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

CAPITAL ASSISTANCE PAPER
Project Number - 527-24-930-139
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Proposal and Recommendations
For the Review of the
Development Loan Committee

PERU: PRIVATE INVESTMENT FUND

AID-DLC/P-558

UNCLASSIFIED

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

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AID-DLC/P-558
June 14, 1967

MEMORANDUM FOR THE DEVELOPMENT LOAN COMMITTEE

SUBJECT: Peru: Private Investment Fund

Attached are revised pages to be inserted in the subject Capital Assistance Paper.

The recommendations for authorization of a loan in an amount not to exceed $7,500,000 to the Republic of Peru or in the alternative to the Industrial Bank of Peru to assist in financing through a Private Investment Fund priority agro-industrial activities, such assistance being designed also to stimulate U.S. exports and expand markets for U.S. equipment, were discussed at a meeting of the Development Loan Staff Committee on Friday, June 9, 1967.

Rachel C. Rogers
Assistant Secretary
Development Loan Committee

Attachments: (Revised June 14, 1967)
Summary and Recommendations, pp. i and iii
Project Analysis, pp. 31 and 37

Previously Distributed: June 5, 1967
Summary and Recommendations
Project Analysis
ANNEXES I-V

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

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AID-DLC/P-558
June 5, 1967

MEMORANDUM FOR THE DEVELOPMENT LOAN COMMITTEE

SUBJECT: Peru: Private Investment Fund

Attached for your review are the recommendations for authorization of a loan in an amount not to exceed $7,500,000 to the Republic of Peru or in the alternative to the Industrial Bank of Peru to assist in financing through a Private Investment Fund priority agro-industrial activities, such assistance being designed also to stimulate U.S. exports and expand markets for U.S. equipment.

This loan proposal is scheduled for consideration by the Development Loan Staff Committee at a meeting on Friday, June 9, 1967.

Rachel C. Rogers
Assistant Secretary
Development Loan Committee

Attachments:
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June 5, 1967

PERU - PRIVATE INVESTMENT FUND

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PERU - PRIVATE INVESTMENT FUND

SUMMARY AND RECOMMENDATIONS

1. BORROWER: The Industrial Bank of Peru will be the Borrower and will relend the A.I.D. loan funds to the Government of Peru for deposit in the Central Bank. The Government of Peru will assume the repayment obligation or will guaranty the obligation to A.I.D. The Central Bank will create and administer a Private Investment Fund (P.I.F.) to be made up of this A.I.D. loan and Central Bank matching funds. State development banks, investment companies (financieras) and commercial banks acting as intermediaries will be utilized to achieve the desired distribution of P.I.F. funds.

2. AMOUNT: Up to $7.5 million for procurement of goods and services in the U.S. (up to $100,000 of this total will be available for technical assistance to the Central Bank.)

3. DESCRIPTION OF LOAN: This loan is directed towards the expansion of the agro-industrial sector of the Peruvian industry. Loans will be made via the various intermediary credit institutions to private industrial enterprises which engage in processing, packaging, or preserving agricultural commodities (both food and non-food). In addition, projects or services which provide major inputs to the agro-industrial field will be eligible when it can be clearly demonstrated that such projects are of sufficient scale to be efficient.

   Project proposals requiring more than $500,000 of U.S. procurement will be referred at an early stage to the Export-Import Bank to determine whether or not the Bank is interested in financing the particular project. In order to avoid potential competition with the normal medium term export financing of the Export-Import Bank, A.I.D. resources will not be made available for pure equipment financing (that is, where dollar loan funds alone are needed to purchase particular pieces of equipment for an existing enterprise).

The AID loan of $7.5 million will be matched by an equivalent amount of Peruvian soles provided by the Central Bank to complement the AID loan dollars and finance a portion of the local currency costs of projects. The total fund of $15 million equivalent should be committed over a two year period with disbursements (allowing for engineering and construction etc.) over a three year period. It is hoped that in the long run the PIF will attract financing to other countries interested in contributing to the further expansion of the private sectors in Peru.

General allocation of the total AID funds will be established from time to time to ensure a broad distribution of the funds among the various intermediate credit institutions. Initially, the commercial banks will be allocated up to $3.2 million of the loan funds, the private financieras up to $2.6 million, and the development banks up to $1.7 million.

The AID loan will carry the concessional terms of 40-year repayment, 1% interest for the first ten years (grace period), and 2½% interest for the remaining 30 years.

PIF funds will be loaned to (or guaranteed by) the intermediate credit institutions at from 8 to 10% per annum (the higher interest rates applying to the longer term loans). The private sub-borrower interest rate would be 12 to 14% (the current rates in Peru for sole development loans) for terms of from 2 to 15 years. The GOP will assume the exchange risk so that repayments of sub-loans will be made to the P.I.F. in soles. The intermediaries will assume the credit risk for all sublending.

The Central Bank will create a three-man Review Committee to manage the P.I.F. and will publish the regulations and operating procedures governing the use of the P.I.F. to intermediaries by means of bank circulars.

Projects proposed by intermediaries will be examined by the Review Committee to see that the project conforms to provisions and Regulations of the P.I.F. The Central Bank will also monitor such things as the 50/50 shipping requirements and report periodically on the expenditures made with loan funds.

4. OBJECTIVES: The AID loan will be used to achieve the following objectives:

   (a) Provide medium to long-term financing without exchange risk for priority agro-industrial activities.

   (b) Provide medium to long-term financing without exchange risk to encourage expansion of Peruvian export industries (when related to the agricultural sector).

   (c) Stimulate U.S. exports and expand markets for U.S. equipment.

   (d) Assist the Central Bank to ensure that priority industrial activities are accommodated during the coming months when the Central Bank's tight credit policies are likely to continue.

   (e) Assist GOP balance of payments by partially substituting PIF financing for commercial and short-term supplier credits currently obtained from non-U.S. sources by Peruvian industrialists.

   (f). Encourage commercial banks to undertake medium term project lending, and support and strengthen financieras.

5. EXIMBANK CLEARANCE: Export-Import Bank clearance has been obtained for this project. Export-Import Bank will participate in the PIF program to the extent they finance projects requiring $500,000 or more in dollar expenditures. All such projects submitted for PIF consideration must be cleared with Ex-im prior to final consideration by the PIF. Ex-im will be given adequate time to consider whether they want to finance such projects or not.

6. IDB and IBRD INTEREST: The IDB and IBRD have both declined to undertake this project.

7. COUNTRY TEAM VIEWS: The USAID/Embassy in Lima supports this project as being highly beneficial to industry in Peru and in furtherance of the major effort now underway in the agricultural sector. In addition, exports to Peru of U.S. equipment and services will be increased.

8. STATUTORY CRITERIA: All statutory criteria have been met.

9. SPECIAL TERMS AND CONDITIONS: None.

10. ISSUES: None.

11. RECOMMENDATION: A loan of $7,500,000 will be made to the Government of Peru through the Industrial Bank to establish the PIF on the following terms:

    a. Interest and Terms of Repayment: The GOP shall repay the loan to AID in United States dollars within forty (40) years from the first disbursement of the loan, including a grace period of not to exceed ten (10) years. GOP shall pay to AID in United States dollars, on the disbursed balance of the loan, interest of one (1) percent per annum during the grace period herein above mentioned and two and one-half (2½) percent per annum thereafter.

    b. The GOP shall deliver the proceeds of the loan in trust to the Central Bank to establish the PIF; the Central Bank shall act as fiduciary of the GOP and operate the PIF as agreed upon with AID.

    c. Equipment, materials and services financed by the loan shall be procured from the United States.

    d. Subloans extended by the PIF shall be made in accordance with the Central Bank regulations governing the use of PIF funds or as amended by mutual agreement between AID and the Borrower.

    e. Except as AID may otherwise agree, no PIF financing will be made available for the processing for export of food or feed commodities currently found in excess supply on world markets or for the processing for export or domestic consumption of any agricultural commodity, other than food or feed, currently in world surplus.

PROJECT COMMITTEE:

Loan Officer	: CBuchanan	USAID/Lima
Industrial Officer	: GLindahl	USAID/Lima
Economist	: GLamberty	EMB/ECO/Lima
Legal Counsel	: DFalk	USAID/Lima
Advisor	: MGerson	AID/W

June 5, 1967

SECTION I - BACKGROUND AND ECONOMIC JUSTIFICATION

A. The Industrial Sector

During the period 1960-65, the Gross National Product of Peru grew at an average rate, in constant prices, of 6.5% per annum and this growth was largely paced by the industrial and private sector. During the four-year period 1960 to 1964, for example, manufacturing increased 43% while agriculture and fishing increased by only 17%. (1) During 1965 manufacturing accounted for 16.1% of GNP, commerce 15.7% and mining 6.5%.

The private sector also plays an important role in new capital formation. In 1965 total gross investment accounted for 21% of GNP and roughly four fifths of this investment took place in the private sector. The industrial sector has also played an important role in the marked expansion of Peruvian exports of mining products and fishmeal. The rapid development of the fishing industry and marked increases in mining production, especially copper, have led to a 54% increase in exports during the period 1960-1965. (1)

In 1965, the total gross product of the manufacturing sector (excluding mining) totalled the equivalent of roughly $570 million. (2) About a third of the production was in the food products industry (including fishmeal) with roughly 12% in textiles, 10% chemicals, and 16 to 20% in basic metal production and metalworking.

In general (with the exception of fishmeal) the Peruvian manufacturing industry is largely directed towards the domestic market. Tariffs on goods imported from outside LAFTA average about 40 to 45% with somewhat less for the LAFTA countries. Tariffs are higher on consumer goods, especially consumer durables, and somewhat lower on capital goods; in fact, the industrial promotion law provides for various reductions in tariffs on capital goods and imported raw materials. It is probably true that most

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(1) 1963 prices
(2) In 1963 prices converted at S/.26.80 per U.S.$

Peruvians believe they have less to gain from full participation in LAFTA than do other countries; without the pressure of LAFTA, the industrial sector of Peru might further develop along the lines of domestically-oriented, tariff-protected industries.

In recent years the growth in manufacturing has been lead by expansion in the fishmeal industry, artificial fibers and textiles, leather goods, the chemical industry, and metal-working. Food processing industries generally have not kept pace. This expansion has largely been in the Lima-Callao area, due principally to the availability of infrastructure and the proximity of the market. As of 1965, the Lima-Callao area accounted for 42.5% of national income and only 22% of the population. In terms of output of the manufacturing sector alone, the figures reveal an even greater disparity; during the last few years the Lima-Callao area has accounted for about 55% of the annual value of all manufacturing.

For many years, Peru has enjoyed an excellent climate for private investment which generally accounts for the performance of the private sector. With a complete absence of exchange controls, a relatively stable economy, and with adequate exports in relationship to imports, foreign credit and direct investment has been readily available.

Nevertheless, credit restraints placed upon the economy by the GOP to combat inflation over the past two years are being felt by the industrial sector. This, combined with the belief held by a number of them that the Peruvian sol may soon be devalued, has made industrialists cautious and investments more selective. It is hoped that the P.I.F. can help both stimulate investments in new industrial activities and keep general industrial expansion from stagnating.

With the exception of the Chimbote steel project, the salt and tobacco industry, an oil company, and relatively minor investments by regional authorities in fertilizers and cement, the government has not invested in the industrial field; the GOP has, in fact, recently opened the tobacco and salt industries to private investments. The industrial promotion law provides various incentives (income and other tax and import duty reductions) for a wide variety of investments outside the Lima-Callo area.

The book value of U.S. direct investment in Peru has been variously estimated in the range of $500 million to $800 million. Encouraged by a special set of incentives (relating largely to tariffs), Ford, Chrysler, General Motors and American Motors have recently established assembly plants in Peru.

B. Agricultural Processing and Marketing and Export Industries

During the 1960-66 period agricultural production has fallen slightly behind the population growth of three percent a year, and agriculture's share of GNP has declined from 21% to 17% although 50% of the population still obtains its livelihood from agriculture. Agricultural imports doubled in the first half of the 60's, increasing from $60.2 million in 1960 to $130.3 in 1965 and about $140.0 million in 1966. Since 1960 agricultural exports have climbed only slightly from the $150 million level attained that year, and agriculture's share of total exports have declined from 35% to an estimated 22% in 1966.

The implications of the relative stagnation of the agricultural sector in terms of economic growth, social development, and an increased domestic market have led AID in Peru to categorize agricultural development as its highest priority. The GOP, AID and other international agencies are attacking the production side of this problem in terms of agricultural credit, technical extension, irrigation, and access-road construction, etc., but a greater effort is clearly needed on the processing and marketing side.

USAID has prepared a loan proposal for assistance in the field of agricultural marketing for the Lima area. This project will be administered by the Banco Industrial in collaboration with CONAP (Government Agricultural Marketing Agency) and will finance primarily the construction and equipping of such facilities as central warehouses and retail supermarkets. Because of the nature of the agencies administering the program, and because of the need for a systematic approach to the entire marketing problem (with a possible high technical assistance/feasibility study component), the AID marketing loan could not appropriately include financing for private sector projects which involve processing of agricultural commodities. Nevertheless, some method of promoting and financing an increased private sector participation in food products processing is clearly required if farmers, fishermen, etc. are to be assured of a steady market for commodities and if the spread between the relatively low prices received by farmers and the high prices paid by consumers is to be reduced.

It is virtually impossible to estimate the amount of investment that could be forthcoming in the agro-industrial sector. However, a few rough estimates will suggest some order of magnitude.

The investment in fixed assets in the food processing (excluding fishmeal), beverages, leather working, and woodworking industries --all closely related to agriculture-- can be rougly estimated at (1) $180 to $280 million in 1963. If these agricultural related industries are to expand by 5 to 10% a year, it would suggest a financing need on the order of $9 to $28 million per year. In addition to such direct industrial investment, any effective agro-industrial program should provide financing for the related activities or services such as refrigeration facilities, etc.

The expansion of export industries will also be an objective of this loan. (Approximately one third of its proceeds may be used for this purpose.) The rapid increase in exports from Peru experienced in the early 60's ended in 1965. Exports in 1965 were at approximately the same level as in 1964; in 1966, the volume of exports remained about the same but value increased by about 15% because of high prices for metals, especially copper and an increase in the U.S. sugar quota. A major reason for export stagnation is limitation of supply and international demand. Fishmeal production is already at the highest level consistent with maintaining supply over the longer run; increased mining production will demand new investments (large amounts of which are presently contemplated) and new production takes about five years to begin to bring substantial returns. Low international prices have affected cotton, sugar and fishmeal exports. Making P.I.F. loans available for export industries, particularly those producing non-traditional items for export, which show prospects of significant foreign exchange earnings can help stimulate the flagging export sector.

C. Credit Sources and Demand in Peru

The domestic sources of credit available to the private sector include the commercial banks, the state development banks (Industry, Mining, Agriculture), the mortgage and housing banks, the mutual savings and loan associations and a few private financieras.

The relative importance of these credit sources can be seen from the table below:

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(1) This is an extremely rough estimate based generally on the industrial census statistics of 1965. It may well be conservative.

CREDIT OUTSTANDING - Dec. 31, 1965 - Billion of Soles

Commercial Banks	14.5 (4.3 to Industry)
Banco Industrial	2.8
Banco Agropecuario	3.2
Banco Minero	0.4
Banco Hipotecario	1.4
Banco de la Vivienda	0.4
Mutuales	1.2
Financieras	0.7
Total	24.6

In terms of financing industrial projects, however, the only relevant domestic credit sources are the commercial banks, the Banco Industrial del Peru, and the private financieras. There is really no developed money market and the insurance companies, government pension fund, and mutual savings and loan associations do not lend to industry. In recent months one of the financieras (Peruinvest) and one of the "Construction banks" arranged to sell 5-year bonds taking advantage of certain tax-incentives associated with those instruments but in both cases there was a peripheral guarantee to re-purchase the bonds prior to maturity giving them the characteristics of a short-term loan. Except for this limited type of access to the money market, there is no real market for medium and long-term industrial debt. The stock market is open for 15 minutes per day and is virtually non-operative.

The limited role played by the commercial banks in financing industrial expansion can be appreciated by noting that loans to industry constituted only 4.3 billion Soles ($160 million) of their total portfolio (14.5 billion Soles, $540 million) and to a large extent, these funds finance ongoing working-capital requirements as opposed to new investment. Furthermore, commercial banks are limited to loans of up to one year duration and tend to lend only when "adequate" security or personal guarantees are available. This latter policy tends to concentrate the credit on a limited number of clients and discourages the banks from lending based on financial projections. In past years a portion of new industrial expansion has been financed through the expansion of commercial bank credit. Between 1961 and 1965 commercial bank credit to industry (in current prices) expanded by roughly 230%. However, a program of increased credit restraint by the Central Bank has, in recent months, severely curtailed this credit expansion (See discussion of Central Bank in

Section II L below.).

It is rather difficult to estimate the total demand for industrial credit. However, two estimates (+) of new investment in manufacturing (excluding mining, and oil) suggest a recent annual level in the range of roughly $100 million to $120 million. These are probably on the conservative side.

Despite the above mentioned limitations, industry has, in past years, been able to finance some of this expansion partially from expanded credit from commercial banks coupled with a tacit understanding that loans of one year would be renewed. In greater part, however, as indicated above, industry has been financed through a heavy reliance on foreign supplier and bank credits. There is no reliable estimate of foreign supplier's and bank credits outstanding but these are generally considered to be extremely heavy, aggravating to a considerable extent the short-term debt service problems of Peru. One estimate (++) prepared about 1964 suggests that roughly 36% of Peruvian industry is financed by domestic and foreign suppliers credits (vs. about 50% by equity and reserves).

D. U.S. - Peruvian Trade; Additionality

U.S. exports to Peru have increased in absolute value from an average of $152 million per year in the period 1951-55 to an average of $230 million in the period 1961-1965. In recent years, the U.S. share of the Peruvian market has been running at about 40% of total imports. Although aggregate imports of consumer goods are increasing, Peru is predominantly a market for capital goods and it is particularly in this field that the U.S. is under heavier competitive pressure from European and Japanese suppliers. Among the principal imports in 1964 were non-electrical machinery and apparatus (18.8 percent of total imports), motor vehicles and transport equipment (14.2 percent), electrical machinery and apparatus (7.6 percent), manufacturers of common metals (4.2 percent) and chemicals and pharmaceuticals (7.4%).

(+) "Diagnostico del Sector Industrial"; Plan Nacional de Desarrollo Comisión de Industriales; April 1966; "Situacion de la Industria Peruana en 1964", Instituto Nacional de Promocion Industrial.
(++) F. Bordelle; Banco de Crédito del Peru

As shown in Table IV, U.S. exports of major capital goods to Peru have suffered a relative decline in recent years. This decline is partly attributable to an increase in trade between Peru and other Latin American countries and partly attributable to competition from Europe and Japan which, by the late 1950's had recovered from the effects of the War and were competing vigorously in terms of quality, price, and financing.

Such competition has been stimulated still further during recent years as European and Japanese companies conduct aggressive sales campaign, succeed in closing transactions promptly and offer cash loans to complement financing of equipment purchases. The companies are now participating in a wide variety of medium and long-term investments. The projects can be generally divided into two categories: those that have GOP backing (these carry the GOP repayment guaranty) and those that do not.

Projects in the first category usually are public sector projects (roads, steel mill, etc.), but frequently private or mixed ownership projects having special importance and/or social implications (i.e. private hospitals) are included. In many cases these projects require local cost financing in addition to equipment imports. Therefore, foreign companies interested in selling the equipment for the projects usually obtain participation of their respective governments and are able to offer "package deals". Data gathered on these credits by the Project Committee showed terms varied from 7 to 9 percent interest with repayment periods of from 5 to 13 years. Grace periods of 1 to 3 years are often allowed. Although P.I.F. financing will go strictly to the private sector, note should be taken that there has been an abundance of these "arrangements" entered into over the past few years and they are increasingly going to represent a heavy debt servicing burden.

The second category of projects includes the industrial type such as those that P.I.F. will be financing. Generally, all these supplier credits are done with the export insurance of the respective foreign government's export promotion agency. They normally carry interest charges of about 6% to 7-1/2% payable in dollars or other hard currency. Repayment periods usually are 3 years but occasionally are given for 4 and 5 years. There is general agreement on the part of Peruvian importers and industrialists with whom the Project Committee discussed this matter, that these supplier credits are very costly. Even if apparently attractive terms (actual example: 3 years, <u>no</u> interest) are offered it is general knowledge

TABLE IV

PERUVIAN IMPORTS BY MAJOR TARIFF GROUPS AND U.S. SHARE - 1960-1964 - CIF Value in Millions of Soles 1/

		1960	1961	1962	1963	1964
Non-Electrical Machinery and Apparatus	Total	1,820.7	2,419.8	3,099.2	3,002.3	2,905.1
	From U.S.	932.9	1,225.5	1,377.4	1,372.7	1,365.0
	U.S. %	51.2	50.6	44.4	45.7	47.0
Electrical Machinery and Apparatus	Total	688.0	898.7	1,175.8	1,277.9	1,190.4
	From U.S.	276.4	355.4	425.9	422.7	370.9
	U.S. %	40.2	39.5	36.2	33.1	31.2
Iron & Steel Mill Products	Total	606.1	729.3	838.1	701.4	772.3
	From U.S.	194.7	203.3	170.0	127.4	157.5
	U. S. %	32.1	27.9	20.3	18.2	20.4
Manufactures of Base Metals	Total	444.5	539.8	587.0	616.4	623.5
	From U.S.	158.8	191.8	197.2	189.0	212.6
	U.S. %	35.7	35.5	33.6	30.7	34.1

1/ One Peruvian Sol equalled U. S. $.).037 in 1960, U.S. $0.0373 in 1961, 1962, 1963 and 1964.

that high financing charges will buried in the final purchase price. The Central Bank has no good record of these transactions. Gross statistics are submitted by commercial banks (not financieras) on a monthly basis to the Superintendencia de Bancos giving only the total values of foreign transactions conducted during the month. Terms of these credits are not tabulated so no figures are available on the total foreign debt servicing burden of the private sector over the next few years. This situation is attributable to the free foreign exchange policies which have prevailed in Peru.

The Project Committee was, therefore, obliged to obtain data directly from importers and bankers during the Intensive Review. After examining the information on these credits, given above in summary form, and after comparing them with the P.I.F. terms, the Project Committee believes indications are that the P.I.F. credit terms will be quite attractive to Peruvian investors and P.I.F. financing will serve to swing new business into the orbit of the U.S. exporter. From the Central Bank's point of view the P.I.F. dollars will be welcome assistance to ease the private sector external debt burden and thus help reduce the growing pressures on the Peruvian sol.

In the final analysis, the fact that the GOP is assuming the exchange risk and sub-borrowers will repay loans in soles indicates that P.I.F. financing will compete more favorably with foreign supplier credits and result in "additionality" for U.S. exports to Peru. All foreign suppliers demand repayment in hard currency (usually dollars).

E. Central Bank Monetary Policy and the P.I.F.

Since 1965 the Central Bank has followed a tight money policy, establishing high reserve requirements (69% for new sol deposits, sol accounts and 100% for new foreign exchange deposits) for commercial banks and channeling most new private sector credit through the state development banks to productive investments. Compared with 1965, during which credit to the private sector increased by 25.7% (public sector by 82.3%), private sector credit expansion in 1966 increased by 11.8% (public sector by 41.8%).

For 1967 the Central Bank has programmed another year of tight credit. The high reserve requirements, under which the commercial banks are almost "loaned up", will be maintained and the most productive uses will be sought from credit expansion to the private sector.

In the context of such a monetary program, the P.I.F. is looked on by the Central Bank as an ideal instrument for achieving two objectives. First, the P.I.F. financing forms a part of the credit expansion contemplated for the private sector which can be directed to productive investments. And second, this expansion can be done through the private sector intermediaries (state development banks were mostly used in 1966) thereby easing somewhat the very tight credit situation into which banks have been forced by reserve requirements.

F. Goals of AID Industrial Credit Program

Given the above background and analysis, the following general goals of an AID credit program can be stated:

1. Sector Goals

The program should provide financing for, and encourage the development of, agro-industrial projects in the private sector and expand export industries significantly earning foreign exchange. To the extent practicable, the program will finance investment outside the Lima-Callao area.

2. Institutional Goals

The program should encourage the Industrial Bank to undertake a more aggressive promotion effort in the agro-industrial field. It should strengthen and support development banking operations of the private financieras to provide a more diversified base for industrial credit within Peru. It should, to the extent possible, encourage the commercial banks to move towards expanded "industrial-development" types of lending. It should offer encouragement where feasible to the development of new financial institutions in the interior of Peru in an effort to mobilize local resources.

3. Export Promotion

The program will assist and finance the growth of U.S. exports to Peru.

4. "Macro-Economic" Goals

In view of a potential period of credit constraint, the program will encourage and assist the Central Bank in channeling available credit to more productive uses. The program will also develop a channel for long-term foreign credit to industry to offset the mounting reliance on suppliers credit and short-term foreign bank financing.

SECTION II - ADMINISTERING AGENCY (Central Bank)

A. The Central Bank

Responsibility for establishing the P.I.F. and supervising its operation rests with the Central Bank (Banco Central de Reserva del Peru). No new legislation is required to create the P.I.F, which will be established pursuant to a trust agreement to be signed between the GOP (Ministry of Finance) and the Central Bank.

It is the country's only bank of issue and exercises significant powers in determining monetary policy and regulating the nation's banking activity. Originally chartered by law in 1932, the Central Bank now operates under a 1962 law which expanded its powers, altered its capital structure and consolidated the numerous amendments made to its founding legislation.

The Bank's authorized and paid-in capital is 50 million soles, all of which is subscribed by the Peruvian Government. The Bank is governed by a nine-man Board of Directors consisting of three directors selected by the President of Peru (one of whom presently serves as the Bank's President); one director elected by the Government development banks; one elected by the commercial banks in Lima, one by the regional commercial banks; one each by the National Agricultural Society and the National Industrial Society, and one jointly by three Chamber of Commerce organizations.

In addition to determining the money supply and effecting the coinage and issuance of currency, the Central Bank's principal functions include short-term lending to the Government and its development bank's and, under special circumstances, to commercial banks and individuals. It also determines the reserves to be maintained by banks, controls interest rates, re-discounts commercial paper and fixes the re-discount rate; undertake open market operations, determines foreign exchange policy, renders clearing-house services, and acts as depositary of the Government and as its representative to the International Monetary Fund, the World Bank and other international financial institutions.

The increased powers of the Central Bank have enabled it to influence recent monetary development in Peru, and the Bank has attempted to use these powers to broaden the availability of credit while resisting excessive inflationary pressures and maintaining adequate foreign exchange reserves. Bank circulars issued since 1962 have limited to 12% per annum the maximum interest rate chargeable by commercial banks, and to 7% and 5% per annum the interest payable on, respectively, time deposits and savings deposits. The Bank recently prohibited the 1% interest previously paid by commercial bank on sight deposits and authorized an additional 1% charge to be made for all discounting of commercial paper. The Bank's rediscount rate has been relatively stable in recent years, at the present time being 9-1/2% for commercial banks, 2 to 4% for development banks and 2% for the government.

Since 1962, the Bank has gradually reduced from 52% to 29% the basic reserve which commercial banks are required to maintain against their deposit liabilities. However since 1965 marginal reserve requirements have been modified several times with the result that the present reserve requirement for new sol deposits is 69% and for dollar deposits, 100%. The Bank required commercial banks to deposit with it Government bonds as security for credits from the Bank in an amount equal to 5% of such bank's capital and reserves.

A large part of the Central Bank's extension of credit has in the past been to the Government. Due to the volume of Government borrowing from the Bank in 1957 and 1958, the amount of Treasury obligations which may be discounted by the Bank in any one year was limited by the 1962 law to one twelfth of the Government's ordinary revenues for such year, and all such obligations must mature within 90 days and be paid by December 15 in each year. Nevertheless, as a result of budgetary deficits in certain recent years, such as 1964, the Bank lent additional funds to the Government by alternative means, such as purchases of Government bonds and direct advances, resulting in increased issues of currency by the Bank.

The Bank has been very instrumental in enabling Peru thus far to maintain one of Latin America's freest systems governing foreign exchange transactions.

As shown in Table I, the total assets of the Central Bank amounted to $500,000,000 at the end of 1966 and capital and reserves over $3,500,000. Table II shows that the profits of the Central Bank have averaged between $2 and $4 million dollars over the past three years. In view of the Bank's financial strength and its excellent reputation in international financial circles there can be little doubt of its ability to manage the P.I.F.

TABLE I

CONSOLIDATED BALANCE SHEET OF PERUVIAN CENTRAL BANK
As Of December 31, 1963, 1964, 1965, 1966
(in millions of soles)

ASSETS

	1963	1964	1965	1966
old and FX	3,489	4,028	4,364.1	3,871
oans & Discounts	4,979	6,244	7,001	8,416
To: Domm'L Banks	(97)	(28)	(108)	241
To: Dev'l Banks	(1,165)	(1,321)	(2,009)	1,229
To Gov't	(3,717)	(4,895)	(4,884)	6,934
nvestments	754	754		945
ther Assets	186	434	646	466
Total	9,408	11,460	12,765	13,699

LIABILITIES

	1963	1964	1965	1966
Capt. & Reserves	53	65	83	94
Bank notes in circulation	5,884	7,186	8,440	9,481
Deposits	2,307	2,925	2,848	2,748
Int'l Mon't Fund	754	754	754	945
Other Int'l Inst.	3	14	12	4
Foreign Currency Deposits	37	58	84	112
Forward sales of Forn. Exch.	-	121	258	-
Other Liabs.	370	337	286	315
Total	9,408	11,460	12,765	13,699

TABLE II

CENTRAL BANK STATEMENT OF PROFIT & LOSS
(thousands of soles)

	1963	1964	1965	1966
Income from Interest and Commissions	141,109	191,826	163,732	158,235
Expenditures:	65,725	72,465	91,860	107,153
Interest Payment	5	3.0	-	-
Salaries	27,989	33,830	37,487	41,649
Directors' Remmerations	212	259	258	302
Contributions	3,765	4,899	4,561	4,242
Administrative Costs	16,764	18,198	34,685	39,766
Penalties & Provisions	16,990	15,277	14,868	21,194
Profits	75,384	119,361	71,872	51,082

SECTION III - PROJECT DESCRIPTION

A. Structure of P.I.F.

The A.I.D. loan will be made to the Banco Industrial, as Borrower, at the most concessional terms (40 years, 10 years grace, 1% interest for 10 years, 2½% thereafter). It is necessary to use the Banco Industrial as Borrower since it presently has the necessary borrowing authority and neither the GOP nor the Central Bank may borrow directly from A.I.D. without Congressional authorization. The Central Bank has given assurances that the Industrial Bank will be only a channel for the funds which will immediately be reloaned to the GOP on identical terms and on the condition that A.I.D. may look solely to the GOP for repayment of principal and interest on the loan. There is presently in the Peruvian Congress a proposed law to grant general borrowing authority to the Executive in the case of loans from "agencies" (including A.I.D.). If the law is passed before the Loan Agreement is signed, the loan will be made directly to the GOP. The GOP will place the A.I.D. funds in the PIF to be established by the Central Bank as trustee of the GOP.

The Central Bank will add to the $7,500,000 A.I.D. loan an equivalent amount of local currency (soles) increasing P.I.F. capitalization to $15,000,000. Such Central Bank contribution will be made available on an annual basis and in accordance with the estimated needs of the Fund. Exchange risk on repayment of the A.I.D. loan will be assumed by the GOP.

These funds will be made available through "intermediaries" (state development banks, financieras and commercial banks) to the private sector for the expansion or modernization of agro-industries (see definition Section B). The A.I.D. loan dollar will be divided between these intermediaries at the outset roughly in the following proportions:

Development Banks	$1,700,000
Financieras	2,600,000
Commercial Banks	3,200,000
Total	$7,500,000

These intermediaries will be responsible for appraising projects and will assume the credit risk.

A Review Committee consisting of 3 members will be established in the Central Bank to review and approve proposals for P.I.F. financing received from intermediaries.

The P.I.F. funds will either be loaned to intermediaries, as in the case of the state banks and financieras, or will be loaned directly to sub-borrowers on the guaranty of commercial banks. The interest rate to sub-borrowers will vary as follows: 12% for two year loans, 13% for loans from over 2 to 5 years, 14% for loans from over 5-15 years. For P.I.F. loans all intermediaries will be entitled to a 4% spread in interest rate to cover administrative costs and profit. This same spread applies to commercial banks guaranteeing projects. Therefore, the Central Bank will be lending P.I.F. resources at 8, 9 and 10%.

B. Eligible Activities

As discussed above, the agro-industries will be the primary activities eligible for P.I.F. financing. The definition used by the Central Bank (and approved by A.I.D.) for agro-industries is as follows:

> "Those industrial activities designed to transform, preserve or otherwise process any animal, vegetable, or other organic materials generally derived from agriculture, livestock, poultry and edible fish production.
>
> "With respect to food products, preservation includes such operations as canning, pickling, freezing, drying, packaging, etc."

An illustrative (not exclusive) list of these activities prepared by the Central Bank in consultation with the National Institute of Industrial Promotion (INPI) and the Peruvian Industrial Bank is included in Annex IV. Other projects to be agreed upon by the Central Bank and A.I.D. may also be eligible.

The second priority category will be those "agro-industrial" enterprises producing "inputs" for the agricultural sector (e.g. hand-tools, pesticides, etc.). However, these industries will not be generally eligible unless it can be demonstrated that the project can operate effectively without sufficient tariff protection.

The Central Bank believes that the application of these priority rankings can be done by the Review Committee at the time project approvals are sought. The Review Committee will examine the P.I.F. lending pattern every three months to see that a rough balance of at least two to one in favor of agro-industrial projects is maintained. No preferential lending terms are considered necessary to encourage agro-industries over export industries, nor desirable since the most uncomplicated lending criteria for the P.I.F. has been sought.

In the Central Bank Circular to be issued to intermediaries, the Central Bank will indicate these first and second priority categories.

Although leasing/purchasing operations are not common in Peru, there appears to be interest on the part of some financieras and the Industrial Bank to experiment with leasing in areas, for example, such as refirgerated trucks and refrigerated storage facilities. Therefore, leasing transactions will also be eligible for P.I.F. financing. Title to the equipment would, of course, remain with the intermediary until time of final purchase.

Ineligible Activities

No P.I.F. financing will be made available for the processing for export of food or feed commodities currently found in surplus supply on world markets or for the processing for export or domestic consumption of any agricultural commodity other than food or feed currently in world surplus. The main food or feed commodities in world surplus produced in Peru are sugar and coffee. The main ineligible non-food or feed commodity would be cotton (although cottonseed oil projects would be eligible).

In addition, the Peruvian fishmeal industry, which suffers from a vacillating world market, will be excluded. Processing of fish and fishmeal for human consumption will be eligible.

Only textile and sugar projects whose production is for domestic consumption will be eligible. No coffee projects will be financed whether for export or for domestic consumption.

No P.I.F. financing will be available for projects not using a domestically produced raw material or semi-finished product as a principal input. The Central Bank Review Committee will reject proposals to create or expand "hot house" industries or those inefficient industries which can only operate successfully behind a protective shield of high import tariffs. Thus excluded will be those manufacturing operations which import raw materials, transform them in some way and sell internally behind protective tariffs for more than what an imported article (usually of better quality) would cost.

The Project Committee and the Central Bank considered placing a maximum allowable import duty (perhaps 25 or 30%) on P.I.F. projects but this was rejected as being overly arbitrary since in some cases import duties (especially temporary ones) could be economically justified. The criteria in this regard will therefore be left as a general one with the Central Bank watching for proposals falling into the over-protected industry category. The Industrial Bank and INPI (Instituto Nacional de Promocion Industrial) have done investigations on such matters and will be of assistance in identifying such projects.

The application of this criterion will be most difficult in the case of new activities since, under the Peruvian Industrial Promotion law, industries which have the capacity to supply the entire domestic market are entitled to seek tariff protection up to 100%. Consequently, the US AID and the Central Bank on a continuous basis will seek ways in which to avoid P.I.F. financing of inefficient "hot-house" industries, including perhaps having some applicants agree not to take advantage of this law in order to receive P.I.F. financing.

C. Operating Procedures and Regulations

The operation of this Private Investment Fund will be similar to other P.I.F.'s created by A.I.D. in Latin America (such as in Brazil and Colombia). However, the administrative bottlenecks that arose in the case of the Colombian P.I.F. will be avoided because of the Peruvian Central Bank's familiarity with the Colombian case and its desire to avoid creating a complicated review authority of its own.

A Review Committee consisting of three person will manage the P.I.F. for the Central Bank to review applications submitted and grant approvals. The Committee will be composed of two members of the Central Bank's Board of Directors and one other official from the Bank's staff. Assisting the Review Committee will be a full-time staff of Central Bank employees. Unanimous consent of the three Committee members will be required for project approvals.

This Committee is intentionally being kept small so that there will be less temptation to "second-guess" intermediaries in their project appraisals. Full responsibility for the credit risk of a project will be taken by the intermediaries. The Review Committee will examine each application for P.I.F. financing against very general criteria to ensure that P.I.F. regulations are being followed and that the P.I.F. financing is directed towards the desired development target areas.

Although there may be isolated cases requiring greater scrutiny by the Review Committee, the normal review of proposed projects will be limited to such things as:

1. Whether a feasibility analysis was done by the intermediary concerned.

2. Whether the project fits into the priority categories of the Fund.

3. Whether a project violates A.I.D. loan restrictions (e.g., no cotton, fishmeal, or coffee projects permitted).

4. Whether a participating financiera meets the Central Bank qualification test. (See Section III D2).

5. Whether the proposed project will receive excessive tariff protection and become a "hot-house" industry.

6. Whether the proposed projects include $500,000 of dollar costs and therefore must be submitted to Eximbank for their consideration prior to further consideration by the Review Committee.

In addition the Central Bank will keep tabs on a number of items not connected with specific project reviews such as:

1. Whether the A.I.D. 50/50 shipping balance is being maintained.

2. Whether the general allocations of P.I.F. funds between development banks, financieras, and commercial banks are proper in light of demand for and movement of funds or whether slow moving funds should be shifted.

3. If P.I.F. activities are receiving adequate and periodic publicity promotion throughout Peru.

4. Through post-audits and spot checks the Bank will police P.I.F. operations to ensure that the funds are used as authorized.

After having approved an operation for P.I.F. financing, the Review Committee will notify the intermediary concerned and authorize it to utilize the A.I.D. loan dollars by opening a letter of credit in favor of the U.S. supplier under one of the Letters of Commitment issued by A.I.D./W to U.S. banks. Local currency will be drawn from an account set up for this purpose in the Central Bank.

Reporting to A.I.D. each quarter on P.I.F. operations will be the responsibility of the Central Bank. USAID intends to hold periodic review sessions with the Central Bank to discuss the P.I.F. and resolve any problems which arise.

The Central Bank will obtain AID approvals for any transactions involving more than $250,000 of A.I.D. loan funds. The Central Bank will obtain Eximbank clearance before financing any project including $500,000 or more of dollar costs.

Such approvals will be obtained by the Review Committee in writing from USAID/Lima at the time it is conducting its review. In the case of Eximbank clearance, the Review Committee must receive notice in writing or by cable that Eximbank is not interested before proceeding with final approval.

Intermediaries will be required to furnish the P.I.F. Review Committee with quarterly reports giving, in summary form, information regarding the projects being financed by P.I.F. Such reports will include data on amounts disbursed to a project, status of equipment imports (if equipment ordered, received, or installed), percentage of physical completion, etc.

D. Participating Intermediaries

To obtain wide dispersion of P.I.F. resources and flexibility in their application, utilization of P.I.F. monies will be open to (1) the three government development banks (2) selected financieras (investment companies) and (3) commercial banks.

General allocations of A.I.D. loan dollars between these groups will be made by the Central Bank as follows:

Development banks		$ 1,700,000
Financieras		2,600,000
Commercial banks		3,200,000
	TOTAL	$ 7,500,000

Use of P.I.F. funds within the general allocations will be on a "first come first served" basis subject to considerations of priority project categories, etc. These allocations were decided upon by the Central Bank and the Project Committee after extensive discussions with the intermediaries concerned to estimate each group's absortive capacity over a two year period. The Central Bank will have the right to modify these allocations after consultation with A.I.D. if it appears that one group's allocation is not being used as rapidly as anticipated. It is worth pointing out that the three state development banks are receiving a relatively small share because of (1) the availability of BID loan funds to the Industrial Bank (2) the generally rather slow pace at which these banks process loans and (3) special interest of the Central Bank in encouraging commercial banks to do more appraisal banking.

1. GOP Development Banks

a. Banco Industrial del Peru (BIP)

The Banco Industrial will be the main recipient of P.I.F. resources allocated to the development banks. Organized as a mixed public (80%)/private (20%) entity in 1939, this bank is the principal source of medium to long term industrial credits. Roughly half of all bank credits outstanding to industry are from the BIP. Its resources include: (1) Equity of $22,000,000 (21%

raised by public offering). GOP receives no dividend on its shares which are purchased with revenues from a 1% duty on all non-food imports. (2) Four IDB loans totalling to date $15.5 million; a balance of about $3.0 million is as yet undisbursed on the last BID credit made in mid-1965 for $7,000,000. (3) Central Bank advances totalling $15,000,000 as of year end 1965. (4) Special credit lines (3 year) for fishing industry from private U.S. banks totalling $24.0 million. (5) Special GOP credit to fishing industry via BIP for $8.2 million. (6) "Deposits on current account" for clients and commercial banks totalling $6.0 million.

Its lending terms for its own funds (in soles) are: Loans can be made for up to 10 years (usually do not exceed 5 years) at maximum interest of 12% free of all taxes. Loans to the jungle carry 9% interest. Subsidized, small industry, promotion loans carry 6% interest.

IDB loan funds in foreign exchange are subloaned usually for 5-10 years at 8% for free world equipment purchases with the exchange risk being taken by the sub-borrower. Most equipment purchased under BID loans comes from Germany and Italy. The Banco Industrial extends its operations to the interior of Peru through eight strategically located Regional Banks which represent it to clients. Small loans up to S/.100,000 (about $3,700) can be made by Regional Banks using Banco Industrial funds without reference to Lima. All loans above this amount must have Lima approval.

In general, loans from BIP are limited to 50% of borrower's assets and first mortgages are usually required on all tangible assets.

b. Banco de Fomento Agropecuario

This bank formed in 1931 lends principally for agricultural and livestock production on short, medium and long terms (up to 20 years). Interest rates vary from 7% to 13% depending on the size of the loan (13% for loans in excess of 200,000 Soles - $7,463). The Agricultural Bank is entirely government owned and has capital and reserves totalling over $20,000,000. It administers three A.I.D. loans to the GOP for agricultural credit which total $24,600,000. A loan from the IBRD for medium and long-term agricultural and livestock credits totalling $15,000,000 was granted in 1965. In the opinion of the Project Committee only a small amount of P.I.F. resources will move through this bank, but the Bank has the legal authority to finance food processing operations conducted by agricultural producers and in response to interest shown by bank officials in expanding such activities it has been included as an eligible intermediary.

c. <u>Banco Minero del Peru</u>

This bank serves the national mining community in Peru. That is, it can operate only with Peruvian companies which limits its activities to the medium and small sized companies. It has been in operation since 1941 and is entirely state owned.

Its loan terms range typically from 3 to 5 years with interest rates varying with the amount of the loan. Interest rates vary from 5% (small mining company promotion subsidy) to 11% for sole loans over $37,300. A commission of 1% is charged in cases where special services (i.e. letter of credit transactions) are required. The demand for P.I.F. funds by Banco Minero is expected to be extremely small or non-existent.

2. <u>Financieras</u>

Over fifty financieras exist in Peru serving a variety of investment functions. Most of these are in no way strong enough to undertake operations with the P.I.F. nor have any experience in anything but high collateral and high interest, commercial transactions.

It is estimated that the eligibility test for financieras, as set forth below, to be applied by the Central Bank will exclude all but about 6 to 8 or the most reliable financieras. Eligibility, as determined by the Central Bank and A.I.D. will be based on (1) minimum paid in capital of $500,000, (2) maximum ratio of debt to net workth of 4:1 and (3) a demonstrated ability for appraisal banking and a reasonably diversified lending experience.

Financieras are not regulated by banking laws as are commercial banks. As a consequence they can lend for more than one year and charge interest in excess of the 14% allowed by law (plus commissions, taxes, etc.) to commercial banks. Many financiera operations carry interest charges of up to 30%. Since they are not required to disclose their books to the Superintendencia de Bancos, no precise statistics are available for financieras. The higher interest charges are, in several respects, justified considering: 1) investments made by Financieras are often medium term. 2) Investments made by financieras are often for relatively high-risk operations for which commercial or development bank financing could not be obtained.

The largest and most dynamic financiera in Peru is PERUINVEST whose total assets on June 30, 1966, amounted to over $16 million. Its loan portfolio totalled almost $11 million on that same date. Its capital stock is held by a number of U.S. and Swiss banks, a few individuals and the Banco Continental of Peru (a Chase Manhattan subsidiary). PERUINVEST has initiated some equipment leasing transactions and with P.I.F. financing could do more. The IDB granted a loan of $750,000 to PERUINVEST in 1963.

The second largest financiera is Financiera Peruana, S. A. associated with Peru's largest commercial bank, Banco de Crédito; it has a loan portfolio of roughly $6.1 million.

A number of smaller financieras, such as Inversiones Abancay, have interest in expanding their medium to long term portfolio and have good equity bases to do so. (Inversiones Abancay paid-in capital represents about 85% of total assets.)

Although many of the financieras would like to contribute more to the expansion of new industrial activities and Peru's development generally through long term lending, the high cost of foreign bank financing obliges them to operate largely in short-term, more-profitable commercial operations. The longer term P.I.F. financing will allow these institutions to carry out term operations without having to incur the high cost foreign bank and supplier obligations. P.I.F. financing will be doubly attractive since financieras normally pass on the exchange risk to clients when foreign purchases are involved.

3. Commercial Banks

All commercial banks will be eligible to participate in P.I.F. financing since, unlike the financieras, they are required to adhere strictly to banking laws and reserve requirements and report on their activities to the Superintendencia de Bancos. By law, commercial banks have never been permitted to make loans for longer than one year. Guarantee operations, on the other hand, can be carried out for longer periods with the approval of the Superintendencia de Bancos. This latter procedure will be employed for P.I.F. operations with commercial banks.

The one year lending limit has not completely restricted the banks from serving the longer term lending needs of their clients. Refinancing debts on a yearly basis is a fairly common practice as is permitting clients to make sizeable overdrafts.

Although no modification to the banking law is needed to make P.I.F. subloans over one year, the Central Bank considers this law out-dated and would like to see it changed.

As commercial banks increase their term lending using P.I.F. resources, the Central Bank hopes to demonstrate the effective role which commercial banks can play in the development effort if permitted to do so. In this way support for modifying the law can be obtained.

Commercial banks in Peru have tended in the past to lend only against the pledge of "adequate" security or personal guarantees. Naturally, this policy has concentrated lending on a limited number of favored clients with good credit rating and discouraged banks from lending on the basis of project appraisals. The Central Bank hopes to break this habit with the P.I.F. by providing the financing needed by industrialists on attractive terms. These industrialists will turn to their commercial banks to obtain P.I.F. financing obliging those banks, in a sense, to appraise projects to meet requirements of the Central Bank. The interest rate spread allowed (4%) should be attractive enough anyway to encourage commercial banks to get into project appraisals.

A list of the commercial banks in Peru with some statistics about each is given in Table III.

Eight commercial banks, strategically located throughout Peru are set up to operate under a 1959 banking law as Regional Banks. These banks are aggressive and ensure that, to the extent possible, complete financial and administrative banking services are available to all parts of the country. Each bank has a region of responsibility. Conversations have been held by the Project Committee with several of these outlying banks and on each occasion considerable enthusiasm was shown for the P.I.F. financing oriented toward agro-industrial expansion.

Besides acting as commercial banks, these regional banks represent the Banco Industrial throughout the interior. Recently (1965), authority was delegated to these banks to act independently for the Banco Industrial in loan approvals up to 100,000 soles ($3,700). Above this amount final decisions must be made in the main office of the Banco Industrial in Lima.

Since the regional banks will be required to staff up before they will be in a position todo appraisal banking for relatively large projects, it is not clear yet the extent to which their initial enthusiasm will be converted into projects submitted for PIF financing. If they do respond will to the incentives afforded by the PIF, these regional banks could be instrumental in stimulating significant amounts of agro-industrial activities in the interior of Peru.

TABLE III

COMMERCIAL BANKS IN PERU+

Commercial Banks	Year of Founding	Number of Offices	Total Deposits (U.S. $ in Millions)
Banco de Credito del Peru	1889	149	202
Banco Popular del Peru	1899	140	106
Banco Internacional del Peru	1897	89	81
Banco Continental (affiliate of U.S. Chase Manhattan Bank)	1951	42	55
Banco Wiese Ltdo.	1943	28	55
Banco del Progreso	1961	23	43
Banco Comercial del Peru	1947	22	43
Banco de Lima	1952	18	28
Banco Union	1952	19	25
Banco Gibson, S.A.	1928	26	22
Caja de Ahorros de Lima	1868	18	20
Banco de la Industria de la Construccion	1965	1	6
Regional Banks			
Banco Nor-Peru (Trujillo)	1961	9	7
Banco Regional del Norte (Piura)	1960	6	6
Banco Regional del Sur Medio (Ica)	1962	9	5
Banco del Sur del Peru (Arequipa)	1962	6	5
Banco Regional del Centro (Huancayo)	1961	8	4
Banco de los Andes (Cuzco)	1962	6	4
Banco Amazonico (Iquitos)	1962	4	3
Banco de Ahorro y Prestamo (Trujillo)	1964	2	1
Foreign Banks			
First National City Bank - U.S.	1920	2	19
Banco de Londres y America del Sud, Ltdo. (England)	1936	2	6
The Royal Bank of Canada (Canada)	1925	1	4
The Bank of Tokyo (Japan)	1965	1	1
Bank of America - U.S.	1966	-	-

+As of December 31, 1965.

E. P.I.F. Lending Terms and Conditions

1. Terms to Sub-borrowers.

The final interest rates charged sub-borrower will be 12% for two year loans, 13% for loans of over two to five year-term and 14% for loans over five years. No commissions or other charges will be added by the intermediaries.

Although 12 to 13% are the highest lending rates employed by the state development banks and considered the development lending rates, the Central Bank decided tocharge a slightly higher rate of 14% for the longest term P.I.F. money considering it to be good banking practice in view the fact that it carries no M.O.V. obligation.

The present cost of loans from commercial banks in soles is currently running at about 18 to 20% per annum. The legal interest rate is 13% on overdrafts and 14% on loans and discounts. The government stamp tax of 0.9% per quarter adds a cost of 3.6% per annum to these basic rates. Prior discounting of interest, compensatory balances, and other techniques tend to add 1 to 3% to borrowing costs. There is a 2% stamp tax on mortgages which tends also to add to the cost of borrowing.

The government stamp tax of 0.9% per quarter charged for each banking transaction (up to a maximum of 3.6%) will be waived for all P.I.F. financing. The Central Bank has authority under Law 9140 to make such exemptions.

P.I.F. subloans will not be made for less than 2 years nor longer than 15 years. Undoubtedly, most projects will have terms of under ten years but 15 years is being allowed as a maximum in case a project is initiated under difficult conditions, such as being located in the Peruvian "selva", and required such a repayment term.

The repayment term of any subloan will be generally related to the pay-out period of the project. Grace periods granted sub-borrowers will be related to plant or equipment start-up time.

The Project Committee believes it desirable to keep the PIF lending criteria as uncomplicated as possible so it can be easily understood by both sub-borrowers and intermediaries. Should experience dictate some other arrangement of terms of sub-loans or even interest spreads for participating intermediaries. A.I.D. and the Banco Central will consult to decide mutually on modifications.

2. Sub-Loan Limitations

P.I.F. financing will not exceed 70% pf project needs but investments in existing assets can be considered in this analysis.

Working capital will come from the local currency window of the P.I.F. from funds provided by the Central Bank, but only when fixed assets are also being financed in a project. Working capital financing to meet up to three months needs has been decided upon as the maximum amount allowable.

Projects involving less than $10,000 of U.S. procurement will not be financed so as to avoid interfering with established U.S. supplier-importer realtionships.

Local currency needed for a project will be limited to the equivalent value in soles of the equipment being purchased unless the Central Bank agrees otherwise.

That is, if the value of equipment and services needed for plant expansion is $50,000 then the equivalent of $50,000 is the maximum amount that the sub-borrower can obtain in local currency from the P.I.F. unless the Central Bank agrees otherwise. This provision is considered a necessary safeguard due to the very great demand for long-term credit in soles and the need to prevent sub-borrowers from procuring a relatively inexpensive piece of machinery in the United States and requesting unreasonable amounts of local currency from the P.I.F. for general use.

It is believed that in some cases the intermediaries will help good clients and not examine too closely the dollar/sol "mix" in projects and simply pass on the proposal to the Central Bank Review Committee. This provision will warn a prospective client that approval will have to be obtained for large amounts of local currency and at the same time free the Review Committee from the task of checking the dollar/sol "mix" in each case.

3. Interest Rate Spread to Intermediaries

Intermediaries will be given a spread of 4% on P.I.F. transactions.

On the basis of conversations with commercial bankers, financiera officers and development bank officials, the Project Committee concluded that this spread was adequate to cover administrative costs of intermediaries and, at the same time, be attractive enough to provide an incentive to participate in P.I.F. operations.

No differential in interest rate spread is being allowed between financieras and commercial banks. Both groups of institutions have shown interest in doing project financing and although financieras may do more complicated appraisals for longer term lending, the commercial banks will be "staffing up" to do even simple appraisals and thereby incur additional administrative costs.

Thus, the 4% spread is considered fair for both groups and the single spread keeps the P.I.F. lending criteria uncomplicated.

4. Exchange Risk

The GOP will assume the exchange risk on the repayment of the AID loan. However, the GOP expects the P.I.F. to operate in a businesslike fashion and earn sufficient surplus to be able to cover the administrative costs of the Central Bank, and pay interest on the AID loan.

The Project Committee considers this attitude to be reasonable considering that sub-loans will be made from the P.I.F. to intermediaries at 8, 9 or 10% interest allowing (during the first ten years grace period) the P.I.F. to earn a spread of 7, 8, or 9% over the AID interest rates. Taking the most conservative approach and using 7% as the spread and applying this to the full resources ($15,000,000), which should be loaned out in two years, one can assume the P.I.F. will earn in the neighborhood of $1,050,000 annually. Assuming the Central Bank costs to be relatively small (about $100,000 per year), there remains roughly $9,050 thousand to protect against bad debts and the possible decapitalization (in real terms) of the fund because of inflation and related devaluation. Although it is impossible to precisely estimate the P.I.F. earning capacity or the extent to which the Peruvian sol may or may not suffer devaluations in the future, the Project Committee believes that the P.I.F. earnings shall adequately serve the purposes mentioned above without any appreciable risk of decapitalization.

7. <u>Dispersion of P.I.F. Financing</u>

Industrial expansion in Peru has been largely concentrated in the Lima/Callao and surrounding areas. Other cities, such as Arequipa in the South, have received some attention from investors due to either incentives (taxes, etc.) offered to attract industries or the availability of industrial park facilities.

To the greatest extent possible the Central Bank will try to obtain wide dispersion with the P.I.F. funds, such effort to be directed primarily at attempting to stimulate project development by the eight regional banks, (see Section III D3). Through the Central Bank's planned widespread promotion of the Fund (through circulars, etc.) throughout the national banking system those clients in the interior who have economically viable proposals but who heretofore have been without necessary "connections" in the Lima money markets to obtain financing on suitable terms will have ready access to the P.I.F.

The availability of P.I.F. funds at the development lending rates of 12, 13 or 14% with no M.O.V. provision should be sufficient incentive for all investors regardless of the location. Intermediaries will be encouraged to ensure that advantage is taken of the long repayment periods allowed. In the opinion of the Project Committee, the repayment period is usually of greater importance to investors in Peru than interest charged.

F. <u>Funds for Technical Assistance</u>

A portion of A.I.D. loan funds up to $100,000 will be available for use by the Central Bank Review Committee to hire U.S. consultants where such might be needed.

It is thought that the Central Bank may need some short-term assistance in managing the P.I.F., evaluating its effectiveness or in reviewing a complicated proposal. Consequently, the Review Committee may, in the public interest, wish to assist some intermediary or sub-borrower in putting together a viable project without obliging the sub-borrower to finance the technical assistance. The Central Bank would be able to draw on these funds to obtain the expertise required.

Of course, the general P.I.F. resources will be available for technical assistance associated with a project's development but such financing would be considered as part of a sub-loan to be repaid by the sub-borrower. Should these funds not be used for technical assistance they will be loaned out for project financing along with other P.I.F. resources.

SECTION IV - LOANS FROM IDB AND IBRD

The Inter-American Development Bank has made the following loans to Peru for industrial development:

Amount	To	Date	Status (at Feb. 1967)
$2,500,000	Industrial Bank	10/62	Disbursed
$5,000,000	Industrial Bank	12/63	Disbursed
$7,000,000	Industrial Bank	4/65	$3,000,000 undisbursed
$1,000,000	Industrial Bank	6/65	$800,000 undisbursed
$ 750,000	Peruinvest	11/63	$109,000 undisbursed

IDB is now engaged in an evaluation of its previous four loans to the Banco Industrial which it will complete before considering a fifth loan of approximately $10,000,000. All these IDB loans are for foreign exchange costs (Free-World procurement) of machinery required for all types of industrial expansion. Most of the procurement according to BIP officials has been from Europe (Germany and Italy).

The IDB has expressed some concern over the fact that the GOP will assume the exchange-risk for this loan and has not done so for the IDB loans to the Banco Industrial. IDB fears that A.I.D. loan will be more attractive and slow down disbursements under its loan. The Industrial Bank does not expect this loan to interrupt the reasonably good disbursement rate of the IDB loan, particularly since most procurement with IDB funds is from Europe. While we anticipate diversion of business from European to U.S. exporters under this loan, the A.I.D. loan is directed at only the agro-industrial and export sector and can fill only a relatively small portion of total industrial needs; also, for reasons of price, suitability and the like there will remain a substantial demand for European exports to all sectors of Peruvian industry. Furthermore, A.I.D. believes that there is a substantial job to be done to stimulate development of agro-industries and Peruvian exports and that this can only be accomplished with the type of loan we are proposing.

The IBRD has not made any loans to Peru for industrial expansion.

SECTION V - IMPACT ON U.S. ECONOMY

During the current period of credit restraints which are likely to be stiffened, it is expected that the P.I.F. loan funds will be in demand and move rapidly. Furthermore, with the P.I.F. financing terms and repayment periods being so competitive with other foreign credits to the Peruvian private sector, there is every reason to expect this loan to quickly result in $7.5 million in imports from the U.S.

Following the procurement of U.S. equipment will, of course, come the requirement for continued purchases of spare parts.

SECTION VI - IMPLEMENTATION PLAN

A. Schedule of Events

Following loan authorization, the USAID Capital Development Office and Legal Counsel respectively will prepare Implementation Letter No. 1 and the loan agreement. Loan negotiations and signing will be conducted in Lima by USAID officials.

Concerning the details of how the P.I.F. will operate, the Central Bank will publish a circular, the draft of which is included herein as Annex II, to all intermediaries.

In the opinion of the Project Committee conditions precedent to disbursement can be met within three months after loan signing.

The P.I.F. resources can probably be allocated to projects within 18 months and the A.I.D. loan fully disbursed in about two years. USAID will maintain close contact with the Central Bank Review Committee and monitor progress. Frequent visits to project sites will be made by USAID loan officers to spot check on end use of loan funds.

B. Small Business Notification

Due to the fact that only adequately elaborated proposals can be presented to the Central Bank by intermediaries, the selection of equipment and supplier will, in most cases, already have been made by the prospective subborrowers when the Central Bank considers a project. In some instances it might be that the selection of equipment was made in consideration of the need to ensure compatibility with equipment already installed. As a result, Central Bank compliance with the Small Business Notification (SBN) requirement would be pointless and misleading to U.S. suppliers causing them unnecessary inconvenience in attempting to compete. In addition, the delays inherent in following the formal SBN procedure could seriously hamper rapid disbursement of the loan. Such delays may well be damaging to a project (retard production, start up, etc.) resulting in additional costs to the sponsors.

Condiering the similarity of these circumstances with those involved in many development bank operations for which the SBN requirements has been occasionally waived (See AIDTO A-143 to Managua), the Project Committee believes that such a waiver is justified for this loan. Instead, a general notice to Small Business could be made in the Commerce Business Daily following this loan's authorization. Such a notice would cover in detail the P.I.F. objectives, describe the eligible sectors, projects, etc., and advise U.S. business men that the funds will be made available through commercial banks, financieras and state development banks in Peru. To ensure adequate disemination this notice could be repeated a number of times in the Commerce Business Daily and small business circulars.

Handling the SBN in this way will help streamline the P.I.F approval process at the Central Bank level.

SECTION VII - ISSUES: None

SECTION VIII - CONDITIONS AND COVENANTS

a. The GOP shall deliver the proceeds of the loan in trust to the Central Bank to establish the P.I.F.; the Central Bank shall act as fiduciary of the GOP and operate the P.I.F as agreed upon with AID.

b. Equipment, materials and services financed by the loan shall be procured from the United States.

c. Subloans extended by the P.I.F. shall be made in accordance with the Central Bank regulations governing the use of P.I.F. funds or as amended by mutual agreement between AID and the Borrower.

d. Except as AID may otherwise agree, no P.I.F. financing will be made available for the processing for export of food or feed commodities currently found in excess supply on world markets or for the processing for export or domestic consumption of any agricultural commodity, other than food or feed, currently in world surplus.

FRAMEWORK FOR A.I.D. PROGRAM

Objectives

U.S. assistance to Peru is properly viewed in the context not only of the traditional Inter-American political institutions which bring the two countries together but also in the context of the very close trade and commercial relations that exist. The U.S. is at once Peru's best customer and largest supplier buying about 40 percent of all Peru's exports and selling roughly the same percentage of Peruvian imports. U.S. private investors have on the order of $500,000,000 invested in this country, and profit remittances abroad from Peru (with the bulk going to the U.S.) currently run to more than 100 million annually.

Beyond these commercial interests, the U.S. has an important stake in the success of the economic and social modernization process initiated by President Belaunde. Internal stability, economic viability, and political development compatible with U.S. policies and objectives depend to a large degree on the success of that process. Accordingly, the objectives of the A.I.D. program are, first, to support Peru's efforts to create improved economic and social opportunities for the presently disadvantaged half of the population living in a subsistence economy, and secondly, to establish an institutional base -- public and private -- for sustained economic and social growth in Peru.

The Setting

Peru has many of the essential ingredients for a meaningful attack on the constraints which hold half the population of this nation in poverty even while maintaining the outstanding economic performance chalked up over the past decade. Peru has a democratic, reform-minded government which believes in the goals of the Alliance for Progress and is deeply committed to development and progress.

Peru is traditionally a private enterprise economy. The private sector has done a remarkable job over the past decade in giving Peru one of the highest aggregate growth rates in Latin America. That growth, however, has been ill-distributed with the urban coastal areas sharing fully in its fruits and the tradition bound peasants of the Andes benefitting little, if at all.

With over two years of his six-year term still before him, President Belaunde is as determined as ever to move forward on a broad development front. The Alliance for Progress is viewed, not only as a source of potential external resources, although that is important, but also as a commitment to internal reform and progress. Specific accomplishments so far include the passage of basic agrarian reform legislation, the first municipal elections in over forty years, and the initiation of a community development program to strengthen small communities and local governments.

Notwithstanding the many favorable factors, however, Peru's economy is not yet sufficiently strong nor adaptable for its government to be able to mobilize the quantity of capital, technical and human resources which will be needed to support the major effort which the size and urgency of the problems require. If, however, Peru can reasonably count on substantial external assistance from the United States, in collaboration with the international lending agencies and European countries, it should be able to achieve a developmental push on a scale sufficient to put it well along towards the solution of its most urgent problems. The consequent advantages to the U.S. in terms of political stability, national and continental economic growth, and success of the Alliance for Progress in South America's third largest country, would be considerable.

Growth Pattern

Peru's per capita income has increased by more than 40 percent since 1950 and by 25 percent since 1959. The growth performance of the past seven years has on average, then, more than met the basic Alliance target of 2.5 percent per capita per year, even while population was growing by nearly three percent per year -- a remarkable performance sustained by very high levels of domestic savings ranging around 20 percent of gross product on the average.

It is in respect to the quality or structure of growth that has been achieved that the Peruvian record is clearly deficient. The expansion in overall output reflected in the national statistics was produced (apart from the mining contribution) almost entirely by the modern export agriculture, fishing, manufacturing, and commerce of the Coast, and the benefits of growth have, in turn, been very largely retained on the Coast.

One of the most significant and basic deficiencies that has become increasingly acute over the years is that in agriculture, food production for domestic consumption appears to have stagnated over the past 15 years. As a result increases in food prices constantly lead upward the general rise in prices while food products are a constantly growing share of Peru's import bill.

While investment has been high, it has been heavily concentrated in directly productive and largely export-oriented activities and, to a lesser extent, in urban construction. Investment in basic economic and social infrastructure has, especially outside of the Coast, been a small part of the total, and very slight indeed in relation to Peru's needs at the present stage in the development process.

The Gaps

The problem of underdevelopment in the past and economic growth in the future -- and this applies in particular to increased public sector investment -- can be stated analytically in terms of gaps in human and financial resources. On both fronts, the problem in Peru are sizeable.

As it concerns the ability of the Government to effectively mobilize its human resources to implement the public investment program, substantial administrative reforms are envisaged in the key ministries of government including Finance, Development, and Education. To cope with the shortage of skills, a growing amount of resources is being devoted to formal education. Furthermore, the technical assistance programs of A.I.D., the FAO, and other organizations add measurably to the available pool of skills.

On the financial side it is clear that higher investment (public or private) requires larger savings (voluntary or forced). Recognizing the need for more public funds, the Belaunde administration embarked on a series of revenue raising measures after its inauguration. This has included two successive boosts in the transactions tax, bringing the rate to five percent; an across-the-board increase in import tariffs, plus additional duties on certain luxuries imports; and new or higher excises on some domestic products, including notably alcoholic beverages. But the experience of the past three years has demonstrated that Peru's basic tax structure will have to be overhauled. It is impossible to pyramid rates much farther on the present archaic tax structure with its large component of earmarked taxes, heavy reliance on indirect levies, vulnerability to foreign trade fluctuations, profusion of minor levies, general complexity, and inadequate administration.

The inability of the present tax system to capture a proportionate share of the growth in national income has forced the government to turn to domestic borrowing to get the resources to finance its programs as the following table shows.

Public Sector

Revenues, Expenditures, and Savings

Percentage of GNP

	1963	1964	1965
Current Revenues	18.3	17.9	17.1
Current Expenditures	15.8	16.1	15.7
Current Savings	2.5	1.8	1.5
Domestic Borrowing (Including change in cash balances)	-.-	.7	1.3
Public Investment	4.4	5.9	5.8

THE BALANCE OF PAYMENTS

The underlying strength, and it is considerable, in the Peruvian balance of payments lies in an extraordinarily diversified natural resource endowment. The catalog includes semi-tropical fertile (when irrigated) coastal lands, an abundance of rich mineral resources close to cheap ocean-going transport and a unique combination of climate and current which make Peru the leading fishing nation of the world. These assets mixed with significant home-grown enterpreneurship and government policy hospitable to foreign investment have generated a remarkable increase in exports. From 1950 to 1960 exports more than doubled rising from $198 million to $440 million and the gain in export value from 1960 to 1966 was equal to the gain of the preceeding decade. After stagnating in 1965 exports rose again in 1966, but imports rose even more rapidly.

It is, however, easy to overstate the strength of Peru's foreign balance. Quite aside from import demand which has generally kept pace with the growth in exports, investment income runs to more than ten percent of the value of Peru's exports. Such outpayments coupled with more than matching outflows for freight and insurance have put the current account of the GOP into deficit in 12 of the last 14 years and five of the past six years.

Indeed, the current account position has deteriorated in each of the past six years, 1964 excepted.

Current Account

Balance of Payments

(millions of dollars)

	1961	1962	1963	1964	1965	1966
Exports	510	556	555	685	687	791
Imports	-429	-478	-515	-513	-646	-742
Freight & Insurance	-53	-63	-63	-75	-85	-102
Investment Income	-63	-66	-72	-72	-77	-125
Miscellaneous	27	15	14	-11	-5	-11
Current Account Surplus (Deficit)	-8	-36	-81	14	-126	-189

There is no reason to expect the trend in current account to reverse itself over the next few years; on the contrary, the weight of the evidence points to an increasing need for foreign capital, private and especially public to maintain equilibrium in the balance of payments.

Summary Balance of Payments

(millions of dollars)

	1961	1962	1963	1964	1965	1966
Balance-Current Account	-8	-36	-81	14	-126	-189
Net Public Loan Receipts	-4	20	47	59	63	145
Private capital, and other non-current items	53	28	64	-38	36	14
Surplus (deficit) on which:	41	12	30	35	(-27)	(-30)
Central Bank	34	6	18	25	15	(-22)
Other Financial Inst.	7	6	12	10	(-42)	(-8)

Public Investment

Total public sector investment has risen over sixty percent during the past three years, but the share of it which is financed by public sector savings has fallen to practically zero.

Available estimates of investment by sector in the pre-Belaunde year of 1962, and in his first full year in office 1964, show that outlays in agriculture and school construction doubled; that hospital and rural medical centers expenditures tripled; and that transportation (highway construction) investments reached a peak of almost one billion soles, equal to 5% of public sector current revenues. Looking to the future, public investment will continue to rise with the larger share of the increase programmed for the same sectors -- agriculture, highway, and education.

Even as the Government continues to invest in bricks and mortar, it is conscious of the need for sustained inputs into human resources. The President's principal vehicle for effecting social change in its many facets -- education, local government, personal motivations, and expectations -- is Cooperacion Popular.

Loan Terms

The disbursed portion of foreign public sector debt has risen from $161 million at the end of 1960 to an estimated $574 million at the end of 1966. Projected annual debt service requirements for 1967 point to a burden of roughly 12 percent of projected exports. There is every expectation that the debt burden will rise rapidly in the next few years. Indeed, the World Bank estimates that even if Peru takes on new debt on terms in use by the international lenders the debt service will still rise to more than 15 percent of projected export volume by 1970. If A.I.D. and other agencies loan on terms significantly shorter than their minimum, there is a real prospect that debt service by 1970 could reach 20 percent of prospective export volume.

Most of the projects included in the Peruvian investment program will yield substantial returns, but in many cases only over a long payout period. Further, the infrastructure investments which will receive priority -- education, agriculture, roads -- often yield a significant part of their benefits in the form of so-called external economies (by way, for example, of expanded opportunity or greater efficiency for the general public) or in a form (improved health) which cannot be directly translated into income. It is administratively difficult to levy user charges to pay off such investments and in addition the social objectives which the public investment serves deserve strong support.

For a combination of reasons, then, balance of payments, the type of public investment envisioned and the end which it serves, the Mission believes that minimum loan terms are fully warranted for Peru.

June 5, 1967

DRAFT CENTRAL BANK RESOLUTION

Part I : Statement Announcing the FIP

With the participation of international development organizations, and the cooperation of the Government of Peru, the "Fondo de Inversiones Privadas" hereby is established within the Banco Central de Reserva del Perú. The Fund is viewed as a valuable instrument in providing the financial intermediaries in the Peruvian economy the incentive to remove existing financial bottlenecks in the financing of private investment projects in order to facilitate the non-inflationary, sustained, and balanced growth of the economy.

Part II : Specifics of Operation of the FIP

(I) Purpose of the Fund:

The resources of the fund are to be used to help finance sound private investment projects in those sectors of the Peruvian economy lacking adequate finance.

(II) Sources of the Fund:

Endowment funds denominated in foreign currency in amounts needed to finance the purchase of machinery, plant, equipment, raw materials, and technical assistance abroad as well as part of the local (soles) cost will be provided by international and national development organizations. These funds will be deposited in an account to be called "Fondo de Inversiones Privadas" (FIP) at the Central Reserve Bank. The funds required for local expenditures ("matching funds") will be generated by the central Reserve Bank as an integral part of its monetary program and deposited in the FIP account at the Bank.

(III) Operation of the Fund:

A customer seeking a loan will approach the financial intermediary (Commercial Banks, Bancos de Fomento or Financieras) with his request for the loan and supporting documents.

The intermediary will be required to study the application for its commercial feasibility and eligibility for financing under the FIP. These studies will be submitted to the Central Bank for approval.

Loan applications to the Central Bank will be judged on a first-come, first-served basis among the financial intermediaries. Should the Central Bank decide in favor of a loan application, upon the guarantee by the participating financial intermediary to the FIP of the resources of the Fund involved in the loan, the Fund's resources will be distributed for lending to the private investor:

(A) Directly to the private investor from the FIP account

or (B) FIP lending to the financial intermediary, and the intermediary lending directly to the private investor.

(IV) Percentage of Loan the Fund will finance

The customer generally will be required to finance approximately 30% of the total cost of the project. The resources of the FIP will be used to finance the remaining cost of the project, approximately 70%.

(V) Terms of Loan

The private investor will receive loans from the FIP for short term (up to two years) at 12%, for medium term (more than two, up to five years) at 13%, and for long term (more than five years) at 14% (c.f. footnote 1/, following page). There shall be no exchange risk to the customer on the international funds borrowed from the FIP (c.f. (VI) and (VII) below). All loans made with FIP resources shall be free of the stamp tax. Should the Central Bank decide that part of the matching funds be supplied from the free reserves of the financial intermediaries rather than from the resources of the FIP, these funds shall be lent at the legal rate of interest and, being conjoined with the development efforts of the FIP, shall be free from the stamp tax.

(VI) Distribution of Revenues Between the Financial Intermediaries and the Central Bank

Any loans granted under the Fund will assure the participating financial intermediary a revenue on that portion of FIP funds distributed in a given loan of 4% on project financing and 2% on the financing of capital equipment imports for an already operating enterprise. 1/ This revenue is intended to cover the administrative cost of the financial intermediary in processing the loan application, provide a sinking fund against the possibility of customer default on the loan, and provide a profit for the intermediary.

The remaining portion of the revenue from the loan involving FIP resources will accrue to the Central Bank. This revenue is intended to cover the Central Bank's administrative cost for running the fund, pay the interest charge on the international funds borrowed, and provide a profit to the Central Bank. This profit will be reinvested to augment the Fund's resources and is to be viewed as a working reserve within the FIP and, simultaneously, as a fund against the risk of exchange devaluation.

(VII) Responsibilities

(A) Responsibility of the Government of Peru will be the exchange risk on dollar resources distributed.

(B) The responsibilities of the Central Reserve Bank shall include:

1/ Once the fund is in operation, the rates given in (V) and (VI) above will be subject to change at the discretion of the Central Bank as credit and market conditions and the movement of FIP funds dictate.

(i) advertising the fund to the public, the commercial banking institutions, Bancos de Fomento, and Financieras;

(ii) processing the loan application:

The Central Reserve Bank will establish a Review Committee to administer the FIP. The Review Committee shall consist of two members of the Board of Directors and one Fund Official from the Central Reserve Bank. The Review Committee will have a full-time staff of bank employees to process the loan application and supplementary information. This staff will be headed by the Fund Official of the Central Bank. The granting of a loan will require as a necessary condition the unanimous consent of the three members of the Review Committee.

(iii) distribution of funds:

The Central Reserve Bank will have the responsibility of distributing the endowment funds, these funds to be used by the intermediaries and borrowers within the limits of the general directives issued by the Review Committee.

(iv) A quarterly evaluation by the Central Bank of the allocation of Fund resources within the sectors of the economy and of the efficiency with which these funds are being used in accomplishing the objectives of the Fund.

(C) Responsibilities of the Financial Intermediaries

Those intermediary institutions wishing to participate will be responsible for:

(i) advertising the fund to the public

(ii) fully processing the customer's application and presenting the application together with the supplementary information required by the Central

Reserve Bank's Review Committee for a decision on the loan application. This supplementary information shall include:

a) A commercial feasibility study of the proposed project.

b) A technical feasibility study of the proposed project. This study shall contain recommendations as to the amount and type of technical assistance desirable for the project, the availability of such technical assistance sources (domestic or foreign), and the cost for this assistance.

c) Proving to the satisfaction of the Central Bank's Board that the loan will represent a net addition in their balance sheet for the sector concerned.

(iii) Guarantee

The financial intermediaries are required to guarantee on their own resources (an "aval") the repayment to the Central Bank of FIP resources (both the International and matching funds involved in loan). In the case where discounting procedures are used to free the funds, the participating financial institution will be required tu supply the usual commercial guarantee on the discounting operation.

(iv) A periodic progress report should the loan be granted.

Part III: Memorandum Concerning the Participation of the Agency for International Development (AID) in the FIP

Outstanding among the problem areas that have developed in the Peruvian economy has been the relative stagnation of the agricultural sector (real output increasing by only 12% during the 6-year period 1960-66), the inflation that has ocurred in this sector (80% during the 6-year period), the necessity of the economy to turn/to importation of foodstuffs and related agricultural products to meet its needs, and the subsequent strain this has put on the balance of payments of the economy. A second problem has developed in the manufacturing sector. Although output in the manufacturing sector has increased substantially during the period under question (an increase of 67% from 1960 to 1966), the increase largely has been concentrated in select areas. This, in the face of broadly rising demand for manufactured goods in the economy, has resulted in inflationary pressures in this sector (85% during the 6-year period), imports increasing over a broad range of manufactured products further increasing the pressures on the balance of payments, and, more importantly, a failure to lay the base for what many consider to be the long run solution to the balance of payments problem, namely, the eventual exportation of manufactured goods.

Fondo de Inversiones Privadas

The Agency for International Development has indicated its willingness to help Peru in its development efforts by initially endowing the FIP with a line of credit for US$ million for a term of not less than 40 years.

(I) Uses of the Fund

(A) Primary use of the AID funds will be towards increasing production in the "agro-industrial" sector of the Peruvian economy. 2/

(II) Project Financing under the Fund

The customer generally will be required to finance approximately 30% of the total cost of the project. The resources of the FIP will be used to finance the remaining cost of the project, approximately 70%. In the case of AID, it is understood that the initial endowment of funds may be used solely to purchase imports (machinery, equipment, raw material, etc.) from the United States. Because of the nature

2/ "Agro-Industrial" activity may be fdefined as an investment designed to transform, preserve, or otherwise process animal, vegetable, or other organic material.

of the projects to be financed within the FIP (c.f. (I) above), it is estimated that, except in the case of financing the importation of capital equipment for a previously operating enterprise 3/, of the 70% of the total cost of the project to be financed from FIP resources, the incidence of AID funds within this 70% generally will amount to a least one-half (50%) of the total value of the loan. The remaining portion of the total cost of the project will be financed as credit and market conditions dictate though matching funds and the use of the free reserves of the participating institutions.

(III) Operation of the Fund

A customer seeking a loan will approach the financial intermediary (Commercial Bank, Bancos de Fomento or Financieras) with his request for the loan and supporting documents.

The intermediary will be required to study the project for its commercial feasibility and eligibility for financing under the FIP. These studies will be submitted to the Central Bank for approval. The Central Bank Review Committee will judge on a loan application on a "first come, first served" basis among the commercial banks, Bancos de Fomento, and Financieras and on the basis of the commercial feasibility and eligibility of the project for financing under the AID grant with consideration being paid to the previous allocation of FIP resources (c.f. (II)). Should the Central Bank decide favorably on the application, the funds will be freed for lending by the intermediaries.

(IV) Special Qualifications

Special qualifications on the use of AID loan funds are that the minimum size of a loan financed under the FIP involve not less than US$10,000 and that all loans requiring $500,000 or more in dollar cost must be submitted to Eximbank for their consideration. A notice of rejection must be received from Eximbank before the FIP can approve such loan.

3/ It is understood that the greater portion of the AID funds will be used in the area of project financing rather than in the area of financing the importation of capital equipment for an already operating enterprise.

PERU--PRIVATE INVESTMENT FUND June 5, 1967

CHECK LIST OF STATUTORY CRITERIA

(Alliance for Progress)

1. FAA S.102. Precautions that have been or are being taken to assure that loan proceeds are not diverted to short-term emergency purposes. (such)as budgetary, balance of payments, or military purposes) or any other purpose not essential to the country's longe-range economic development.

1. All loan disbursements will only be made for the purchase by the private sector of Peru of equipment and services in the U. S. on the basis of adequately prepared proposals approved by the Central Bank. USAID Capital Development Office will receive periodic progress reports and make spot checks of projects to ensure proper end use of loan funds and the GOP matching contribution (Section III).

2. FAA S.102. Information on measures taken to utilize United States Government excess personal property in lieu of the procuremnt of now items.

2. NOT APPLICABLE

3. FAA S.102. Information whether the country permits, or fails to take adequate measures to prevent, the damage or destruction by mob action of United States property.

3. The GOP does not permit, and takes adequate measures to prevent, damage or destruction of U.S. property by mob action.

4. FAA S.201(d). Information and conclusion on legality (under laws of country and U.S.) and reasonableness of lending and relending terms of the loan.

4. The proposed loan is consistent with the laws of Peru and the United States and the United States and the terms are considered reasonable by both the Borrower and A.I.D.

5. FAA S.251(a). Manner in which loan will promote country's economic development and contribute to the welfare of its people.

5. This loan will promote Peru's economic development and contribute to the welfare of its people.

6. FAA S.251(b)(1). Extent to which country is adhering to the principles of the Act of Bogota and Charter of Punta del Este and is showing a responsiveness to the vital economic, political, and social concerns of its people and extent to which country has demonstrated a clear determination to take effective self-help measures.

6. Account has been taken of the GOP's adherence to the principles of the Act of Bogota and the Charter of Punta del Este, and the Borrower's responsiveness to the vital economic, political and social concerns of its people. Contributions by the GOP to various programs including agrarian reform, low and medium cost housing, civic action, education and community development are demonstrations of effective self-help measures.

7. FAA S.251(b)(2). Information and conclusion on activity's economic and technical soundness.

7. This activity has been found economically and technically sound.

8. FAA S.251(b)(3). Information and conclusion on activity's relationship to and consistency with other development activities, and its contribution to realizable long-range objectives.

8. This activity has a basic significance for GOP's development activities, and will play an essential part in the realization of long range objectives.

9. FAA S.251(b)(4). Information and conclusion on possible effects on U.S. economy, with special reference to areas of substantial labor surplus.

9. The impact of this loan on the U.S. economy is stated in Section V.

10. FAA S.251(b)(5). Information and conclusion on the degree to which the country is

10. Peru has a democratic reform-minded government which believes in the goals of the

making progress toward respect for the rule of law, freedom of expression and of the press, and recognition of the importance of individual freedom, initiative, and private enterprise.

Alliance for Progress and is deeply committed in the development and process. Efforts to improve economic and social opportunities for the presently disadvantaged half of the population living in a subsistence economy and to establish an institutional base--public and private--for sustained economy and social growth in Peru are examples of movement in this direction.

11. FAA S.251(b)(6). Information and conclusion on the degree to which the country is taking steps to improve its climate for private

11. Peru's economy is strongly orientated toward private enterprise. The private sector provides 80% of the GNP. The Peruvian industrial promotion law encourages foreign and domestic private investments in Peru's industrial sector. Several private investment banks have been established in Peru in the past five years.

12. FAA S.251(b)(7). Information and conclusion on whether or not the activity to be financed will contribute to the achievement of self-sustaining growth.

12. See "Purpose" in Summary and Recommendations section of Loan Paper and Section I.

13. FAA S.251(b)(8). Information and conclusion on the extent to which the activity will contribute to the economic and political integration of Latin America.

13. Export industries being financed by the P.I.F. will expand trade between Peru and other Latin American countries.

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

14. Financing for this activity is not available from other free world sources, including private sources with the United States, on reasonable terms. Eximbank has option to participate on projects requiring $500,000 or more in dollar costs.

15. FAA S.251(b). Information and conclusion on capacity of the country to repay the loan.

15. It appears reasonably certain that the Borrower will be capable of repaying the loan.

16. FAA S.251(b). Information and conclusion on country's efforts to repatriate capital invested in other countries by its own citizens.

16. It appears that the GOP is attempting to repatriate capital invested in other countries by its own citizens through its free exchange policy and strong endorsement of private enterprise.

17. FAA S.251(b). Information and conclusion on reasonable prospects of repayment.

17. It appears reasonably certain that the GOP will be willing and able to repay the loan.

18. FAA S.251(e). Information and conclusion on availability of an application together with sufficient information and assurances to indicate reasonably that funds will be used in an economically and technically sound manner.

18. The GOP has made a formal application for loan-funded assistance in this activity, and A.I.D. has received sufficient information and assurance to indicate reasonably that funds will be used in an economically and technically sound manner.

19. FAA S.251(g). Information and conclusion on use of loan to assist in promoting the cooperative movement in Latin America.

19. NOT APPLICABLE.

20. FAA S.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 review of national development activities

20. This activity is fully consistent with recommendations made by the CIAP committee during its September 1966 meeting on Peru.

21. FAA S.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 procurement from private sources.

21. The entire A.I.D. loan will be used by intermediate credit institutions and commercial banks for re-lending to the private sector in Peru, to finance U.S. procurement of equipment and services from private sources.

222. FAA S.281. 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 developing countries, through the encouragement of democratic private and local governmental institutions.

22. Private financial institutions will be strengthened by this loan and maximum participation by Peruvians will be obtained through PIF subloans for industrial expansion (See Sections I and III).

23. FAA S.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

23. This loan will encourage efforts of the GOP in relation to (a), (b), (d) and (e). (Section I)

24. FAA S.601(b). Information and conclusion on how the loan will encourage U.S. private trade and invest-

24. U.S. manufacturers will be supplying equipment for projects financed by this loan.

ment 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).

25. FAA S.601(d). Conclusion and supporting information on compliance with the Congressional policy that engineering and professional services of U.S. firms and their affiliates are to be used in connection with capital projects to the maximum extent consistent with the national interest.

25. The $100,000 of the loan allocated for technical assistance may be used for procurement of U.S. professional services to the Central Bank. Otherwise, engineering and professional services are not involved.

26. FAA S.602. Information and conclusions whether loan will permit American small business to participate equitably in the furnishing of goods and services financed by it.

26. Small business will be advised of this loan and be given a fair chance to compete (Section VI)

27. FAA S.604(a); App. S.108. Compliance with restriction of commodity procurement to U.S. except as othewise determined by the President and subject to statutory reporting requirements.

27. AID loan dollars will be spent in the US for equipment and services.

28. FAA S.604(b). Compliance with bulk commodity procurement restriction to prices no higher than the market price prevailing in the U.S. at time of purchase.

28. Any commodities financed by the loan and purchased in bulk will be purchased at prices no higher than prevailing US market prices.

29. FAA S.604(d). Compliance with requirement that marine insurance be purchased on commodities if the host country discriminates, and that such insurance be placed in the U.S.	29. This section will be complied with.
30. FAA S.604(e). Compliance with requirement that funds not be used for procurement of any agricultural commodity or product thereof outside the United States when the domestic price of such commodity is less than parity.	30. NOT APPLICABLE
31. FAA S.611(a)(1). Information and conslusion on availability of engineering, financial, and other plans necessary to carry out the assistance and of a reasonably firm estimate of the cost of the assistance to the United States.	31. The necessary engineering, financial and other plans for the project, and a reasonably firm estimate of the cost of the project, have been made.
32. FAA S.611(a)(2). Necessary legislative action required within recipient country and basis for reasonable anticipation such action will be completed in time to permit orderly accomplishment of purposes of loan.	32. No legislation required.
33. FAA S.611(b); App. S.101. If water or water-related land resource construction project or program, information and conclusion on benefit-cost computation.	33. NOT APPLICABLE

34. <u>FAA S.611(c).</u> Compliance with requirement that contracts for construction be let on competitive basis to maximum extent practicable.	34. The Project does not directly involve construction contracts.
35. <u>FAA S.612(b) and 636(h).</u> Appropriate steps that have been taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services and foreign currencies owned by the U.S. are utilized to meet the cost of contractual and other services.	35. USAID/Lima will ensure that GOP matching funds are available as needed.
36. <u>FAA S.619.</u> Compliance with requirement that assistance to newly independent countries be furnished through multilateral organizations orplans to maximum extent appropriate.	36. NOT APPLICABLE
37. <u>FAA S.620(a); App. S.107(a) and (b).</u> Compliance with prohibitations against assistance to Cuba and any country (a) which furnishes assistance to Cuba or failed to take appropriate steps by February 14, 1964, to prevent ships or aircraft under its registry from carrying equipment, materials, or supplies from or to Cuba; or (b) which sells, furnishes, or permits any ships under its registry from carrying items of primary strategic significance, or items of economic assistance to Cuba.	37. No assistance will be furnished under this loan to the present government of Cuba, nor does theGOP furnish assistance to the present government of Cuba. The GOP has taken appropriate steps to prevent ships or aircraft under its registry from engaging in any Cuba trade.

38. FAA S.6.20(b). If assistance to the government of a country, existence of determination it is not controlled by the international Communist movement.

38. The Secretary of State has determined that the Borrower is not controlled by the international communist movement.

39. FAA S.620(c). If assistance to the government of a country, existence of indebtedness to a U.S. citizen for goods and services furnished or ordered where such citizen has exhausted available legal remedies or where the debt is not denied or contested by such government or the indebtedness arises under an unconditional guaranty given by such government.

39. The GOP is not known to be indebted to any US citizen has exhausted available legal remedies or where the debt is not denied or contested by the GOP or the indebtedness arises under an unconditional guaranty of payment by the GOP.

40. FAA S.620(d). If assistance for any productive enterprise which will compete in the U.S. with U.S. enterprise, existence of agreement by the recipient country to prevent export to the U.S. of more than 20 1/2 of the enterprise's annual production during the life of the loan.

40. With respect to agro-industries see Section III B, with respecto to other export industries it is not now known what products will be produced and there is not substantial evidence available that competition will take place in the U.S. market (See M.O. 1016.1). No agreement is considered necessary.

41. FAA S.620(e)(1). If assistance to the government of a country, extent to which it (including government agencies or subdivisions) has, after Januray 1, 1962, taken steps to repudiate or nullify contracts or taken

41. The GOP (including Government Agencies or Subdivisions) is not known to have taken steps since January 1, 1962 to repudiate or nullify contracts or taken any action which has the effect of nationalizing, expropriating

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 appropriate steps to discharge its oblitgations.	or otherwise seizing ownerships or control of property of US citizens or entities beneficially owned by them without taking appropriate steps to discharge its obligations as specified in this section.
42. FAA S.620(f); App. S.109. Compliance with prohibitions against assistance to any Communisty country.	42. Assistance provided under this loan will not be furnished to any Communisty country.
43. FAA S.620(g). Compliance with prohibition against use of assistance to compensate owners for expropriated or nationalized property.	43. Assistance provided by this loan will not be used to compensate for expropriated or nationalized property.
44. FAA S.620(h). Compliance with regulations and procedures adopted to insure against use of assistance in a manner which, contrary to the Best interests of the U.S., promotes or assists the foreign aid projects or activities of the Communist-bloc countries.	44. Assistance provided by this loan will not be used in a manner which, contrary to the best interests of the U.S., promotes or assists the foreign aid projects or activities of the Communist bloc countries.
45. FAA S.620(i). Existence of determination that the country is engaging in or preparing for aggressive military efforts.	45. The President has not determined that the GOP is engaging in or preparing for aggressive military efforts.
46. FAA S.620(i). Information on representation of the country at any international	46. There has been no official representation of Peru at any international conferences

conference when that representation includes the planning of activities involving insurrection or subversion against the U.S. or countries receiving U.S. assistance.	which included the planning of activities involving insurrection or subversion against the United States or countries receiving U.S. assistance.
47. FAA. S. 620(k). If construction of productive enterprise where aggregate value of assistance to be furnished by U.S. will exceed $100 million identification of statutory authority.	47. NOT APPLICABLE.
48. FAA S.620(1). Consideration which has been given to denying assistance to the government of a country which after December 31, 1966, has failed to institute the investment guaranty program for the specific risks of inconvertibility and expropriation or confiscation.	48. Consideration was given and it was determined to review the situation again in June 1967.
49. FAA S.620(n); App. 107(b) and 116. Compliance with prohibition against assistance to countries which traffic or permit trafficking with North Viet-Nam.	49. The Host Country does not traffic or knowingly permit trafficking with North Viet-Nam.
50. FAA S.620(c). 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, information on the	50. Consideration is currently being given to resolution of the problem arising from the Peruvian assertion of 200-mile territorial limit.

consideration which has been given to excluding the country from assistance.

51. FAA S.620(q). Existence of default under any Foreign Assistance Act loan to the country.

51. Peru is not in default under any FAA loan.

52. FAA S.621. Information and conclusion on how the loan in providing technical assistance will utilize to the fullest extent practicable 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.

52. The $100,000 allocated to technical assistance may be spent for the procurement of U.S. professional services from private enterprise.

53. App. S.102. Compliance with requirement that payments in excess of $25,000 for architectural and engineering services on any one project be reported to Congress.

53. Payment in excess of $25,000 for engineering services on this project will be reported to Congress pursuant to the requirement of this section.

54. App. S.104. Compliance with bar against funds to pay pensions, etc. for military personnel.

54. Funds obligated by the loan and local currency generated thereby will not be used to pay pensions, annuities, etc. as prohibited in this section.

55. App. S. 106. If country attempts to create distinctions because of their race or religion among Americans in granting personal or commercial access or other rights otherwise available to U.S. citizens generally, application which will be made in negotiations of contrary principles as expressed by Congress.	55. No attempts by the Host Government to create distinctions because of race or religion among Americans in granting personal or commercial access or other rights otherwise available to U.S. citizens generally are known. If the Host Government attempts to create such distinctions, application will be made in negotiations of contrary principles as expressed by Congress.
56. App. S. 111. Compliance with existing requirements for security clearance of personnel.	56. This requirement will be enforced.
57. App. S. 112. Compliance with requirement for approval of contractors and contract terms for capital projects.	57. NOT APPLICABLE.
58. App. S. 114. Compliance with bar against use of funds to pay assessments, etc., of U.N. member.	58. Loan funds will not be used to make any payment to the U.N.
59. App. S. 115. Compliance with regulations on employment of U.S. and local personnel for funds obligated after April 30, 1964 (Regulation 7).	59. NOT APPLICABLE.
60. App. S. 401. Compliance with bar against use of funds for publicity or propaganda purposes within U.S. not heretofore authorized by Congress.	60. Loan funds will not be used for publicity or propaganda purposes within the United States.

June 5, 1967

ILLUSTRATIVE LIST OF ELIGIBLE AGRO-INDUSTRIAL PROJECTS

Code No.	(Categories extracted from United Nations "Uniform International Industrial Classification").
20	Food manufacturing industries excepting drinks
201	Slaughter, preparation and conservation of meats and foul slaughter-houses, packing plants; includes curing, smoking, packing, etc. and freezing; also, preparation of greases and other edible animal oils.
202	Dairy products; making of cheeses, butter, condensed milk, pasteurizing and bottling of milk or milk products.
203	Conservation and packing of fruits and vegetables; includes bottling of juices, sauces, soups and packing, dehydrating, or freezing of fruits and vegetables.
204	Conservation and packing of fish and other sea food; includes salting, drying, freezing, filleting, etc.
205	Flour and other mills; grinding preparation, cleaning, etc. of rice, grains and cereals, for human or animal consumption.
206	Manufacture of breads and related products.
208	Cocoa, chocolate, etc.
212	Wine making, cider, etc.
23	Textiles manufacture of various fibers (except cotton)
233	Manufacture of ropes and cord.
25	Wood and cork industries
251	Wood construction materials
252	Wood and cane packing containers
26	Furniture
27	Paper Pulp and cardboard manufacture
272	Pulp and paper products including bags and boxes
29	Leather and furs; curing and tanning plants;
292	Manufacture of leather articles.
312	Vegetable and animal oils and greases; cottonseed oils, etc.

DRAFT
LOAN AUTHORIZATION

Provided From: Alliance for Progress Funds
PERU: Private Investment Fund

Pursuant to the authority vested in the Deputy U.S. Coordinator, Alliance for Progress, by the Foreign Assistance Act of 1961, as amended, and the delegations of authority issued thereunder, I hereby authorize the establishment of a loan ("Loan") pursuant to Part I, Chapter 2, Title VI, Alliance for Progress, to the Republic of Peru or in the alternative to the Industrial Bank of Peru ("Borrower") of not to exceed seven million five hundred thousand United States Dollars ($7,500,000) to assist in financing through a Private Investment Fund priority agro-industrial activities, such assistance being designed also to stimulate U.S. exports and expand markets for U.S. equipment. This Loan is to be subject to the following terms and conditions:

1. Terms of Repayment: Borrower shall repay the Loan to A.I.D. in United States Dollars within forty (40) years from the first disbursement of the Loan, including a grace period of not to exceed ten (10) years. Borrower shall pay to A.I.D. in United States dollars on the disbursed balance of the Loan, interest of one (1) percent per annum during the grace period and two and one-half ($2\frac{1}{2}$) percent per annum thereafter.

2. Other Terms and Conditions:

   (a) The Government of Peru shall deliver the proceeds of the Loan in trust to the Central Bank of Peru in order to establish a Private Investment Fund. The Central Bank shall act as fiduciary of the Government of Peru and operate the Private Investment Fund as agreed upon with A.I.D.

   (b) In the event the Borrower is the Industrial Bank of Peru, this Loan will be guaranteed by the Government of Peru.

   (c) Equipment, materials and services financed by the Loan shall be procured from the United States.

(d) Sub-loans made by the Private Investment Fund with A.I.D. loan funds shall be made in accordance with A.I.D.-approved regulations governing the use of such funds.

(e) Except as A.I.D. may otherwise agree, no Private Investment Fund financing will be made available for the processing for export of food or feed commodities currently found in excess supply on world markets or for the processing of export or domestic consumption of any agricultural commodities, other than food or feed, currently in world surplus.

(f) The loan shall be subject to such other terms and conditions as A.I.D. may deem advisable.

Deputy U.S. Coordinator
Alliance for Progress

Date