411	374	336	291	245	199
Interest payments on Mortgage Certificates	70	140	173	165	150	132
Investments	174	174	174	174	174	174
Interest on deposits	156	164	173	181	190	198
Amortization of Mortgage Certificates	--	--	100	200	250	250
Closing cash balance of the Department **of Credit** and Operations	74	131	241	397	640	947
Reserve requirement at the Central **Bank**	1,799	1,892	1,985	2,078	2,170	2,263

BANCO NACIONAL DE FOMENTO
Department of Development
Source and Use of Funds
(In thousands)

SOURCE	1972	1973	1974	1975	1976	1977
Beginning cash balance	$(1,529)	$ 237	$ 52	$ 58	$ 48	$ 27
GOH Contribution	2,000	500	500	500	500	500
Sale of Sula Milk Plant	1,840	--	--	--	--	--
Profits from Investment and Farming Activities						
a. EXCAHO	59	100	103	105	108	110
b. Sula Milk Plant	100	103	105	108	110	113
c. Rice Production	--	5	10	13	15	15
d. Cotton Production	--	354	--	--	--	--
Other Cash Inflows						
a. Marcalina Cooperative (Sale of shares)	4	4	4	4	4	4
b. Southern Cotton Cooperative (sale of plant)	12	12	12	--	--	--
c. Paraiseña Cooperative (sale of shares)	6	6	6	6	6	6
d. DESARRURAL (loan repayment)	24	24	24	24	24	24
e. ENEE (land sale)	11	8	8	8	8	--
f. FANALCO (land sale)	5	5	--	--	--	--
g. INGESA (sale of SAHSA airline shares)	50	50	50	50	--	--
h. Rental Income	5	--	--	--	--	--
i. Interest	45	35	27	20	12	5
j. Other	8	6	5	5	3	3
Total Inflow	$2,638	$1,449	$ 906	$ 901	$ 838	$ 807

USE	1972	1973	1974	1975	1976	1977
Personnel Costs	33	696	372	399	374	358
Operating Costs	18	363	190	199	185	176
Payments on Obligations						
a. Honduran Coffee Institute a/	159	155	155	158	158	158
b. M.E. Larios y M. de Motz (land purchase)	17	--	--	--	--	--
c. Albertina v. de Mendieta (land purchase)	33	31	--	--	--	--
d. Bank of America (EXCAHO stock)	35	34	32	--	--	--
e. Interest	72	35	31	27	23	19
f. Other	35	30	28	25	23	20
Investment Programs						
a. Agroavicola Inc. b/	98	--	--	--	--	--
b. Grain purchase c/	1144					
c. Rice cultivation	19	23	25	25	25	25
d. Cotton cultivation	450	--	--	--	--	--
e. Melon cultivation	169	--	--	--	--	--
f. Sesame seed cultivation	4	--	--	--	--	--
New Investment in Fixed Assets	115	30	15	20	23	25
Total Outflow	2401	1397	848	853	811	781
Closing Balance	237	52	58	48	27	26

a/ Dues to International Coffe Committee

b/ In Liquidation

c/ BNF's Initial Grain Purchase

BNF INVESTMENTS

Investment	Amount
"Altos Hornos" Steel Mill Project	$ 25,000
"Fanalco" Feed concentrate plant	6,350
BNF Employee Credit Cooperative	5,000
PLAHSA Milk Plant	810,105
"Excaho" Coffee Exporting Company	250,000
Choluteca Sugar Co.	52,500
"COPINO" Pulp and Paper Project	217,000
Barbed Wire Project	43,000
CANASA Paper Carton Company	50,000
Agroavícola Hatchery	49,399
SULA Milk Plant	1,469,800
BNF Retail Sales Department	501,006
Grain Silos and Warehouses	903,937
Tobacco Processing Plant	45,288
Honey Bee Project	12,913
Puerto Cortés Development	135,169
	$4,576,467

Annex II
Exhibit II

BNF Grain Storage and Marketing Revolving Fund

Projected Cash Flow Statement

(in thousands of dollars)

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Beginning Cash Balance	–	1900	2529	3337	4227	4351	4493	4267	4107	4190	4243	4316
Prior Year's Profits	–	29	8	90	124	142	157	223	216	186	206	226
BNF orig. contribution	1400	–	–	–	–	–	–	–	–	–	–	–
BNF temp. contribution	600	471	263	–	–	–	–	–	–	–	–	–
Central Bank loan	1000	–	–	–	–	–	–	–	–	–	–	–
BNF new contribution	–	100	100	100	–	–	–	–	–	–	–	–
AID loan disbursements	–	500	700	700	–	–	–	–	–	–	–	–
Total:	3000	3000	3600	4227	4351	4493	4650	4490	4323	4376	4449	4542
Repayments:												
Central Bank	500	–	–	–	–	–	250	250	–	–	–	–
AID	–	–	–	–	–	–	133	133	133	133	133	133
BNF temporary	600	471	263	–	–	–	–	–	–	–	–	–
Total Repayments:	1100	471	263	–	–	–	383	383	133	133	133	133
Ending Cash Balance:	1900	2529	3337	4227	4351	4493	4267	4107	4190	4243	4316	4409
% Mark-up of Grain Sales over Grain Purchases	20	20	20	19	19	18.5	18	17.5	17	16.5	16	15
Yearly turnover of capital	1.08	1.1	1.1	1.1	1.15	1.2	1.3	1.4	1.5	1.6	1.7	1.8

Projected Profit and Loss Statement

	1972	1973	1974	1975	1976	1977	1978	1979	1980	1981	1982	1983
Grain Sales	3908	3960	4752	5534	5955	6390	7133	7386	7586	8157	8773	9402
Grain Purchases	3240	3300	3960	4650	5004	5392	6045	6286	6484	7002	7563	8176
Services and Rentals	30	38	45	50	55	60	66	73	80	88	97	106
Gross Margin	698	698	837	934	1006	1060	1154	1173	1182	1243	1307	1332
Personnel Costs	261	274	288	302	317	333	350	367	386	405	425	446
Operations and Maint.	141	148	155	163	171	180	189	198	208	219	230	241
Other	102	107	112	118	124	130	137	144	151	158	166	174
Overhead	125	131	138	145	152	160	168	176	185	194	204	214
Interest-Central Bank	40	20	20	20	20	20	10	–	–	–	–	–
Interest-AID	–	10	34	62	80	80	77	72	66	61	56	51
Total Costs	669	690	747	810	864	903	931	957	996	1037	1081	1126
Profit (Loss)	29	8	90	124	142	157	223	216	186	206	226	206

Projected BNF Operations in the Corn Market
(Thousands of cwt. and dollars)

	Production (3.6%)	Marketed %	Marketed Amount	BNF Purchases %	BNF Purchases Amount	BNF Purchases Value	Prices Buying	Prices % Markup	Prices Selling	Value of Sales	Uses on Farm	Uses Other	Available
1972	7480	50	3740	14.1	526.8	$1712	$ 3.25	17	$ 3.80	$ 2036	3740	3406	334
1973	7749	50	3875	18.0	698.4	2200	3.15	20	3.78	2641	3874	3549	326
1974	8028	51	4094	18.2	745.2	2310	3.10	19	3.69	2749	3934	3698	396
1975	8317	52	4325	19.8	857.0	2571	3.00	18	3.54	3034	3992	3853	472
1976	8617	53	4567	20.8	948.7	2846	3.00	18	3.54	3359	4050	4015	552
1977	8927	54	4821	21.7	1045.0	3135	3.00	17	3.51	3668	4106	4184	637
1978	9248	55	5086	23.4	1191.7	3575	3.00	17	3.51	4183	4162	4360	726
1979	9581	56	5365	25.1	1347.3	4042	3.00	16	3.48	4689	4216	4543	822
1980	9926	57	5658	26.7	1512.3	4537	3.00	15	3.45	5219	4268	4734	906
1981	10,283	58	5964	28.3	1686.7	5060	3.00	14	3.42	5769	4319	4932	1032
1982	10,654	59	6286	29.7	1870.0	5610	3.00	13	3.39	6639	4368	5140	1246
1983	11,037	60	6622	31.1	2062.3	6187	3.00	12	3.36	6930	4415	5355	1267
1984	11,435	61	6975	32.5	2264.3	6793	3.00	11	3.33	7539	4460	5580	1395

Projected BNF Operations in the Bean Market

(Thousands of cwt. and dollars)

	Production (5.5%)	Marketed %	Marketed Amount	BNF Purchases %	BNF Purchases Amount	BNF Purchases Value	Prices Buying	Prices % Markup	Prices Selling	Value of Sales	Uses on Farm	Uses Other	Available
1972	1144	50	572	22.9	131.0	$ 917	$7.00	17	$8.19	$1382	572	469	103
1973	1207	52	628	27.3	171.4	1200	7.00	20	8.40	1441	579	489	139
1974	1273	54	687	26.2	180.0	1260	7.00	19	8.33	1499	586	509	178
1975	1343	56	752	26.6	200.3	1402	7.00	18	8.26	1655	591	531	221
1976	1417	58	822	27.0	221.7	1552	7.00	18	8.26	1832	595	553	269
1977	1495	60	897	27.2	244.3	1710	7.00	17	8.19	2001	598	576	321
1978	1577	60	946	29.5	278.6	1950	7.00	17	8.19	2281	631	600	346
1979	1664	61	1015	31.0	315.0	2205	7.00	16	8.12	2558	649	626	389
1980	1756	61	1071	33.0	353.6	2475	7.00	15	8.05	2846	685	652	419
1981	1852	61	1130	34.3	394.3	2760	7.00	14	7.98	3146	722	679	451
1982	1954	62	1211	36.1	437.1	3060	7.00	13	7.91	3458	743	708	503
1983	2062	62	1278	37.7	482.1	3375	7.00	12	7.84	3780	784	737	541
1984	2175	62	1349	39.3	529.3	3705	7.00	11	7.77	4112	826	768	581

AID 1240-2

CHECKLIST OF STATUTORY CRITERIA

(Alliance for Progress)

In the right-hand margin, for each item, write answer or, as appropriate, a summary of required discussion. As necessary, reference the section(s) of the Capital Assistance Paper, or other clearly identified and available document, in which the matter is further discussed. This form may be made a part of the Capital Assistance Paper.

The following abbreviations are used:

FAA - Foreign Assistance Act of 1961, as amended.

App. - Foreign Assistance and Related Agencies Appropriations Act, 1972.

MMA - Merchant Marine Act of 1936, as amended.

COUNTRY PERFORMANCE

Progress Towards Country Goals

1. *FAA § 208; §.251(b).*

A. Describe extent to which country is:

(1) Making appropriate efforts to increase food production and improve means for food storage and distribution.

(1) The Government of Honduras has placed a strong emphasis on increasing food production and providing enlarged facilities for its storage and distribution. A comprehensive analysis of the agricultural sector was initiated at the beginning of this CY. All the international agencies involved in Honduran economic development are contributing through various programs to the goals of increased food production and improved food distribution.

(2) Creating a favorable climate for foreign and domestic private enterprise and investment.

(2) Honduras is striving to create as favorable a climate as possible for foreign and domestic private enterprise and investment. The GOH has just recently organized an export promotion department in the Ministry of Economy. This department provides assistance to domestic firms entering international markets and foreign companies wishing to invest in Honduras. The AID Specific Risk Investment Guarantee Program is fully operative here. Firms can obtain loans from several sources including the Government-owned National Development Bank and the Central American Bank for Economic Integration.

(3) Increasing the public's role in the developmental process.	(3) Honduras is activily encouraging the participation of its citizens in the development process. The export promotion department, previously mentioned, is working to involve private businessmen in developing an enlarged industrial base. The GOH is working with AID in several grant and loan programs, designed to strengthen private institutions, including coops.
(4) (a) Allocating available budgetary resources to development.	(4-a) Honduras has been allocating slightly over 25% of its budget in the recent past for investment purposes.
(b) Diverting such resources for unnecessary military expenditure (See also Item No. 16 and intervention in affairs of other free and independent nations.) (See also Item No. 14.)	(4-b) Military spending increased somewhat because of the 1969 hostilities with El Salvador. This increase does not appear to be disproportionate to Honduran defense needs. The material obtained has been used only for defense purposes and not to intervene in the affairs of other free and independent nations.
(5) Willing to contribute funds to the project or program.	(5) The BNF is providing a substantial contribution to this project. For more information see Section II D of the Capital Assistance Paper.
(6) Making economic, social, and political reforms such as tax collection improvements and changes in land tenure arrangements, and making progress toward respect for the rule of law, freedom of expression and of the press, and recognizing the importance of individual freedom, initiative, and private enterprise.	(6) At the present time the Honduran Congress is studying ways to improve tax collection procedures. A law allowing a pilot cadaster to be made has just been passed. The cadaster will assist in making changes in land titling procedures. Honduras does not restrict freedom of expression and of the press and recognizes the importance of individual freedom, initiative, and private enterprise.

(7) Adhering to the principles of the Act of Bogota and Charter of Punta del Este.

(7) Honduras has been adhering to the principles of the Act of Bogota and the Charter of Punta del Este.

(8) Attempting to repatriate capital invested in other countries by its own citizens.

(8) By following a course of political stability and attempting to promote economic development. Honduras is taking an effective step to induce its own citizens to repatriate capital.

(9) Otherwise responding to the vital economic, political, and social concerns of its people, and demonstrating a clear determination to take effective self-help measures.

(9) In June 1971, a new government was inaugurated following elections in March. The elections took place in accordance with the constitution and enabled the Honduran people to participate directly in the country's political process.

B. Are above factors taken into account in the furnishing of the subject assistance?

B. All of the above factors were taken into account.

Treatment of U.S. Citizens

2. *FAA § 620(c). If assistance is to government, is the government liable as debtor or unconditional guarantor on any debt to a U.S. citizen for goods or services furnished or ordered where (a) such citizen has exhausted available legal remedies and (b) debt is not denied or contested by such government?*

2. AID knows of no such indebtedness to any U.S. citizen.

AID 1240-2

3. *FAA § 620(e)(1). If assistance is to a government, has it (including government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities?*

3. There is no evidence of any such action.

4. *FAA § 620(o); Fishermen's Protective Act. § 5. If country has seized, or imposed any penalty or sanction against, any U.S. fishing vessel on account of its fishing activities in international waters,*

4. Honduras has not seized or imposed any such sanction on any U.S. fishing vessels on account of their activities in international waters during recent years.

a. has any deduction required by Fishermen's Protective Act been made?

b. has complete denial of assistance been considered by A.I.D. Administrator?

AID 1240-2

Relations with U.S. Government and Other Nations

5. *FAA § 620(d). If assistance is for any productive enterprise which will compete in the United States with United States enterprise, is there an agreement by the recipient country to prevent export to the United States of more than 20% of the enterprise's annual production during the life of the loan?*

5. This loan is not for a productive enterprise.

6. *FAA § 620(j). Has the country permitted, or failed to take adequate measures to prevent, the damage or destruction, by mob action, of U.S. property?*

6. During periods of tension and public commotion caused by factors such as the educational reform program being carried out by the GOH with AID loan assistance the Government failed to take adequate measures to prevent damage to the U.S. Chancery, USIS installations, and U.S. Military Advisory Group offices. Honduran officials have subsequently assured the Mission of adequate protection from any future disturbances. The Chancery has been given a 24 hour guard. The GOH has to date shown willingness to compensate the USG for all damages sustained.

7. *FAA § 620(l). If the country has failed to institute the investment guaranty program for the specific risks of expropriation, inconvertibility or confiscation, has the A.I.D. administration within the past year considered denying assistance to such government for this reason?*

7. Honduras has initiated the OPIC Investment Guaranty Program.

8. *FAA § 620(q). Is the government of the recipient country in default on interest or principal of any A.I.D. loan to the country?*

8. Honduras is not in default on any such loan.

AID 1240-2 (4-71)

9. *FAA § 620(t). Has the country severed diplomatic relations with the United States? If so, have they been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?*

9. Honduras has maintained diplomatic relations with the U.S.

10. *FAA § 620(u). What is the payment status of the country's U N. obligations? If the country is in arrears, were such arrearages taken into account by the A.I.D. Administrator in determining the current A.I.D. Operational Year Budget?*

10. Honduras is not in arrears to the extent described in Article 19 of the U N Charter.

11. *FAA § 620(a). Does recipient country furnish assistance to Cuba or fail to take appropriate steps to prevent ships or aircraft under its flag from carrying cargoes to or from Cuba?*

11. Honduras neither furnishes assistance to Cuba nor permits ships or aircraft under its flag to carry cargo to or from Cuba.

12. *FAA § 620(b). If assistance is to a government, has the Secretary of State determined that it is not controlled by the international Communist movement?*

12. The Secretary of State has determined that Honduras is not controlled by the international Communist movement.

13. *FAA § 620(f). Is recipient country a Communist country?*

13. Honduras is not a communist country.

14. *FAA § 620(i). Is recipient country in any way involved in (a) subversion of, or military aggression against, the United States or any country receiving U.S. assistance, or (b) the planning of such subversion or aggression?*

14. AID has no evidence of any subversion or aggression or of plans for any such action against any country.

15. *FAA § 620(n). Does recipient country furnish goods to North Viet-Nam or permit ships or aircraft under its flag to carry cargoes to or from North Viet-Nam?*

15. AID has no evidence of Honduran involvement in such matters.

Military Expenditures

16. *FAA § 620(s). What percentage of country budget is for military expenditures? How much of foreign exchange resources spent on military equipment? How much spent for the purchase of sophisticated weapons systems? (Consideration of these points is to be coordinated with the Bureau for Program and Policy Coordination, Regional Coordinators and Military Assistance Staff (PPC/RC).)*

16. According to official released figures, 10.2% of the GOH budget is allocated to military spending during 1972. The Mission believes the major portion of this fund is used for standard arms and ammunition, personnel costs, maintenance, etc. There is no reason to believe the GOH has any sophisticated weapons systems.

AID 1240-2

CONDITIONS OF THE LOAN

General Soundness

17. *FAA § 201(d). Information and conclusion on reasonableness and legality (under laws of country and the United States) of lending and relending terms of the loan.*

17. The proposed loan is legal under Honduran and U.S. law and the proposed terms are reasonable for Honduras.

18. *FAA § 251(b)(2); § 251(e). Information and conclusion on activity's economic and technical soundness. If loan is not made pursuant to a multilateral plan, and the amount of the loan exceeds $100,000, has country submitted to A.I.D. an application for such funds together with assurances to indicate that funds will be used in an economically and technically sound manner?*

18. The activity has been found economically and technically sound. The Borrower has submitted a loan application to AID dated May 8, 1972 which contains assurances that the funds will be used in a sound manner.

19. *FAA § 251(b). Information and conclusion on capacity of the country to repay the loan, including reasonableness of repayment prospects.*

19. It appears reasonably certain that the BNF (Borrower) will be able to repay the loan.

20. *FAA § 611(a)(1). Prior to signing of loan will there be (a) engineering, financial, and other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost to the United States of the assistance?*

20. The necessary plans have been completed and a reasonably firm estimate of the cost to the U.S. of the activity to be financed has been obtained.

21. *FAA § 611(a)(2). If further legislative action is required within recipient country, what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purposes of loan?*

21. Since the GOH will guarantee the loan, ratification by the Honduran Congress will be necessary prior to initiation of disbursements. AID loans made to the Government and its agencies in the past have been ratified on a timely basis.

22. *FAA § 611(e). If loan is for Capital Assistance, and all U.S. assistance to project now exceeds $1 million, has Mission Director certified the country's capability effectively to maintain and utilize the project?*

22. The Mission Director has signed the certification included in Annex I of this CAP.

23. *FAA § 251(b). Information and conclusion on availability of financing from other free-world sources, including private sources within the United States.*

23. Financing for this project is apparently not available from other free-world sources, including private sources within the United States.

Loan's Relationship to Achievement of Country and Regional Goals

24. *FAA § 207; § 251(a). Extent to which assistance reflects appropriate emphasis on: (a) encouraging development of democratic, economic, political, and social institutions; (b) self-help in meeting the country's food needs; (c) improving availability of trained manpower in the country; (d) programs designed to meet the country's health needs, or*

24. This loan is designed to improve the National Development Bank's grain marketing program which will in turn improve agricultural production and distribution. It will not have a direct effect on improving availability of trained manpower in the country or meeting the country's health needs other than in nutrition.

24. *(e) other important areas of economic, political, and social development, including industry; free labor unions, cooperatives, and Voluntary Agencies; transportation and communication; planning and public administration; urban development, and modernization of existing laws.*

25. *<u>FAA § 209.</u> Is project susceptible of execution as part of regional project? If so why is project not so executed?*

25. This project is not suitable for execution as part of a regional project. See Annex V of the CAP (classified).

26. *<u>FAA § 251(b)(3)</u>. Information and conclusion on activity's relationship to, and consistency with, other development activities, and its contribution to realizable long-range objectives.*

26. This project is consistent with the host country's development plan and the AID program in agriculture and its execution is essential to the realization of long-range development objectives.

27. *<u>FAA § 251(b)(7)</u>. Information and conclusion on whether or not the activity to be financed will contribute to the achievement of self-sustaining growth.*

27. This project will contribute to the achievement of self-sustaining growth of the National Development Bank (BNF) since it emphasizes improvement in administrative practices and the financial position of the Bank.

28. *<u>FAA § 281(a)</u>. Describe extent to which the loan will contribute to the objective of assuring maximum participation in the task of economic development on the part of the people of the country, through the encouragement of democratic, private, and local governmental institutions.*

28. By developing a national basic grain pricing policy and having the resources necessary to back it up the BNF will be in a position to help small farmers gain a greater share of participation in economic development.

AID 1240-2

29. *FAA § 281(b). Describe extent to which program recognizes the particular needs, desires, and capacities of the people of the country; utilizes the country's intellectual resources to encourage institutional development; and supports civic education and training in skills required for effective participation in governmental and political processes essential to self-government.*

29. The loan recognizes the need of small farmers as well as low income consumers to be assured of stable basic grain prices. The BNF is using its own staff to develop a pricing policy which will produce a stable situation.

30. *FAA § 601(a). Information and conclusions whether loan will encourage efforts of the country to: (a) increase the flow of international trade; (b) foster private initiative and competition; (c) encourage development and use of cooperatives, credit unions, and savings and loan associations; (d) discourage monopolistic practices; (e) improve technical efficiency of industry, agriculture, and commerce; and (f) strengthen free labor unions.*

30. This project will increase the flow of international trade by giving small farmers an incentive through stable prices to produce for market rather than just for personal consumption. Cooperatives, credit unions, etc. will receive indirect encouragement from this project because more farmers will be able and willing to engage in such activities.

31. *FAA § 619. If assistance is for newly independent country; is it furnished through multilateral organizations or plans to the maximum extent appropriate?*

31. Honduras is not a newly independent country.

32. *FAA § 251(h). Information and conclusion on whether the activity is consistent with the findings and recommendations of the Inter-American Committee for the Alliance for Progress in its annual review of national development activities.*

32. It has been determined that this activity is consistent with the findings and recommendations of the Inter American Committee for the Alliance for Progress. (See page 33 of the CAP).

AID 1240-2

33. *<u>FAA § 251(g)</u>. Information and conclusion on use of loan to assist in promoting the cooperative movement in Latin America.*

33. This loan will allow small farmers to engage in more cooperative activities by increasing the income they can use for such activities.

34. *<u>FAA § 209; § 251(b)(8)</u>. Information and conclusion whether assistance will encourage regional development programs, and contribute to the economic and political integration of Latin America.*

34. This project will have a secondary effect on regional development by strengthening Honduras' position in the international grains market thus giving them a stronger bargaining position in CACM negotiations.

<u>Loan's Effect on U.S. and A.I.D. Program</u>

35. *<u>FAA § 251(b)(4); § 102</u>. Information and conclusion on possible effects of loan on U.S. economy, with special reference to areas of substantial labor surplus, and extent to which U.S. commodities and assistance are furnished in a manner consistent with improving the U.S. balance of payments position.*

35. This project will have no foreseeable adverse effects on the U.S. economy.

36. *<u>FAA § 601(b)</u>. Information and conclusion on how the loan will encourage U.S. private trade and investment abroad and how it will encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).*

36. U.S. private trade will be encouraged indirectly through the increased ability of farmers to purchase U.S. manufactured products.

AID 1240-2

37. *FAA § 601(d). If a capital project, are engineering and professional services of U.S. firms and their affiliates used to the maximum extent consistent with the national interest?*

37. Services of U.S. consultants will be used to the maximum extent.

38. *FAA § 602. Information and conclusion whether U.S. small business will participate equitably in the furnishing of goods and services financed by the loan.*

38. No funds under this loan are to be allocated for commodities normally produced by U.S. small business.

39. *FAA § 620(h). Will the loan promote or assist the foreign aid projects or activities of the Communist-Bloc countries?*

39. This loan will not promote or assist foreign aid projects of Communist-Bloc countries.

40. *FAA § 621. If Technical Assistance is financed by the loan, information and conclusion whether such assistance will be furnished to the fullest extent practicable as goods and professional and other services from private enterprise on a contract basis. If the facilities of other Federal agencies will be utilized, information and conclusion on whether they are particularly suitable, are not competitive with private enterprise, and can be made available without undue interference with domestic programs.*

40. Technical assistance to be financed under the loan will be furnished to the fullest extent practicable by private organizations. Because the facilities and personnel of the U.S. Department of Agriculture are particularly suitable for providing some of the technical assistance and training to be funded under this loan, some use of these facilities is contemplated but A.I.D. understands that they can be made available without undue interference with domestic programs.

D 1240-2

__FAA § 252(a)__. Total amount of money under loan which is going directly to private enterprise, is going to intermediate credit institutions or other borrowers for use by private enterprise, is being used to finance imports from private sources, or is otherwise being used to finance procurements from private sources.

41. The entire amount of the loan will be made available to an intermediate credit institution for inventory financing of grain produced within Honduras by the private sector, as well as to finance related training and technical assistance for personnel.

__m's Compliance with Specific uirements__

__FAA § 201(d)__. Is interest rate of loan at least 2% per annum during grace period and at least 3% per annum thereafter?

42. Yes

__FAA § 608(a)__. Information on measures to be taken to utilize U.S. Government excess personal property in lieu of the procurement of new items.

43. A requirement to this effect will be included in the Loan Agreement.

__FAA § 604(a)__. Will all commodity procurement financed under the loan be from the United States except as otherwise determined by the President?

44. Any possible commodity procurement under the loan will be restricted to countries included in AID Geographic Code 941.

__FAA § 604(b)__. What provision is made to prevent financing commodity procurement in bulk at prices higher than adjusted U.S. market price?

45. No bulk commodity procurement is contemplated under this loan.

AID 1240-2

46. *FAA § 604(d). If the cooperating country discriminates against U.S. marine insurance companies, will loan agreement require that marine insurance be placed in the United States on commodities financed by the loan?*

46. The Loan Agreement will provide for compliance with this provision.

47. *FAA § 604(e). If offshore procurement of agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity?*

47. No such procurement is contemplated.

48. *FAA § 611(b); App. § 101. If loan finances water or water-related land resource construction project or program, is there a benefit-cost computation made, insofar as practicable, in accordance with the procedures set forth in the Memorandum of the President dated May 15, 1962?*

48. This project is not a water or water-related land resources construction project.

49. *FAA § 611(c). If contracts for construction are to be financed, what provision will be made that they be let on a competitive basis to maximum extent practicable?*

49. No construction is contemplated under the loan.

50. *FAA § 620(g). What provision is there against use of subject assistance to compensate owners for expropriated or nationalized property?*

50. The Loan Agreement will provide for specific use of the loan funds and thereby preclude allocation of the funds for such purposes.

51. *FAA § 612(b); § 636(h). Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the United States are utilized to meet the cost of contractual and other services.*	51. No U.S. owned foreign currency is available for use in the loan. Honduras is contributing local currency to the project. See Section II D of the CAP.
52. *App. § 104. Will any loan funds be used to pay pensions, etc., for military personnel?*	52. Loan funds will not be used for this purpose.
53. *App. § 106. If loan is for capital project, is there provision for A.I.D. approval of all contractors and contract terms?*	53. The loan agreement will require AID approval of any firm providing services for the project as well as the terms of any contracts under which such services are provided.
54. *App. § 108. Will any loan funds be used to pay U.N. assessments?*	54. No loan funds will be used to pay U.N. assessments.
55. *App. § 109. Compliance with regulations on employment of U.S. and local personnel for funds obligated after April 30, 1964 (A.I.D. Regulation 7).*	55. This provision will be complied with.
56. *FAA § 636(i). Will any loan funds be used to finance purchase, long-term lease, or exchange of motor vehicle manufactured outside the United States, or any guaranty of such a transaction?*	56. No loan funds will be used for this purpose.

AID 1240-2

57. *App. § 401. Will any loan funds be used for publicity or propaganda purposes with the United States not authorized by the Congress?*

57. No loan funds will be used for propoganda purposes.

58. *FAA § 620(k). If construction of productive enterprise, will aggregate value of assistance to be furnished by the United States exceed $100 million?*

58. This project will not involve construction of a productive enterprise.

59. *FAA § 612(d). Does the United States own excess foreign currency and, if so, what arrangements have been made for its release?*

59. The United States does not own excess foreign currency suitable or available for utilization in this project.

60. *MMA § 901.b. Compliance with requirement that at least 50 per centum of the gross tonnage of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed with funds made available under this loan shall be transported on privately owned U.S.-flag commercial vessels to the extent that such vessels are available at fair and reasonable rates.*

60. The Loan Agreement will provide for compliance with this provision.

61. FAA 481. Has the government of recipient country failed to take adequate steps to prevent narcotic drugs and other controlled substances (as defined by the Comprehensive Drug Abuse Prevention and Control Act of 1970) produced or processed, in whole or in part, in such country, or transported through such country, from being sold illegally within the jurisdiction of such country to U.S. Government personnel or their dependents, or from entering the U.S. unlawfully?

61. The GOH has taken adequate steps to control illegal narcotics traffic. A special Narcotics Investigation Branch was established within the Police (CES) in 1970. Honduras is not at this time a channel for international traffic in heroin or cocaine, and most cases have been in the area of the internal use, sale or growing of marijuana or the use or sale of amphetamines or barbituates. The Honduran Police have cooperated with BNDD on two recent occasions involving suspected trafficking. Draft legislation was introduced in the Honduran Congress to provide criminal penalties for drug abuses not covered by the existing code.