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

CAPITAL ASSISTANCE PAPER

Project and Description
for the Benefit of the
Development Loan Committee

AREA: SMALL BUSINESS (EASTUSWAKE AREA)

AID-118/P-121

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PD AAB-394-B1

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

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AID-DLC/P-1021

May 16, 1972

MEMORANDUM FOR THE DEVELOPMENT LOAN COMMITTEE

SUBJECT: Peru - Small Business (Earthquake Area)

Attached for your review are the recommendations for authorization of a loan in an amount not to exceed \$2,500,000 to the Government of Peru to assist in financing the United States dollar and local currency costs of a project to provide technical assistance and credit for the reconstruction and development of small businesses in the area affected by the earthquake of May 31, 1970 ("Project").

Please advise us as soon as possible but in no event later than close of business on Wednesday, May 24 1972, if you have a basic policy issue arising out of this proposal.

Rachel R. Agee
Secretary
Development Loan Committee

Attachments:
Summary and Recommendations
Project Analysis
ANNEXES I - XIII

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May 16, 1972

PERU - SMALL BUSINESS (EARTHQUAKE AREA)

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May 16, 1972

PERU - SMALL BUSINESS (EARTHQUAKE AREA)

SUMMARY AND RECOMMENDATIONS

1. BORROWER: The loan will be made to the Government of Peru (GOP). The GOP will designate its Commission for Reconstruction and Rehabilitation of the Earthquake Zone ("CRYRZA") as the Executing Agency for a program of sub-lending through local banks, branch banks, and other financial agents ("Local Banks") to finance reconstruction and development of Small Business in the area most seriously affected by the earthquake of May 31, 1970.
2. AMOUNT OF LOAN:

Not to exceed \$2,500,000.
3. PROJECT DESCRIPTION: The project consists of the establishment of a special fund (CRECE* FUND) in a Fiduciary Bank which can be drawn upon by Local Banks to make short and medium term sub-loans to small and medium industries and businesses in the Disaster Area. Each sub-loan will require at least 10% participation by the Local Bank in the sub-loan from its own resources and must be approved by CRYRZA. The project will also provide for the training of a CRYRZA technical assistance staff which will oversee the project and render assistance to the sub-borrowers. The total amount of the loan will be available for conversion to local currency.
4. PURPOSE OF THE PROJECT: The project is designed to assist in the recovery of the Disaster Area by:
 - a. Reestablishing and developing local industry and commerce.
 - b. Stimulating the production of goods and provision of services necessary or useful to the people of the disaster area, particularly those needed for major reconstruction activities.
 - c. Generating employment opportunities.
 - d. Stimulating private initiative through support of small business.

Most small enterprise in Peru does not have adequate resources to recover from major catastrophes, and, lacking complete collateral or equivalent guarantees, has little access to credit at reasonable terms. Thus, CRYRZA, in conjunction with its broader plans, has requested assistance in financing the credit needs of private entrepreneurs in rebuilding the small industries, services and commercial

*CRECE is the imperative form of the verb "to grow" in Spanish and is an acronym for "Creditos para la Reconstruccion de Comercio y Empresas".

NOTE: Exchange Rate: \$1 equals 43.38 Soles.

establishments which previously provided much of the employment in the area, as well as providing needed goods and services.

Through adequate credit, it is intended to make it possible for small entrepreneurs in the disaster area to increase production, improve their incomes, and become a stronger force in the economic, social and political life of their region. It is a counterpart to similar activities being carried out for the benefit of small farmers.

Assuming an average loan of \$4,600 (200,000 soles) it is estimated that over 800 small enterprises would obtain assistance under this project over a 3-year period, and that over 2,400 new job opportunities, directly related to this loan, would be created.

5. FINANCIAL PLAN:
- | | Local Currency
Expressed In
<u>U.S. Dollars</u> |
|--|---|
| A. Sub-projects | |
| A.I.D. contribution (85%) | \$2,450,000 |
| Participation of Local Financial
Agents (10%) | 288,000 |
| Sub-borrower equity participation (5%) | <u>144,000</u> |
| | <u>\$2,882,000</u> |
| B. Technical Assistance | |
| Consultants (AID) | \$ 50,000 |
| Staff (CRYRZA/GOP) 5 years opn | <u>375,000</u> |
| | <u>\$ 425,000</u> |
|
TOTAL Program |
<u><u>\$3,307,000</u></u> |
6. ALTERNATE SOURCES OF FINANCING: EXIM Bank, IBRD and IDB have all expressed no interest in financing this project. Neither local nor foreign private credit institutions would be likely to provide the concessional terms needed by the GOP.
7. STATUTORY CRITERIA: All statutory criteria have been considered.
8. VIEWS OF COUNTRY TEAM: Humanitarian assistance in relief and rehabilitation of the Earthquake area is high among USG and GOP priorities.

The project is expected to have an immediate beneficial effect on the economy of the Area by providing employment and needed goods and services, and improving income distribution, and additionally to benefit Peru by reducing migration from the Disaster Area toward the Lima/Callao area.

9. RECOMMENDATIONS: It is recommended that AID make a loan to Peru of an amount not to exceed \$2,500,000 for the subject project. Terms of the Loan would be the most liberal permitted by the Foreign Assistance Act i.e. 40 years, 10 year grace period with interest at 2% during the grace period and 3% thereafter.

Prior to disbursement for sub-loans, CRYRZA shall furnish AID with:

- 1) A detailed administrative and policy manual setting forth all pertinent lending policies, procedures and criteria to be applied in sub-lending.
- 2) Evidence of satisfactory arrangements by CRYRZA for providing necessary technical assistance and administrative support.

10. PROJECT COMMITTEE:

William McP Jones	-	Project Chairman, USAID/Peru
Edward Butler	-	Community Development Officer USAID/Peru
George Gebhart	-	Economist, USAID/Peru
Luis Morales	-	Cooperative Advisor, USAID/Peru
Arthur Mudge	-	Assistant Director for Capital Projects, USAID/Peru
Richard Seifman	-	Loan Officer, AID/W
Leonard Rosenberg	-	Economist, AID/W

May 16, 1972

Section I. BACKGROUND AND LOAN OBJECTIVES

A. Background and Need for Assistance to Small and Medium Business

On Sunday afternoon, May 31, 1970, occurred what has been called "The most destructive earthquake in the history of the Western Hemisphere". In Central Peru, 70,000 people were lost, 150,000 injured, and the material damage was estimated at more than \$500 million. In March, 1972, another disaster occurred - severe flooding on the Northern and Central coast. (Annexes VI and VII provide additional data on the earthquake, the disaster area, rehabilitation efforts to date, and the planned reconstruction of the area).

In a study by the Latin American Institute of Planning (ILPES), the role of small enterprise in the Disaster Area was evaluated.^{1/} The study concluded that the greatest negative effect of the earthquake on the economy of the Disaster Area was "the weakening of small and medium industry, considering both the stoppage of production and the paralysis of the commercial and administrative function, and that a vicious circle of progressive impoverishment of the Zone has been established by the deterioration of purchasing power (as much by unemployment as by the destruction of shops, etc) which reduces employment and, in turn, further reduces purchasing power." In other words, the effect of the multiplier principle on the down side reinforced the direct impact of the disaster.

The availability of credit to small and medium sized businesses under existing banking practices is almost non-existent. Without such credit availability, the time required for the rehabilitation of this key economic sector will be lengthened substantially with a consequent widening of the gap between jobs made available and the growing labor force.

While the plans of the GOP provide for the formation of a small industry office and the development of the infrastructure for small industries and crafts, the existing plans are two to five years from fruition. To provide some immediate relief and assistance which will enable the small entrepreneur to reestablish his business and to assist in the reconstruction of the area, the GOP has requested that AID help in establishing a Small Business Reconstruction and Development Fund.

^{1/}

Plan for Rehabilitation and Development of the Zone Affected by the Earthquake, ORDEN, ILPES, CEPAL, Lima, March 1971, 3 Vols.

NOTE: Exchange Rate: \$1 equals 43.38 Soles.

B. Loan Objectives

1. Reestablishment and Development of Local Industry and Commerce

The intent of the loan is to provide a fund which through sub-lending will assist small and medium enterprises to reconstruct facilities, replace lost equipment, and, in general to regain and improve their economic position.

The tasks of the small entrepreneurs in the disaster area are varied; Annex VIII provides some general information on the types of small business activities in the area. It includes almost every conceivable type of business activity.

Typically, small retailers or tradesmen have regular customers and it is expected that they extend credit. They are the distribution outlet for local producers and the market for middle wholesalers in the area. In some cases they function as the channel for distribution of government food assistance or other like services. Their reestablishment can instill confidence in the community that the situation is normalizing and commerce returning.

Further, it is expected that sub-loans will be made to provide for the creation of new small industries and/or the expansion of old ones which will supply materials for the reconstruction of the Disaster Area, most of which, up to now, have been brought in from outside the area.

Assuming that the average loan is for \$4,600 (Sales 200,000), more than 600 businesses will obtain assistance from this project in the first two years.

2. Development of Services, Industry and Trade Complementary for Major Reconstruction Activities

Of the industries and commerce established by sub-loans provided by this loan, a considerable number are expected to be engaged in the manufacture or provision of materials and services required in the reconstruction. There is a lack of local brick plants; there is no local manufacture of door and window frames, building hardware, and similar items; there will be a need for new equipment and furniture for homes and business establishments. Considering that 70,000 houses will have to be replaced and possibly 10,000 business

establishments, it is reasonable to assume that a significant portion of these requirements could be manufactured locally. This would require new brick plants, and woodworking plants, to say nothing of requirements for glass, plumbing, electrical, and hardware firms.

3. Generation of Additional Employment Opportunities

It is estimated that, prior to the Earthquake, small business and commerce provided 25% of the total employment in the zone and 59% of the non-agricultural employment. (See Annex VIII, Table 2, for complete employment data) The reconstruction of the Disaster Area will create a larger requirement for small business. The proposed loan of \$2,500,000 will create a total investment of approximately \$2,830,000 and this will provide in the first five years more than 1,450 loans averaging \$4,600 for 3 years with 6 months grace. The best information available indicates that a business with this amount of capital employs from 2 to 4 employees. Using the figure of 3 jobs created per loan, 4,350 jobs would be directly created in 5 years by the project.

4. Entrepreneurial Development

The GOP plan for the reconstruction and rehabilitation of the area states specifically that the major portion of the task of reconstruction of industry, services, and commerce will be borne by the private sector. The only assistance planned for this sector is the provision of some credit for artisans and the construction of some commercial centers in the poorer housing areas.

The present project is directed to the small and medium entrepreneur and is designed to assist him, on a business basis, to build or rebuild his enterprises on his own initiative. Complementary technical assistance will be supplied; and it is expected that many small entrepreneurs will have a reasonable opportunity to establish themselves, who otherwise would either fail or never emerge.

Section II - ECONOMIC JUSTIFICATION

A. Coastal Area

The coastal region of the Disaster Area contains approximately 7.5% of Peru's population and 57% of the population of the affected area (1,528,000). About 58% of the population of this coastal area is urban. (See Annex VIII, Table 1).

Historically all of the coastal cities have received a flow of migrants from the Sierra, most of whom, with relatively short delay, have continued on to the the Lima-Callao metropolitan area. In addition, these cities have traditionally lost a significant portion of their indigenous populations to Lima-Callao. One of the most serious effects of the earthquake of May 1970 was to accelerate this migration, thus straining even more the already inadequate capacity of these coastal cities and Lima-Callao to supply the necessary job opportunities and social services.

The average unemployment rate in the coastal area is estimated at 35% of the labor force of 324,000, with the rate in Chimbote, one of the major urban areas, reaching 50%. This severe unemployment, together with the high underemployment rate existing in the area, points up the severity of the economic and social problem facing Peruvian officials in their rehabilitation and reconstruction program. This lack of job opportunities is also a major factor causing the flow of migrants to the Lima-Callao area.

Economic activity along the coast consists of relatively highly productive irrigated agriculture situated in long river valleys formed by the run off from the Sierra and a varied industrial structure composed of a few large scale enterprises and a large number of medium and small scale firms. In addition, there exists a large number of individual or family artisan shops located primarily in the cities.

All agricultural production along the coast requires irrigation because of the complete absence of rainfall; and irrigation systems have been established bringing extensive areas under cultivation. These irrigation systems were badly damaged by the floods of March, 1972. The principal crops produced are sugar, cotton, corn, rice, beans and potatoes. Productivity is high compared with agriculture in the Sierra, but low by international standards.

The current government's agrarian reform efforts have resulted in the expropriation of many of the large haciendas (including some sugar plantations) and their redistribution to cooperatives and, in some cases, to individual campesinos. AID is currently proposing a loan of \$5million for agricultural credit within the earthquake zone, which should help in reducing rural under-employment and provide some stimulus

to those farms supplying agricultural inputs. The employment generating effects of this program will not be large, however.

The industrial structure of the coastal area is composed of a small number of relatively large scale firms situated in the coastal cities and producing primarily for export (including a sugar complex and several fishmeal plants) and a large number of medium and small size firms located primarily in the urban areas. In addition, there are innumerable 1 or 2 worker artisan shops which in total were estimated to have employed on a full or part-time basis over 32,000 persons. (See Annex VIII).

Most of the medium and small size firms are undercapitalized and highly inefficient which keeps the quality of the products low and their prices high and prevents the firms located in the area from selling outside of the immediate vicinity. In addition, these firms are unable to obtain credit with which to increase their efficiency and the size of their operations due to their low levels of profit and investment. Thus, they are caught in a vicious circle: no capital, therefore inefficiency; inefficiency, therefore no access to credit and thus to capital. As a result, these firms continue to produce inefficiently and a large part of the areas' markets are served by producers outside the area.

B. Mountain Area (Sierra)

The mountainous area of the zone contains approximately 650,000 inhabitants or about 43% of the population of the affected area. The population growth rate of this area is only 0.7% reflecting the heavy outmigration to the coast. The urbanization phenomenon is affecting this area as well. Since the migration consists of the younger more able members of the work force, there is a tremendous loss of manpower to the area resulting in a high dependency ratio and low productivity.

The agriculture in the area is highly inefficient due to a combination of factors including the leaching and erosion of soils by heavy rains, lack of capital and technical know how, and bad management practices on the farms. Most of the farming is done in small valleys interspersed among the mountains, with the farms situated around small villages which are the centers of the economic and social activities in their areas. There is very little unused land available in this area. As previously noted, a proposed AID loan of \$5 million for agricultural credit will provide some stimulus to Sierra agriculture.

There exists very little that could be considered industry in the mountainous region of the Disaster Area. The cities located in the area have the usual mechanic shops, small construction firms, etc., but there are few large or medium size firms producing for export even to neighboring villages.

This area does contain some natural resources which could eventually provide the basis for some large scale industry, however commercial exploitation of these resources will probably be costly, especially with respect to providing the necessary infrastructure, eg., roads to transport the product to market.

C. Reconstruction Plan for the Earthquake Zone

In the early rehabilitation and reconstruction planning in the aftermath of the earthquake the GOP decided that it would not merely replace the poverty that existed in the area prior to the earthquake, but rather it would undertake an economic and social development program for the area which would lift it out of its previous stagnant situation. With this in mind, a new agency, CRYRZA, was established (Comisión de Reconstrucción y Rehabilitación de la Zona Afectada - CRYRZA) charged with the responsibility of planning and coordinating a program for the rehabilitation, reconstruction and development of the area.

At the present time, the plan for the Rehabilitation and Reconstruction of the Affected Area has been completed and is in the process of being implemented. The Plan is no less than a regional economic and social development plan for the north-central region of Peru. It involves considerable GOP participation in the economy of the region, especially in the establishment of infrastructure.

The entire reconstruction and rehabilitation program is expected to take ten years, and studies are currently underway to flesh out the program (See Annex VI).

1. Industrial and Commercial Sector

The reconstruction and development of light industry, commerce and services is to be left in the hands of the private sector. As noted above, the infrastructure of the area is being expanded by the GOP and this will provide incentives to private entrepreneurs. The GOP has recently promulgated new legislation providing financial incentives for investments outside the Lima-Callao Area. These incentives, plus the new commercial centers planned for the area, will stimulate the desire to invest; however, financing will be required to transform this desire into effective investment.

2. Employment Generation

The current level of unemployment in the Disaster Area is estimated to be approximately 150,000 workers or 30% of the area's labor force. In addition, underemployment in the area is thought to involve an equivalent number of workers.

The "Plan for Rehabilitation and Reconstruction of the Disaster Area" does not set specific goals with respect to the creation of employment in the area. It points out the number of positions which will be required over the next decade (25,000 per year) if the structural unemployment is to be absorbed, but it does not indicate the number of positions to be created by the Plan. The additional planning studies currently being undertaken should specify the potential effects of the long term plan on employment.

3. Financial Assistance

a) Internal

Out of its 1970 and 1971-72 budgets, the GOP made available to CRYRZA approximately \$100 million to begin its rehabilitation and reconstruction work. (See Annex VI, Planned Efforts in the Disaster Area). The budget for the next biennium has not been made public as yet, but the GOP continues to emphasize its commitment to this effort. The development programs established for the Disaster Area by the various ministries will amount to several hundreds of millions of dollars over the next decade, thereby making a major contribution to the development of the area.

b) External

The donations received early after the disaster from various countries and the multilateral agencies, both in kind and in cash, amounted to \$44 millions including the \$7.4 million emergency A.I.D. grant. Since then, additional assistance has continued to flow in mostly in the form of loans and credit.

Among these were the Interamerican Development Bank and World Bank loans of \$35 million and \$30 million respectively the A.I.D. guarantee of a \$28 million housing loan provided by two U.S. Federal banks, and a \$17 million loan from Japan for the construction of a transmission line from Lima to Chimbote.

The assistance offered covered a broad spectrum of activities, but was concentrated on the repair and construction of schools and health centers, the construction of housing, and in the rebuilding of communications and highway systems.

4. Relationship to National Industry and Commerce Development Plans

The long term rehabilitation and reconstruction plan for the Disaster Area has been meshed with the Peruvian National Development Plan for 1971-75. The goals of these two plans coincide with respect to the economic and social development of the northern region of Peru (which includes the Disaster Area) and, in fact, the study document which provided the basis for the rehabilitation and reconstruction plan was developed by the Regional Development Planning Office of the Northern Region in conjunction with advisors from the Economic Commission for Latin America. This same document was also a basic document in the development of the National Development Plan.^{1/}

The public investment expenditures proposed for the region in the rehabilitation and reconstruction plan are included in those proposed in the National Development Plan 1971-75, and the sector programs coincide in the two plans.

^{1/} Op Cit

Section III BORROWERS EXECUTING AGENCIES

A. CRYRZA

"The Commission for Reconstruction and Rehabilitation of the Zone Affected by the Earthquake of May 31, 1970" (CRYRZA) was established by the GOP to coordinate all national and international relief and reconstruction efforts in the area devastated by the Earthquake. It has further been charged with coordinating the execution of the national development plan for the Disaster Area.

For the execution of these assignments CRYRZA has been allotted 2% of the national budget for the biennium 1972-73⁴. Headquartered in Huaraz, one of the Sierra cities most seriously damaged, its people are wellacquainted with the problems and needs of the area. Headed by a Peruvian Army General, CRYRZA now has a civilian and military staff of engineers, architects, and economists, and is rapidly increasing its number of professionals. CRYRZA intends to hire 4-5 qualified technicians to work full-time in the promotion and supervision of this project. They will be located in areas determined by the anticipated demand for credit. [These sub-areas are now considered to be Chimbote, Huaraz, and possibly Trujillo considering the degree of damage suffered from recent flooding.]

It is noteworthy that CRYRZA, by its initial approval of a sub-loan, technical assistance to the sub-borrower, and decisions as to policy on the collection of delinquent accounts, will retain control of every activity carried out under the loan. To assist it in its supervision it will receive monthly reports on Fund operations from the Fiduciary Bank which will consolidate the information received on the loan applications from the Local Banks. Further, it will be advised of delinquencies immediately upon their occurrence.

B. Fiduciary Bank

The Central Reserve Bank of Peru appears to be the most appropriate repository for the Fund. With considerable staff experienced in rediscounting transactions, a number of Funds operating in a similar fashion, and familiarity with AID procedures, the Central Bank should easily accomodate the Small Business Fund in the limited role the Fiduciary will have in Fund operations.

The Fiduciary will rely on CRYRZA and the Local Banks for sub-loan review and approval, on the Local Banks for normal collection of principal and interest and on CRYRZA for protection against decapitalization of the Fund. The prime tasks of the Fiduciary will be:

* The amount allotted is \$91.1 million.

a) to disburse funds against satisfactory documentation from the Local Banks;

b) request additional drawdowns from AID when the Fund has reached a replenishment level; and

c) submit reports and maintain records pursuant to AID and GOP requirements.

The Central Reserve Bank, by virtue of its prestige and regulatory powers, should be able to command responsive action from the Local Banks and already has established contact with the head offices of all credit institutions expected to participate in the program.

In the selection of the Central Bank as Fiduciary, the fact that it has no branch banks in the disaster area was carefully considered. The loss of local contact was, aside from factors already mentioned, considered to be of less importance than the advantage of having an independent fiduciary who would not compete for sub-loans and would therefore cause no reduction in the possible number of participating credit institutions.

C. Participating Credit Institutions (Local Banks)

The Local Bank may be any financing agency which is approved by the Superintendent of Banks. This includes the GOP development banks, GOP owned commercial banks and private commercial banks.

There will be available in the Disaster Area 47 offices of the various banking institutions entitled to make loans under the program. Located in 19 cities and towns, all major population centers are represented and it is felt that all potential borrowers will have reasonably ready access to an eligible local bank..

Local Credit Unions and Credit Cooperatives will be eligible to participate once an acceptable method of operation has been established.

Eligible Banking Establishments in the Disaster Area

	<u>Offices in the Area</u>
1. Government Development Banks	15
a. Banco Industrial	3
b. Banco Minero	2
c. Banco Agropecuario	<u>10</u>
2. Government Commercial Banks (Banca Asociada)	12
a. Banco Popular	3
b. Banco Internacional	<u>9</u>
3. Private Commercial Banks	14
a. Banco de Crédito	12
b. Banco Nor-Perú	<u>2</u>
4. Credit Unions and Mutual Savings and Loans	<u>6</u>
TOTAL ELIGIBLE AGENCIES	<u><u>47</u></u>

(Other banking establishments in the area are: Government owned Central Mortgage Bank - 2 Agencies, Government Fiscal Agency - Banco de la Nación - 86 agencies).

The banks listed as eligible to serve as local financial agents are closely supervised by the Superintendency of Banks and are considered financially responsible. (See Annex IX).

The three Government Development Banks (Industrial, Agricultural and Mining) are highly specialized and are not expected to contribute much toward the disbursement of the proposed loan.

The commercial banks, both public owned and private, are expected to prove the major instruments in the disbursement. They are reasonably competitive, well staffed, and, the private banks especially, are innovative. The local offices in the Disaster Area are full line banks, able to give complete banking service at the local level (Agencies and branches in the same city with a full line bank were not listed). These banks are generally capable of performing the lending, customer assistance, and collection services required under the loan. (See Annex IX).

D. Local Credit Committees

The Local Committee will provide advisory services to the CRYRZA representative in the area, but shall not have a vote on credit approval. As now conceived, they will be composed of appropriate members of the community, and will be selected by the CRYRZA representative.

The Chambers of Commerce of the three principal cities in the Disaster Area have expressed interest in the project and have offered their assistance. Prominent businessmen in the area have offered their support. It seems, therefore, that CRYRZA will be able to obtain competent local assistance in the evaluation of sub-borrowers and their projects.

Section IV PROJECT ANALYSIS

A. Size of the Program and allocation of resources by sub-region.

The total resources generated by the fund are approximately \$2,880,000. The CRYRZA representative in each sub-region will be given a quota against which he may approve sub-loans. This quota will be assigned initially by CRYRZA with A.I.D. concurrence and will be based on anticipated demand and reconstruction priorities. Should experience require reallocation of these quotas, CRYRZA will make such re-allocation, with AID concurrence.

MAJOR URBAN CENTERS IN THE EARTHQUAKE ZONE

	<u>Population</u>	<u>% of Population Affected</u>	<u>Tentative Allocation of the Fund</u>
Chimbote/Santa	167,700	85%	60%
Trujillo	120,000	18%	16%
Huaraz	28,000	70%	10%
Huarmey	11,600	50%	4%
Casma	8,600	100%	6%
Caraz	8,500	50%	3%

B. Promotion of the Program

CRYRZA will undertake the promotion of the program. A descriptive memorandum will be sent to each eligible Local Bank, all Chambers of Commerce and Industry, the media, and to each CRYRZA office in the Disaster Area. Seminars for CRYRZA representatives, managers of interested Local Banks and potential borrowers will be held to explain the eligibility criteria, terms and conditions, and the mechanics of the operation. In addition, the following actions are considered prerequisites to assure successful implementation of the loan:

- 1) Indoctrination sessions for the personnel of the Local Banks. These would serve the primary purpose of developing uniform criteria for review of loan applications, emphasize the innovative elements of the credit policies and provide a forum for discussions of operating problems which would be of common interest to personnel of the local banks, the fiduciary bank and CRYRZA. These would be conducted by such technical consultants as required and personnel from CRYRZA and probably in the form of one day seminars held quarterly throughout the first year.

2) Promotional sessions with potential sub-borrower groups, civic associations, Church leaders, Peace Corps Volunteers, GOP Agencies, Area Development Agencies and the media to provide ample information on activities which the loan will support, procedures, repayments, etc. These sessions will provide the broad informational base necessary to reach all potential sub-borrowers, furnish feedback on loan execution and difficulties encountered by loan committees, sub-borrowers, etc., and provide for effective coordination at the local level.

These sessions would be directed by the Technical Staff which CRRMZA will have recruited to assist in loan implementation.

3) Promotional campaigns will be designed to assure that all potential sub-borrowers become familiar with the loan objectives.

C) Community Participation

The loan will focus primarily on the major towns within the Disaster Area. Although it is anticipated that many communities will participate in the activities supported by the loan, it is estimated that 70% of the projects will come from the urban areas of Chimbote and Huaraz, the two major towns affected by the Earthquake of 1970 and, in the case of Chimbote, more recently by flash floods.

Chimbote, the largest city on the coast and considered a development pole, now has a population estimated at 167,700, and conservative estimates indicate that it will double within the next five years. Potential sub-borrowers are spread throughout the city, mainly in the center of the town and the commercial areas now expanding along the Panamerican Highway. Huaraz, the largest city in the mountain area, has a population estimated at 28,000 with growth projection to 50,000 by 1975. Sub-borrowers here are concentrated in the city and its expanding suburbs.

The sub-borrowers are for the most part already organized in local chapters of the Peruvian Chamber of Commerce and possess the leadership and capabilities to promote and carry out projects with little external stimulus.

It is anticipated that cooperative production groups already operating, or to be formed, in the Disaster Area will utilize loan funds for expansion of their facilities, purchase of equipment and operating capital.

There are already 19 cooperatives operating in the Earthquake Zone, and about 12 more in a stage of organization. They have a capital base in the vicinity of \$4.6 million, most of which is held by two credit unions, i.e. San Francisco de Asis in Huaraz and San Francisco de Sales in Chimbote. Both credit unions have branches in even the smaller towns in the area, have business dealings with local banks and enjoy a good reputation in the business community. It is anticipated that these credit unions will be in a position to solicit loans for their members for productive business purposes and could serve as guarantors. Although both credit unions are affiliated with the Central Credit Cooperative Bank, these two organizations do not yet enjoy rediscount privileges with any of the GOP banks. Therefore, loans to credit unions will at first be channeled through the local private banks. Repayment of these loans would be made by the credit union to the local bank. Credit unions, due to their experience in handling small to medium sized loans mostly with "character" guarantees, are also in a position to assist the CRYRZA representatives in overcoming the existing resistance to loans to small business with little security.

D. Types of Sub-Loans (eligible activities)

1. Nature of Business

The loan will be directed toward small and medium business* (in United States terms "very small business") which, for the purposes of this paper, is defined as a business which has, at the time of the sub-loan application, gross sales of less than two million soles (\$46,000) per year and a capital of less than one million soles (\$23,050). Exceptions to those limits may be made in the case of larger loans to Cooperatives. No requirement as to number of employees will be used, as the main thrust of the loan is toward the creation of employment opportunities. The practice of a profession, such as lawyer, accountant, engineer, architect, doctor, etc., will be excluded. Otherwise, the project can be in any legal activity except direct investment in mineral extraction, fishmeal, agricultural production, or entertainment.

2. Purpose of the Financing

Loans will be reviewed by CRYRZA representatives with weight to be given to the following objectives:

- a) Repair of demonstrable damage suffered in the earthquake or flooding,
- b) Provision of materials and services needed for reconstruction of the area, and
- c) Employment creation.

* See Annex VIII, Table 2

Sub-loans may be made for the acquisition or repair of capital goods to expand or improve production or services, or for working capital to purchase raw materials, build up inventories of merchandise, pay salary and other operating costs, and, in the case of artisans, to meet family living expenses during the lag between production and sale.

3. Eligibility Criteria

- Area,
- a) At least three years residence in the Disaster Area,
 - b) A good credit record, or two character references from other entrepreneurs, priest, school teachers, police etc.
 - c) A reasonable amount of experience in the field of business for which the credit is requested, or a related field.
 - d) Operation of a going concern or other satisfactory indication of entrepreneurial skill.
 - e) A viable project in view, either reconstruction, purchase of production equipment, replacement of destroyed stock in trade, or creation of a new enterprise designed to assist in the reconstruction of the area, etc.
 - f) Personal participation by the owner of the enterprise in the production and/or management aspects of the enterprise, devoting a majority of his time to these activities.
 - g) Insufficient earnings or assets to qualify for a normal banking credit for his project. A borrower who has sufficient assets to handle his normal business but insufficient for a new and desirable project or expansion would be eligible.

E) Terms of sub-loans to sub-borrowers - Justification

1. Interest Rates

The legal maximum interest allowed banks is 12% per annum, but the banks are authorized an additional 1% service charge, a 1% risk charge, and are required to collect a .9% tax quarterly. Over and above this, the banks are allowed to collect a fee for correspondence,

placing the tax stamps on the notes, and other miscellaneous charges, such that the effective rate usually exceeds 18%. Two banks in Lima make small business loans at these rates. Financieras and other private development banks, who can lend for more than one year, charge additional fees and interest, and an effective rate of 25% is normal.

The GOP Industrial Development Bank lends at lower rates and for longer terms both to large and small enterprises. The usual small business loan by the Industrial Bank is at 9%, before taxes. A special rediscount fund to develop the Regional (non-Lima) Banks established in October, 1971, by the Central Reserve Bank of Peru offers an interest rate of 10% to certain small businesses. Rates lower than 9% can occasionally be obtained from government banks but only by special dispensation and at the cost of months of negotiations in Lima by the borrower.

The inflation rate in Peru is about 7% per annum. While it is desired that the struggling small businessmen should get maximum benefit from the concessional terms of the loan, the GOP and AID have agreed that excessively concessional terms to the sub-borrowers could do them a disservice in tending to foster enterprises which could only survive on such concessions.

A financing fee of 8% per annum on the declining balance exempt from taxes was determined to be an appropriate starting point, subject to further review and adjustment, as necessary.

An interest charge of 8% to the sub-borrower allows for the following spread:

Interest cost to the sub-borrower	8.0%
Less: 13% interest on the 10% participation by the Local Bank	1.3%
3% service charge on the 90% Fund participation	2.7
Total to Local Bank	<u>4.0%</u> <u>4.0%</u>
Less: 1% charge by Fiduciary Bank on 90% Fund participation	<u>.9</u>
Gross revenue of Fund	<u><u>3.1%</u></u>

KEY: AN = annual
 SA = semiannual
 Q = quarterly
 dsct. = discounted
 comp. = compounded

INTEREST RATES EFFECTIVE IN PERU

Data as of Sep. 30, 1971

OPERATION	Rate to Borrower	COST OF MONEY			
		Savings Accounts	Time Deposits	Bonds & Dividends	Rediscount Rate - BCR -
Commercial Banks:					
Lima: 90 day notes	Commercial 14% AN dsct.	5% Comp SA	7% Comp Q		9.5% AN dsct
Authorized Overdrafts	"				Not Eligible
Outstanding balance	" 13% AN				
Stand by fee	" 1% Q				
Regional Banks					
Provinces: 90 day notes	Commercial 13% AN dsct.	5% Comp SA	7% Comp Q		6% AN dsct
Authorized Overdrafts	"				Not Eligible
Outstanding Balance	" 12% AN				
Stand by fee	" 1% Q				
Special Development Fund (BCR) 180 day notes, Specified enterprises	10% AN dsct.				2% AN dsct.
Financieras, Private Development Banks					
Term loans, over 1 year	18% AN & UP			Not Eligible	Not Eligible
Mortgage Banks (GOP)	10/11% AN			9%	Not Eligible
Construction Bank (Private)	14% + 6%			10%	
Government Development Banks					
Industrial Bank					
Normal Loans	14% AN				4% AN dsct
Jungle loans	9% AN				4% AN dsct
Special projects (political)	Lower				4% AN dsct
Agriculture Bank					
Normal loans	7% AN				2% AN dsct
Rice Program	7% AN				2.25% AN dsct
Mining Bank	5% AN				4% AN dsct
Credit Unions					
Lima	9% AN	6% AN			
Provinces	8% AN	6% AN			

2. Principal Repayment Period

Sub-Loans would normally be made for terms of up to 7 years and, in special cases involving buildings or heavy equipment, up to a maximum of 10 years. The credit manual will develop the factors to be taken into consideration in determining the principal repayment period. These guidelines will assist the Local Banks and the CRYRZA representative in their determination of the appropriate repayment period. A survey made in the area indicated that the average term for this type of loan would be in the 2 to 3 year range.

3. Grace Periods

Grace period would be allowed according to the requirements of the enterprise but not to exceed two years. The credit manual will develop the necessary guidelines. The survey made in the area indicated that the average demand called for an 8 month to one year grace period.

4. Security Requirements

The average borrower having by definition little or no assets or other security, would be required to pledge the assets acquired or repaired with the proceeds of the sub-loan. Since this loan is directed toward the provision of capital assets for reconstruction, and working capital requirements would be secondary, there would normally be a tangible asset upon which security could be based. No other guarantees would be required.

These reduced security requirements are perhaps the major feature of the loan in that they make borrowed capital available to a class of borrowers who have never before enjoyed this advantage.

Normal lending procedures in Peru require the pledge of assets equal to the amount of the loan plus the pledge of the assets acquired through the loan, a security of 200% of the loan. This custom has had the effect of denying credit to the beginning businessman who had neither substantial assets of his own, or wealthy backers. By denying opportunity to many otherwise capable entrepreneurs, it has been a major cause of underdevelopment in Peru.

This loan may be the first exposure to character loans for many bankers in the area and it is hoped that the experience will be such as to warrant the adoption of the character loan as a standard banking practice. Should this occur, it would substantially increase the contribution of the commercial banks to the development of the country.

F. Terms to the Local Banks - Justification

1. Capital Participation

In order to ensure the active participation of the Local Bank both in the granting of the sub-loan and its subsequent collection, the Local Bank will be required to provide from its own funds a minimum of 10% of the sub-loan principal for the maximum period allowed by law. As co-lender of the note, the Local Bank will have a direct interest in the payment performance of the sub-borrower, and will treat him as a regular bank customer.

Under present regulations, Regional and Commercial Banks are forbidden to lend for more than one year from their own funds, and only for specially favored customers do they renew for longer periods. In this loan it is desirable that their participation extend throughout the life of the loan and special permission of the Superintendent of Banks will be sought for this purpose. However, should this permission not be forthcoming, it is felt that it is not critical and will not materially affect the project. These terms have been discussed with the eligible banks and are acceptable to them.

2. Interest Fees and Service Charges

a) Interest

The Local Bank will be entitled to the total interest collected from the sub-borrower on the funds provided from its own resources. This interest has been established at 13%.

The cost of money to banks is between 7 and 8% per annum. They currently pay 5% per annum compounded semi-annually on savings accounts; 7% compounded quarterly on Time deposits and 9.5% per annum on rediscounts with the Central Reserve Bank. Government Bonds and other prime obligations are quoted at prices yielding 10% per annum. Operating costs of banks, as more fully explored in the following section, range from 3 to 4% per annum depending on the size of the bank. Banks, therefore, are accustomed to operating on effective interest rates of 14%, or higher, to cover their services and the risk factor.

Allowing the local bank its normal rate of return on its share of the loan should tend to encourage the local bank to increase its share from the minimum 10% and thereby correspondingly increase the resources available under the program.

b) Local Bank Service Fee

(1) Amount of Fee

The amount to be allowed the local bank as its service fee on the Government share of the sub-loan could significantly affect the

success of the program. If such service fee on the government's share is proportionately more lucrative than the interest earned on the Local Bank's own share, the Local Bank maximizes its return by making subloans with the maximum 90% GOP participation, thereby minimizing the Local Bank share of subloans and correspondingly minimizing the total amount of financing available under the program. On the other hand if the Local Bank's service fee is set too low it could discourage the Local Banks from participating at all in the program.

Preliminary discussions with commercial banks represented in the disaster area indicate either a lack of knowledge or a reluctance to discuss their costs for administering money, as separated from cost of money, credit risk and profit. Fees suggested or already in use range from 6.25% of original principal to 3% of outstanding balance, the current figures for administration of trustee accounts. One bank, which is ineligible to participate because it lacks branches in the area, claimed to have determined by cost analysis that administration of a single loan account cost \$6.90 a month. This would be equivalent to 3% per annum of outstanding balance on a loan of \$3,600, slightly above the subloan average anticipated for the program. The Central Bank is in the process of completing a study on cost of credit in Peru which could be quite helpful in determining appropriate compensation to the local banks for administering the GOP share of subloans.

Fortunately, the setting of the fee need not be too precise. As long as the Local Bank's return from the service fee exceeds the out of pocket costs of administering the government's share, the disincentive for Local bank participation would be avoided. And it would seem that there should be substantial room for maneuver between, on the low side, the "marginal unit cost" per account, i.e. a fee adequate to cover the Local Bank's out of pocket costs, and, on the high side, a fee making the compensation for servicing the GOP share more attractive than the interest income on the Local Bank's own share.

The bearing of credit risk is, of course, also a major factor in the Local Bank's determination of the extent of its participation in a particular subloan. For one sub-borrower it might be willing to share more of the subloan than for another.

In short, the important thing is that the service fee on the GOP share be neither so high as to become a significant factor discouraging the Local Banks from sharing more than the required 10% of the subloan, nor so low as to discourage participation at all in the project.

For purposes of the financial estimates contained in this loan paper the service fee is included in an amount which could equal that produced by the 3% per annum of outstanding balance proposed by the commercial banks. However, during the negotiation of the service fee prior to implementation of the project the burden of proof will be upon the commercial banks to justify such amount and whatever amount is justified will, to the extent feasible, be negotiated toward a more appropriate formula.

(2) Formula By Which Fee Derived

Once the amount of appropriate compensation for servicing the GOP share is determined, a second critical factor is the formula by which it is derived. Stated as a percentage of amounts collected the Local Bank service fee could provide a significant incentive for efficient sub-loan collection. Also, logically, after the initial proceeding of making the loan, which could be covered by a transaction fee, costs of administering a loan generally remain constant throughout the life of the loan.

Unfortunately, the Peruvian commercial banks are accustomed to think of administrative costs as a part of the interest spread i.e. - a percentage per annum of outstanding balance, just like the interest charge for use of money. Where, as under present commercial banking practice the loans are made for one year or less, the difference tends to be moot. But for longer term loans it is, of course, fallacious to think of purely administrative costs as a percentage of outstanding balance, since such costs tend to remain constant rather than decrease as the balance of the loan decreases. Moreover, a service fee computed as a percentage of outstanding balance provides not an incentive, but rather a possible disincentive, for efficient collections which would reduce the outstanding balance of principal.

There are however, other programs, such as the AID housing guaranty projects, in which Peruvian banks have been persuaded to take their service fee as a percentage of collections; and it is hoped that such a formula can be arranged with the commercial banks participating in the subject program.

In any event both the fee and the formula will be subject to periodic review by CRYRZA and AID in determining their effect upon performance of the Local Banks, and adjustments will be negotiated as indicated.

3. Collection Responsibility for Sub-loans

a) Normal

As presently conceived the local bank will be responsible for normal collection activities, and the service charge will cover the necessary expenses. This includes notification of payment due, inspection visits by the Bank staff and follow up by a collection agent. It also includes usual legal services short of litigation.

b) Delinquencies

In the case of a note unpaid beyond the due date and the customary 8-day grace period, the Local Bank will immediately notify CRYRZA, and automatically file a "Protest", as it would in similar circumstances with its regular customers, similarly debiting the account for the notarial charge of about \$2.00. Having taken this step, the bank will then review the account and see if there are alternatives to legal collection.

The continuing personal contact implicit in the technical assistance to be rendered by CRYRZA to the sub-borrowers and the inspection visits customary in Peruvian banking practice should assist in the early identification of sub-borrowers in difficulties, and, in many cases, obtain solution of the sub-borrowers problem. For example, if the problem is liquidity, with the sub-project functioning satisfactorily, and could be solved by a short term moratorium on principal payments, the Local Bank with CRYRZA concurrence could grant the moratorium as it normally would in assisting a client to fulfill his obligations.

In any moratorium or renegotiation, CRYRZA and the Local Bank must agree, as each has an interest in the loan. Should, however, either CRYRZA or the Local Bank feel that its investment is in danger and insist on collection by legal means while the other insists that collection by other means is more desirable, then the party advocating the more lenient method will have the option of purchasing the interest of the other party.

A recent study by the Small Business Administration in the USA pointed out that 50% of small business failures occur in the first 24 months of operation and 25% in the following 12 months. Assuming that the experience encountered in Peru is about the same, the average delinquency will occur before the pledged asset is completely wasted.

c) Uncollectible Accounts

In the event that CRYRZA and the Local Bank agree that there are no alternatives to legal procedures to recover the debt, they will proceed in one of the following ways to execute seizure (embargo) or commence litigation:

- 1) Utilizing the legal collection services available to the Local Bank, with the Local Bank acting as the authorized agent of the GOP in the suit or seizure, and dividing the costs pro-rata; or

2) Utilizing CRYRZA's own legal staff to effect collection, again dividing the costs pro-rata; or

3) CRYRZA entering a separate action, utilizing its own attorneys, to protect the GOP's interest. The costs of collection of the Fund's portion of the debt would come from the interest earned by the Fund. Should such costs, plus the principal and interest written off as uncollectible, exceed the amount earned by the funds, CRYRZA will replenish the fund for the excess.

G. Fiduciary Bank

The Fiduciary Bank will act as depository of the Fund and will receive and disburse the monies of the fund as agreed between CRYRZA and the Bank. The service fee to the fiduciary has been agreed between CRYRZA and AID at not to exceed 1% per annum on the outstanding balance of the fund.

The service fee allowed the fiduciary covers the performance of the transactions involved in obtaining the funds from AID, disbursing them to and collecting them from the Local Financial Agents, and the rendering of a monthly report of fund operations to AID and CRYRZA, in such form as they will prescribe, throughout the life of the Fund. Considering that the fees currently charged by local banks for similar services are comparable and that the fees authorized in the recent housing loans and housing guarantees are similar, it is considered that the 1% fee for the Fiduciary is justifiable.

The Banco Central de Reserva is currently considering the matter of fiduciary fee and it appears that it should not exceed 1% of outstanding principal per annum.

The remainder of the interest collected from the sub-borrower after deduction of the Local Banks' fees and the Fiduciary Fee is the gross income of the fund and will be retained in the fund, available for relending and for meeting the expenses of collection and Bad Debts.

H. Technical Assistance

1. Provided by the Loan

A basic consideration in the formulation of this project has been the provision of adequate technical assistance to the sub-borrower. Experience in the United States and other countries has shown that such assistance is critical to the success or failure of the ventures financed.

The present loan is an entirely new concept within Peru and it is agreed by CRYRZA and AID that consultants with experience and know-how should be employed to train the technical staff of 3 to 5 persons furnished by CRYRZA, assist in preparing the Credit Manual and give the necessary preliminary instruction to the personnel of the Local Banks, CRYRZA administrators and others interested in the operation of the project.

To finance this assistance, up to \$50,000 of loan proceeds may be used.

2. Provided by CRYRZA

a) Technical Assistance Staff

CRYRZA has undertaken to provide from the funds provided by its biennial budget the full time services of a Technical Assistance Staff of from 3 to 5 technicians who are, or will be, trained to assist sub-borrowers under this loan. This contribution, which is estimated to cost around \$75,000 per year and will include the necessary administrative support, will be supplemented by the occasional services of other technicians of the CRYRZA staff.

CRYRZA does not now have the necessary technicians. However, they have undertaken to employ them and to utilize the technical assistance component of the Loan to train them in the necessary skills. CRYRZA does have the administrative staff, with offices in all large population centers, to render adequate administrative support. The Technical Assistance Staff will be composed of industrial engineers, accountants, economists, or other suitable disciplines and will be located in the areas of major potential demand. It will render assistance to the sub-borrower as follows:

1) Promotion of the Program

A member of the Technical Assistance Staff will visit developing small business areas, including the pueblos jóvenes (concentrations of recent immigrants, low salaried employees, unemployed, etc.), and will talk to likely small entrepreneurs, speak before their organizations, and explain the purpose of the loan and its availability.

2) Preparation of the Sub-loan application

The Technical Assistance Staff member will often be the first person contacted by a potential sub-borrower and will assist him through the introduction to a banker. Whether contacted first

or not, when necessary a member of the staff will assist the prospective borrower in preparing a simple and informal feasibility study. He will also assist, if required, in the preparation of the sub-loan application.

3) Approval of the sub-loan

The Technical Assistance Staff member, when necessary, will cooperate with the Local Bank in determining the credit worthiness of the project. He will assess the validity of the project, consulting as necessary with local businessmen, Chambers of Commerce, Cooperative Councils, and other sources. He will insure that the project falls within the CRYRZA guidelines for approval and that there are funds available in the allotment. With this information, he will normally act as approval officer for CRYRZA.

4) Implementation of the sub-project

Following loan approval, the Technical Assistance Staff member will give technical, managerial, financial, and administrative advice as required. It is expected that periodic visits to each sub-borrower will be made and that, during these visits, problems can be identified and solved before the sub-borrower gets in trouble.

5) Collection follow-up

The member of the Technical Assistance Staff charged with the supervision of a client who becomes delinquent will advise CRYRZA and the Local Bank as to the most desirable procedure in the circumstances.

b) Credit Manual

A Credit Manual will be prepared by CRYRZA for the information and use of the local CRYRZA representatives and the Local Banks. This manual will clearly state the purposes of the loan, the rules on eligibility of sub-borrowers, the rules on types and terms of sub-loans, and the operating procedures prescribed.

It is anticipated that the outside consultants employed with the Technical Assistance component of the loan will assist in the development of the Credit Manual.

The Manual will also serve as a promotional document and will be distributed to the local Chambers of Commerce and other interested parties.

The Manual will be periodically revised as experience in the implementation of the project dictates.

3. Provided by Local Bank

The Local Bank, as a matter of normal banking practice, assists the customer in the preparation of the loan application and the simple statement of financial affairs which accompanies it. Further assistance and advice is given to clients on request. Banks normally visit a new client's establishment several times during the course of a loan and these "inspection" staffs are equipped to render some assistance and advice to the client.

I. Alternative Methods and Sources of Financing

1. Methods

At the outset of the project, various alternate methods of financing were considered. Considering the needs to be met, their urgency, and the requirements for speed and flexibility in handling the administrative details, the decision was made to use the methods described above.

One alternate was the selection of an intermediate credit institution which would make all sub-loans. The Industrial Bank of Peru (BIP), a GOP development bank, is charged with small industry lending. The bank has traditionally required massive guarantees and has, therefore, made few loans in the area covered by the present loan. Prior to the earthquake, this bank had made 4 loans to medium industry and none to small enterprise in the Disaster Area. In 1971, it made 21 loans to medium industry and 5 to small enterprise in the Disaster Area. The BIP is now in reorganization and it will be at least one year before it will be ready to undertake a new assignment of the magnitude of the subject project. Other possible choices as sole sub-lender either were not equipped to handle small loans for business, were not represented in the zone, or were privately owned banks and therefore not acceptable to the GOP as ICI's.

The division of the fund among several banks was also considered and discarded as lacking flexibility and being too difficult to control.

Section V. FINANCIAL ANALYSIS

A. Financial Plan by Source and Use of Funds

1. Funds provided in thousands of U.S. Dollars

<u>Provided by</u>	<u>Funds for Sub-Lending</u>	<u>Technical Assistance</u>	<u>Total</u>
A.I.D.	\$2,450	\$ 50	\$2,500
Local Banks	288	(1)	288
Sub-borrowers	144	-	144
	<u>\$2,882</u>	<u>\$ 50</u>	<u>\$2,932</u>
CRYRZA (5 yrs)	<u>-</u>	<u>\$375</u>	<u>375</u>
TOTAL	\$2,882	\$425	\$3,307

(1) Some Technical Assistance will be given by Local Banks.

2. Fund Revenue in thousands of U.S. Dollars in 5 years at a maximum lending rate of \$1,250,000 per year;

Interest charge to sub-borrower at 8% on the declining balance (assuming an average loan of \$4,610 for 3 years with 6 months grace) 813

Less: 13% per annum on 10% loaned by
Local Banks \$132
3% per annum service charge 275

TOTAL To Local Banks 407
406

Less: 1% per annum service charge
of fiduciary bank 91
Net to Fund 315

B. Need for Local Cost Financing

Considering that the greater part of the subloans are expected to be for local construction; equipment purchases will be of a wide variety of smaller items which can be purchased locally as required; and the size and variety of sub-borrowers expected would obviate direct

imports or bulk purchases, the GOP has requested authorization for local expenditure of the entire amount of the AID loan (with the possible exception of dollar costs associated with technical assistance procured from 941 countries). Because of the humanitarian purpose of the loan and the type and size of procurement contemplated (construction activity will be the largest single element of procurement), it is felt that the request of the GOP is fully justifiable.

C. GOP Inputs

1. Replenishment of the Fund for uncollectable accounts

After deduction of Local Bank interest and service fees and Central Bank fiduciary fee the remaining net income of the Fund will be available to cover bad debt losses and expenses of collection. To the extent that such losses and expenses exceed the net income of the Fund, CRYRZA would be required to protect the Fund against decapitalization by annual replenishment from its ordinary biennial budget or other funds. This provision could also tend to encourage a business like attitude by CRYRZA in exercising its loan approval function.

2. Technical Assistance Staff

As described in the section under Technical Assistance, CRYRZA undertakes to provide a Technical Assistance Staff of three to five men from its own funds, together with the necessary administrative support. The cost of this team and its support is estimated at \$75,000 per year.

D. Utilization of Repayments

Repayments of sub-loans, together with interest received after payment of the fiduciary's fee, will be added to the Fund and made available for relending under the terms and conditions of the Fund for the life of the Fund, which is presently estimated at 5 years from the date of the initial disbursement by A.I.D.

Upon the termination of this period, the proceeds of the loan will be used for such purposes as may be agreed between the GOP and A.I.D.

E. GOP

1. Monetary Policy

The current monetary policy in Peru is designed to stimulate private investment by making money sufficiently available for

those firms wishing to invest within the context of Peruvian Reform. However, interest rates (which are fairly insensitive to changes in the money supply) and collateral requirements on loans (especially to small borrowers) are such as to discourage many from investing. Thus, the bulk of the investment now taking place is being financed from profits.

Also, there is considerable, but diminishing, uncertainty in the minds of many private businessmen with respect to the nature and extent of the structural reforms being pressed by Peru's current government, and thus the demand for money is not as strong as it would otherwise be. The inflexibility of interest rates prevents any significant decline in the cost of money. In recent months a large portion of the increase in the money supply has been invested in government bonds and mutual savings associations, rather than invested directly in private industry.

2. Balance of Payments

Peru's balance of payments showed a large surplus in 1970 (\$320 million) and a moderate deficit in 1971 (\$75 million), with trade balance surpluses of \$429 million and \$140 million respectively in the two years. At the end of 1971, Peru's net international reserves stood at approximately \$345 million, or 45% of 1971 imports.

Assuming Peru fulfills its National Development Plans for 1972-75, its projected balance of payments deficit for the period will total \$731 million, or more than double its current net international reserves. Recognizing the magnitude of the problem the GOP has requested assistance from foreign governments and foreign private banks. The U.S. private banks with loans outstanding to Peru have agreed to a rescheduling of a large percentage of these loans and have granted substantial new loans to Peru. At the recent consultative group meeting on Peru initiated by the World Bank, Peruvian officials were promised substantial foreign financing for projects to be carried out within the framework of the National Development Plan. This financing, if actually forthcoming, should be sufficient to cover most of Peru's needs over the period, with very little reserve loss for the country. If this financing is not forthcoming in the magnitude required, Peru will probably fall short of its development goals, with corresponding reduction in its balance of payments, deficits and some loss of reserves.

Peru's debt service payments will approach 20% of annual exports for the years 1972 through 1974, after which they should fall to less than 15% of exports. The current GOP has refrained from acquiring additional short term foreign debt, and is making a serious effort to plan its debt structure for coming years.

F. Impact on U.S. Economy

Although the loan will be disbursed in local currency it is a small loan, entirely for humanitarian purposes, and is expected to have a

negligible effect on the U.S. economy. To the extent that U.S. made shelf items are purchased to aid in the reconstruction there will be some beneficial effects.

Section VI. IMPLEMENTATION PLAN

A. Execution

1. Authorization of Loan (A) May, 1972
2. Termination of Negotiations and Signature of loan agreement A + 2 months
3. Conditions Precedent Met A + 4 months
4. First Disbursement by AID A + 5 months
5. Final Disbursement A + 36 months

B. Procurement

Upon the meeting of the Conditions Precedent for the first disbursement under the loan, CRYRZA, with AID concurrence, will proceed to contract the consultants required to train the technical staff (See IV H 1). These consultants will be obtained from the USA or Code 941 countries.

AID will defray the costs of these consultants upon presentation of appropriate vouchers.

C. Disbursement Procedures

Upon meeting the conditions precedent for the first disbursement for relending under the loan, AID will, after obtaining the necessary disbursement authority, deposit in the CRECE fund in the selected Fiduciary the soles equivalent of \$250,000.00 to cover the estimated requirements of the fund for 90 days. At the end of the first month and each month thereafter, the Fiduciary will prepare a listing of disbursements from the fund to the local banks, detailing the sub-borrowers and furnishing such information regarding them as AID may require. When the accumulated disbursements from the fund reach \$125,000.00, or such other amount as may be agreed with the Fiduciary, AID will replenish the fund for the amounts disbursed. This periodic replenishment will continue until the loan is fully disbursed.

D. Reporting

The monthly reports from the Fiduciary, listing the disbursements to the local banks, will also furnish a list of the sub-borrowers, giving the name, address, type of business, amount and term of the sub-loan, and such other information as AID may require. The monthly reports will also include details as to repayments and the overall status of the fund.

CRYRZA will submit a quarterly narrative report covering fund operations, problems encountered, and such other information as may be required by AID for the proper monitoring of the Fund.

E. Monitoring

The monitoring of the loan will be the responsibility of a Project Manager and a Loan Officer (who may be the same person) assigned by the Mission.

It will be the responsibility of the Project Manager to review the monthly reports received from the Fiduciary and to satisfy himself that the sub-loans are bonafide and meet the established criteria. Having done so, he will approve the listing for AID replenishment of the fund as described above.

The Project Manager will also be the AID representative at the periodic meetings between CRYRZA, the local banks, and AID for consideration of sub-loan operations.

Section VII. ENVIRONMENT

The possible adverse effects of the present project on the environment have been carefully considered and it has been concluded that the resultant effects will be negligible.

In reaching this conclusion, the fact that the loan proposes to finance a multiplicity of smaller enterprises through the medium of local banks was considered. The environmental implications will, therefore, be difficult, if not impossible to predict and therefore should not be required. However, there is little immediate possibility of significant adverse environmental impact from this loan considering the state of development of the Earthquake Area and the smallness of the sub-projects.

Section VIII. Conditions and Covenants

Prior to disbursement for sub-loans, CRIRZA shall furnish AID with:

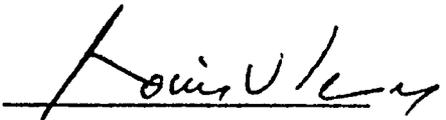
- 1) A detailed administrative and policy manual setting forth all pertinent lending policies, procedures and criteria to be applied in sub-lending.
- 2) Evidence of satisfactory arrangements by CRIRZA for providing necessary technical assistance and administrative support.

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

I, Louis V. Perez, Director of the Agency for International Development in Peru, do hereby certify that, to the best of my knowledge and belief, Peru possesses both the financial and human resources to effectively utilize and maintain the project for assistance to Small Business (Earthquake Area) proposed to be financed by an A.I.D. \$2.5 million dollar loan to the Government of Peru. In so certifying, I have taken into account the utilization of similar projects in Peru previously financed or assisted by the United States, and I have particularly taken into account the capabilities of the proposed implementing agencies, CRYRZA, the Central Reserve Bank and the Peruvian banking system, in past performance of functions similar to those assumed by them in the subject project, and the memorandum dated April 29, 1972, from the Assistant Director of Capital Projects, USAID/Peru.

May 1, 1972

Date

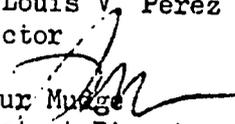


Louis V. Perez

MEMORANDUM

April 29, 1972

TO : Mr. Louis V. Perez
Director

FROM : Arthur Mudge 
Assistant Director for Capital Projects

SUBJECT: Section 611(e) Certification for Proposed Small
Business Loan for the Disaster Area

Section 611(e) of the Foreign Assistance Act, as amended, requires that before development loans are made for any capital assistance project estimated to cost in excess of \$1,000,000, the Administrator of AID must have received and taken into consideration a certification from the principal officer of AID in the country in which the project is located as to the capability of the country (in both financial and human resources) to effectively maintain and utilize the project, taking into account, among other things, the maintenance and utilization of previous projects in such country previously financed or assisted by AID.

The proposed loan for small business rehabilitation and development is a new concept in both method of operation and the field of small industry and commerce in which it will operate. CRYRZA, the Central Bank and the private banks, the agencies to whom the various functions of project implementation would be assigned, have, in the past, in performing similar functions, proven reasonably capable. Accordingly, I consider that they have the capability to carry out the subject project.

On the basis of the information contained in the loan paper, I recommend that you sign the attached certification.

DRAFT

AID-DLC/P-1021

ANNEX II

Page 1 of 3

Mr. Louis V. Perez
Director
Agency for International Development
Lima.-

Dear Mr. Perez:

This letter constitutes the official application of my Government to the Agency for International Development for a loan, on AID's most concessional terms, of \$2,500,000 to assist in financing the rehabilitation and development of small and medium size business and industry in the area affected by the earthquake of May 31, 1970. The Borrower would be the Government of Peru, and the Executing Agency would be CRYRZA. A description of the program is attached hereto.

As you know, the earthquake and flood disasters seriously affected a large number of small business and commercial establishment in the Zone which employed many people. Financial assistance is therefore of high priority to permit the recovery of such firms or cooperatives. Moreover, the provision of credit to small worthy enterprises will greatly assist these to participate in the reconstruction program and lay a base for development of the area.

In order to assure adequate administration of the program, the Government, through CRYRZA, will provide additional technical personnel (estimated at 5) who will be responsible for supervision of the credit program and for technical assistance needed by borrowers. The Government, through CRYRZA, will assume the credit risk under the program.

Sincerely,

Minister of Economy and
Finance

Attachment

ATTACHMENT

PROGRAM FOR CREDIT TO SMALL AND MEDIUM SIZED BUSINESS
AND COMMERCIAL ESTABLISHMENTS IN THE AREA AFFECTED BY
THE EARTHQUAKE OF MAY 31, 1970

Borrower: The Government of Peru, acting through the Minister of Economy and Finance.

Executing Agency: CRYRZA.

Purpose of Loan: To establish a fund for relending to small and medium sized businesses in the Disaster Area through established banking channels.

Fiduciary of Fund: Banco Central de la Reserva.

Eligible Sublending Agencies: Offices and agencies in the area of Government Development Banks, Government owned Commercial Banks, Privately owned Regional and Commercial Banks, Credit Unions and Credit Cooperatives. The sub-lending agency must participate in the loan with a minimum of 10% of the loan advanced from its own funds.

Eligible Sub-borrowers: Any Cooperative, firm or private individual, resident in the area and engaged in an industrial or commercial pursuit, whose capital does not exceed S/.2 million, whose annual sales do not exceed S/.5 million, and whose application for a loan is approved by CRYRZA.

Terms to the Sub-borrowers: Interest of from 8 to 10% per annum on the outstanding balance, depending on the size of the loan, grace period of not to exceed two years, and total time for repayment of not to exceed 10 years. Guarantees would be required only to the extent of the pledge of the assets acquired with the proceeds of the sub-loan.

Fees to the Sub-lending Agency and Fiduciary: The sublending bank would be entitled to a return of 13% per annum on the portion of the loan advanced from its own funds and a management fee of 3% per annum on the balance. The fiduciary would be entitled to not more than 1% per annum on the outstanding balance; both fees to be drawn from the collections of interest from the sub-borrower.

Disposition of Repayments of Principal and Interest Collected by the Fund: Repayments of principal to the fund and interest collected by it are to be available for relending. However, a provision for uncollectible accounts in the amount of 2% per annum on the

outstanding balances will be established within the fund and will be available to cover accounts not collectible and the costs of collection by legal means.

Annually, for the 5 year life of the fund, losses from uncollectible sub-loans in excess of the provision will be made up by the GOP.

Technical Assistance: CRYRZA will supply a technical assistance staff, estimated at 5 persons, who will assist the sub-borrowers in the preparation of their loan applications and in the operation of their businesses. From the proceeds of the loan, up to \$50,000 will be made available for the provision of technical specialists to assist in the promotion of the loan, the writing of a credit manual, and the training of the technical staff to be furnished by CRYRZA.

Taxes: Sub-loans granted by the fund provided by this loan will be exempt from all stamp taxes, as presently provided by existing legislation.



Department of State

TELEGRAM

ACTION AID

UNCLASSIFIED

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INFO AMB DCM CHRON ECON

Classification

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ATTN: CAP (Files)
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RECEIVED
USAID
MAILROOM

AIDAC

SUBJECT: IRR FOR SMALL BUSINESS RECONSTRUCTION

CAEC MET ON FEBRUARY 17 AND APPROVED SUBJECT IRR WITH
FOLLOWING OUSERVATIONS:

SEE

IV D
ANNEX III
IF3 1. LOAN PAPER SHOULD CONTAIN DEFINITION OF SMALL AND MEDIUM ENTERPRISE AND PROFILE OF MARKET TO BE SERVED. EMPLOYMENT GENERATION IMPACT SHOULD ALSO BE EXAMINED.

ANNEX III 2. PAPER SHOULD DISCUSS GOP INDUSTRIAL POLICY VIS-A-VIS EMPLOYEE OWNERSHIP/ATTITUDE TOWARD PRIVATE SECTOR AND EXAMINE LIKELY EFFECTS ON PROPOSED PROJECT.

IV H
IV H 3. PAPER SHOULD DESCRIBE NATURE AND AMOUNT OF PROPOSED TECHNICAL ASSISTANCE FROM CRYRZA, INCLUDING EVIDENCE THAT CRYRZA CAN MOBILIZE NECESSARY EXPERTISE. GREATER EXAMINATION SHOULD BE MADE OF WHETHER SUCH TECHNICAL ASSISTANCE WILL LIKELY BE REQUIRED FOR MAJORITY OF SUB-BORROWERS OR GENERALLY LIMITED TO EXCEPTIONS.

IV F2
IV F3
IV F3 4. CAREFUL EXAMINATION SHOULD BE MADE OF WHAT IS "ADEQUATE BUT NOT EXCESSIVE" FINANCIAL INCENTIVE TO INDUCE PARTICIPATION LOCAL LENDING AGENCY. PAPER SHOULD ALSO EXAMINE ESTIMATED SUB-LOAN ADMINISTRATION COSTS, INCLUDING COST OF CALLING DELINQUENT LOANS, AND INDICATE WHO WILL BEAR SUCH COSTS FROM WHAT SOURCES. IF LOCAL LENDING AGENCY EXPECTED TO COVER LITTER COST FROM A PERCENT SPREAD PROPOSED, THIS WOULD AFFECT DETERMINATION OF WHAT WOULD BE ADEQUATE BUT NOT EXCESSIVE INCENTIVE. Like A9

IV A CREDIT LOAN, BASIS RATIONALE THIS LOAN VIEWED IN TERMS OF ITS IMPACT OF EARTHQUAKE PROBLEMS. ROGERS

CHECKLIST OF STATUTORY CRITERIA

(Alliance for Progress)

The following abbreviations are used:

- FAA - Foreign Assistance Act of 1961, as amended
App - Foreign Assistance and Related Agencies Appropriations Act, 1971
MMA - Merchant Marine Act of 1936, as amended

COUNTRY PERFORMANCE

Progress Towards Country Goals

1. FAA § 208; § 251 (b).

A. Describe extent to which country is:

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

The GOP has an active agricultural credit program for both large and small farmers. A top priority activity of the GOP is the Agrarian Reform program which is designed to bring new lands under cultivation.

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

In the context of its industrial reform program (Industrial Law) and its balance of payments management, the GOP is actively seeking foreign and domestic private investments in areas identified as being essential to growth.

(3) Increasing the public's role in the developmental process.

Newly decreed programs in Industry (Industrial Law), fishing (Fishing Law), and Agrarian Reform are specifically designed to achieve this objective.

- (4) (a) Allocating available budgetary resources to development.
- Sizeable portions of the GOP national budget are being allocated to the top priority programs of educational, agricultural and industrial reform.
- (b) Diverting such resources for unnecessary military expenditure (see also Item N° 16) and intervention in affairs of other free and independent nations. (See also Item N° 14).
- GOP Military expenditures for the years 1971 and 1972 are \$433 million or 16% of the total two-year budget. No known intervention in affairs of other nations.
- (5) Willing to contribute funds to the project or program.
- The GOP commitment to supply technical assistance staff and administrative support plus their undertaking to reimburse losses from bad debts for 5 years is considered ample proof of their willingness to contribute.
- (6) Making economic, social, and political reforms such as tax collection improvements and changes in land tenure arrangements, and making progress toward respect for the rule of law, freedom of expression and of the press, and recognizing the importance of individual freedom, initiative, and private enterprise.
- While freedom of press and of expression has been somewhat curtailed in recent years, tax collections have improved, laws are enforced and land reform has been given high priority. GOP is making significant efforts to improve quality of judiciary.
- (7) Adhering to the principles of the Act of Bogota and Charter of Punta del Este.
- Sound monetary and fiscal policies leading to real growth in GNP, stable prices, and a balance of payments surplus, coupled with significant economic and social reforms designed to restructure the Peruvian society along more equitable lines, clearly indicate Peru's compliance with Alliance for Progress goals.

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

Recent decrees requiring full repatriation of foreign capital of Peruvians have had an important impact on the balance of payments and make available resources for investments in Peru.

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

The GOP appears to be responding to the economic, political and social concerns of its people, particularly the poor, and has strengthened self-help measures as indicated above.

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

Yes.

Treatment of U.S. Citizens

2. FAA § 620 (c).

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

No known recent instance.

3. FAA § 629 (e) (1).

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

In 1968 the GOP expropriated the holdings of IPC, a company beneficially owned by U.S. citizens. It has been determined that appropriate steps to discharge its obligations have been taken by the GOP, within the meaning of the statute.

4. FAA § 620 (o); Fishermen's Protective Act. §.5.

If country has seized, or imposed any penalty or sanction against, any U.S. fishing vessel on account of its fishing activities in international waters. No known seizure during past year.

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

No claim has been made and therefore no deduction is required by the Fisherman's Protective Act.

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

The Administrator has taken into consideration prior seizures of U.S. fishing vessels by the GOP in his determination to continue to furnish assistance to Peru.

Relations with U.S. Government and Other Nations

5. FAA § 620 (d).

If assistance is for any productive enterprise which will compete in the U.S. with U.S. enterprise, is there an agreement by the recipient country to prevent export to the U.S. of more than 20% of the enterprise's annual production during the life of the loan?

No such enterprises to be assisted.

6. FAA § 620 (j).

Has the country permitted, or failed to take adequate measures to prevent, the damage or destruction by mob action, of U.S. property?

No known recent instance.

7. FAA § 620 (1).

If the country has failed to institute the investment guaranty program for the specific risks of expropriation, in convertibility or confiscation, has the A.I.D. administration within the past year considered denying assistance to such government for this reason?

The Administrator has taken Peru's limited guaranty program into consideration in determining to continue to furnish assistance to Peru.

8. FAA § 620 (q).

Is the government of the recipient country in default on interest or principal of any A.I.D. loan to the country? No.

9. FAA § 620 (r).

Has the country severed diplomatic relations with U.S.? If so, have they been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption? No.

10. FAA § 620 (u).

What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the A.I.D. Administrator in determining the current A.I.D. Operating Year Budget? GOP budget authorizes expenditure for delinquent UN dues and payments on regular budget account. The GOP has stated its intention to liquidate delinquent obligations. Peru's arrearages were considered in determining the current OYB.

11. FAA § 620 (a).

Does recipient country furnish assistance to Cuba or fail to take appropriate steps to prevent ships or aircraft under its flag from carrying cargoes to or from Cuba? No known assistance to Cuba or carriage of cargoes to or from Cuba by Peruvian flag ships. A commercial sale of fishmeal was made to Cuba and was carried to Cuba in Cuban vessels.

12. FAA § 620 (b).

If assistance is to a government, has the Secretary of State determined that it is not controlled by the International Communist movement? Yes.

13. FAA § 620 (f).

Is recipient country a communist country? No.

14. FAA § 620 (i).

Is recipient country in any way involved in (a) subversion of, or military aggression against, the U.S. or any country receiving U.S. assistance, or (b) the planning of such subversion or aggression? No.

15. FAA § 620 (n).

Does recipient country furnish goods to North Viet-Nam or permit ships or aircraft under its flag to carry cargoes to or from North Viet-Nam? No known instances.

*16. See last page

Military Expenditures

17. FAA § 620 (s).

What percentage of country budget is for military expenditures? How much of foreign exchange resources spent on military equipment? How much spent for the purchase of sophisticated weapons systems? (Consideration of these points to be coordinated with PPC/MAS).

In 1970, Peru's defense expenditures represented 18.7% of central governments expenditures. Of the two-year 1971-72 budget, 16% is earmarked for military expenditures.

In 1969 (the latest year for which data is available), the GOP spent \$249 million in foreign exchange on military imports.

With respect to sophisticated weapons systems, Peru purchased 16 mirage type aircraft, plus spare parts, for a total of \$28 million in 1968, repayable over 8 years beginning as of 1970.

The Administrator has taken these matters into account in determining to continue to furnish assistance to Peru

CONDITIONS OF THE LOAN

General Soundness

18. FAA § 201 (d).

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

The sub-loan terms are reasonable and legal under both United States and Peruvian law.

The Sub-loan terms for this project are proposed by the GOP and considered reasonable and legal in all respects.

19. FAA § 251 (b) (2); § 251 (e).

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

For the reasons given in the loan paper the project is considered economically and technically sound. An application with appropriate assurances has been received and is included as an annex in this paper. (Annex II).

20. FAA § 251 (b).

Information and conclusion on capacity of the country to repay the loan, including reasonableness of repayment aspects.

See Section V.E.2.

21. FAA § 611 (a) (1).

Prior to signing of loan will there be (a) engineering, financial, and other plans necessary to carry out the assistance and (b) a reasonably firm estimate of the cost to the U.S. of the assistance?

Yes.

22. FAA § 611 (a) (2).

If further legislative action required within recipient country what is basis for reasonable expectation that such action will be completed in time to permit orderly accomplishment of purposes of loan?

None Required.

23. FAA § 611 (a).

If loan is for capital assistance and all U.S. assistance to project now exceeds \$1 million, has Mission Director certified the country's capability effectively to maintain and utilize the project?

See Annex I.

24. FAA § 251 (b).

Information and conclusion on availability of financing from other free-world sources, including private sources within the United States.

Section IV i of loan paper.

Loan's Relationship to Achievement of Country and Regional Goals

25. FAA § 207; § 251 (a).

Extent to which assistance reflects appropriate emphasis on: (a) encouraging development of democratic economic, political, and social institutions; (b) self-help in meeting the country's food needs; (c) improving availability of trained manpower in the country; (d) programs designed to meet the country's health needs, or (e) other important areas of economic, political, and social development, including industry; free labor unions, cooperatives, and voluntary agencies; transportation and communication; planning and public administration; urban development; and modernization of existing laws.

Proposed loan is entirely designed to assist private enterprise in the reconstruction of a disaster area and strengthen the capacity of the Peruvian commercial banking system to contribute to the development of new private enterprises.

26. FAA § 209.

Is project susceptible of execution as part of regional project? If so why is project not so executed?

Not susceptible.

27. FAA § 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.

The proposed program will contribute to the rebuilding of small business and the provision of employment in a disaster area. See also Item 25.

28. FAA § 251 (b) (7).

Information and conclusion on whether or not the activity to be financed will contribute to the achievement of self-sustaining growth.

The promotion and assistance to small enterprise will contribute significantly to long term self sustaining growth.

29. FAA § 281 (a).

Describe extent to which the loan will contribute to the objective of assuring maximum participation in the task of economic development on the part of the people of the country, through the encouragement of democratic, private and local governmental institutions.

The loan is designed to assist the reconstruction and development of private enterprise and strengthen the capacity of the Peruvian commercial banking system to contribute to development of new private enterprises.

30. FAA § 281 (b).

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

Program contemplates a significant self-help input at the community level to satisfy needs of the highest priority in the disaster zone. By promoting a cooperative effort, the program strengthens democratic processes at the grass-roots level.

31. FAA § 601 (a).

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

- (a) not significantly;
- (b) yes, loan will help to restore the economic life of several communities;
- (c) not particularly;
- (d) by fostering new enterprises will promote free competition;
- (e) Yes, by assisting communities with the reconstruction of commerce and industry.
- (f) no.

32. FAA § 619.

If assistance is for newly independent country; is it furnished through multilateral organizations or plans to the maximum extent appropriate?

Peru not newly independent.

33. FAA § 251 (h).

Information and conclusion on whether the activity is consistent with the findings and recommendations of the Inter-American Committee for the Alliance for Progress in its annual review of national development activities.

The CIAP review of Peru emphasized the justifiable need of international financial assistance to Peru's development programs.

34. FAA § 251 (g).

Information and conclusion on use of loan to assist in promoting the cooperative movement in Latin American.

Sub-loans may be made to local cooperatives, thus supporting the cooperative movement in Latin America.

35. FAA § 209; § 251 (b) (8).

Information and conclusion whether assistance will encourage regional development programs, and contribute to the economic and political integration of Latin America.

Not directed toward regional development.

Loan's Effect on U.S. and A.I.D.
Program

36. FAA § 251 (b) (4); § 102.

Information and conclusion on possible effects of loan on U.S. economy, with special reference to areas of substantial labor surplus, and extent to which U.S. commodities and assistance are furnished in a manner consistent with improving the U.S. balance of payments position.

Apart from possible purchase of some U.S. goods and services, loan is for local costs with negligible effect on U.S. economy, slight adverse effect on U.S. balance of payments.

37. FAA § 601 (b).

Information and conclusion on how the loan will encourage U.S. private trade and investment abroad and how it will encourage private U.S. participation in foreign assistance programs (including use of private trade channels and the services of U.S. private enterprise).

See item 36.

38. FAA § 601 (d).

If a capital project, are engineering and professional services of U.S. firms and their affiliates used to the maximum extent consistent with the national interest?

Services of U.S., Peruvian, Code 941 firms may be used for technical assistance as appropriate. All other financing for local costs of sub-borrowers under ICI guidelines.

39. FAA § 602.

Information and conclusion whether U.S. small business will participate equitably in the furnishing of goods and services finance by the loan.

See items 36 and 38.

40. FAA § 620 (h).

Will the loan promote or assist the foreign aid projects or activities of the Communist-bloc countries?

Loan agreement will specifically provide against such eventuality.

41. FAA § 621.

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

It is contemplated that technical assistance will be provided by private enterprise on a contract basis.

42. FAA § 252 (a).

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

It is contemplated that, except for technical assistance to be procured from private sources by GOP, all loan funds will be used to finance procurement from private sources by private borrowers, through private financing institutions.

Loan's Compliance with Specific Requirements.

43. FAA § 201 (d).

Is interest rate of loan at least 2% per annum during grace period and at least 3% per annum thereafter.

Yes.

44. FAA § 608 (a).

Information on measures to be taken to utilize U.S. Government excess personal property in lieu of the procurement of new items.

All loan financing, except possibly technical assistance, to be local costs.

45. FAA § 604 (a).

Will all commodity procurement financed under the loan be from U.S. except as otherwise determined by the President?

Yes.

46. FAA § 604 (b).

What provision is made to prevent financing commodity procurement in bulk at prices higher than adjusted U.S. market price?

Not Applicable.

47. FAA § 604 (d).

If the host country discriminates against U.S. marine insurance companies, will loan agreement require that marine insurance be placed in the U.S. on commodities financed by the Loan?

Loan Agreement will so specify.

48. FAA § 604 (e).

If off-shore procurement of agricultural commodity or product is to be financed, is there provision against such procurement when the domestic price of such commodity is less than parity?

No financing of such procurement is contemplated.

49. FAA § 611 (b); App § 101.

If loan finances water or water-related land resource construction project or program, is there a benefit-cost computation made, insofar as practicable, in accordance with the procedures set forth in the Memorandum of the President dated May 15, 1962?

No large scale water or water-related land resource construction project or program will be financed.

50. FAA § 611 (c).

If contracts for construction are to be financed what provision will be made that they be let on a competitive basis to maximum extent practicable?

No such financing is contemplated.

51. FAA § 620 (g).

What provision is there against use of subject assistance to compensate owners for expropriated or nationalized property?

No such financing contemplated.

52. FAA § 612 (b); § 636 (h).

Describe steps taken to assure that, to the maximum extent possible, the country is contributing local currencies to meet the cost of contractual and other services, and foreign currencies owned by the U.S. are utilized to meet the cost of contractual and other services.

GOP will cover all local costs of CRYRZA administrative personnel. No excess U.S. owned currencies are available in Peru.

53. App. § 104

Will any loan funds be used to pay pensions, etc., for military personnel?

No.

54. App. § 106.

If loan is for capital project, is there provision for A.I.D. approval of all contractors and contract terms?

Loan agreement will so provide.

55. App. § 108.

Will any loan funds be used to pay U.S. assessments?

No.

56. App. § 109.

Compliance with regulations on employment of U.S. and local personnel for funds obligated after April 30, 1964 (Regulation 7).

Loan Agreement and implementation letters will provide for application of Regulation 7.

57. FAA § 636 (i).

Will any loan funds be used to finance purchase, long-term lease, or exchange of motor vehicle manufactured outside of United States, or any guaranty of such a transaction.

No.

58. App. § 501.

Will any loan funds be used for publicity or propaganda purposes within U.S. not authorized by the Congress?

No.

59. FAA § 620(k).

If construction of productive enterprise, will aggregate value of assistance to be furnished by the United States exceed \$100 million?

Not applicable.

60. FAA § 612(d).

Does the United States own excess foreign currency and, if so, what arrangements have been made for its release?

No U.S. owned excess foreign currencies available.

61. MNA § 901.b.

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

The Loan Agreement will provide for compliance with the 50% U.S. flag shipping requirements.

*16. FAA § 481.

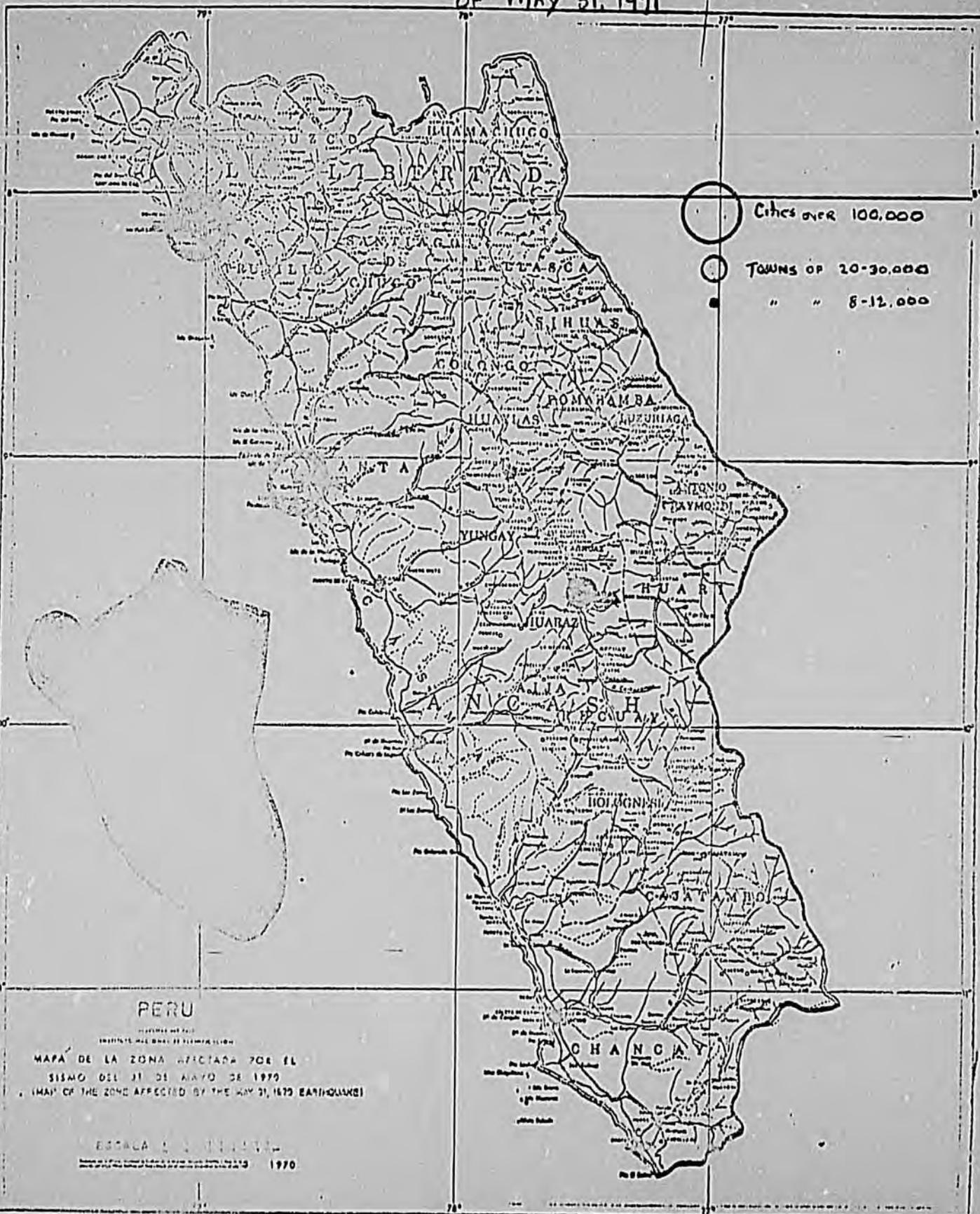
Has the government of recipient country failed to take adequate steps to prevent narcotic drugs and other controlled substances (as defined by the Comprehensive Drug Abuse Prevention and Control Act of 1970) produced or processed, in whole or in part, in such

No. The GOP has taken such measures as are within its capacity to control narcotics traffic and is cooperating with U.S. efforts to eliminate production and trade in narcotics.

16. Cont'd.

country, or transported through such country, from being sold illegally within the jurisdiction of such country to U.S. Government personnel or their dependents, or from entering the U.S. unlawfully.

AREA DEVASTATED BY THE EARTHQUAKE OF MAY 31, 1971



PERU

MAPA DE LA ZONA AFECTADA POR EL
SISMO DEL 31 DE MAYO DE 1971
(MAP OF THE ZONE AFFECTED BY THE MAY 31, 1971 EARTHQUAKE)

ESCALA 1:1,000,000

1970

THE EARTHQUAKE OF MAY 31, 1970

Relief and Reconstruction Efforts to Date

1. History

Earthquake of May 31, 1970 and its aftermath:

On the afternoon of Sunday, May 31, 1970, occurred what UNESCO was to call "the most destructive earthquake in the history of the Western Hemisphere". News of enormous damage in the coastal cities was received early, but only on the second day after the quake did the cloud of dust which had covered the beautiful valley of the Callejon de Huaylas disappear and reveal what was worse; the north wall of 23,000 foot Huascarán had fallen into the valley and buried the town of Yucay. In the 43 seconds of the earthquake; according to the official Government figures:

50,000 were killed, 20,000 were missing, and 150,000 injured;
Of 38 towns, 15 lost more than 80% of their houses;
70,000 homes were destroyed as well as 6,730 school rooms and
uncounted business buildings;
90% of the electric power was gone;
77% of the roads were destroyed, together with the only railroad;
83,000 square kilometers (7% of Peru's total land area),
1,700,000 persons (13% of the country's population) were significantly affected, and the total damage was estimated to exceed \$500 million.

Immediate relief was prompt and effective. Sixty nine nations and international organizations provided in the form of grants, commodities, or other assistance, some \$44,268,000 for immediate relief; the United States and its U.S. Voluntary Agencies contributing \$26,796,446 or 60% of the total. By this magnificent effort, the injured received care and the survivors received food and shelter.

2. Present Situation in the Zone Affected by the Earthquake

The immediate relief of the Zone Affected by the Earthquake (Zona Afectada por el Sismo - ZAS) having been handled, the Government of Peru turned its attention to the long-range problem of reconstruction. To that end, it established "The Commission for Reconstruction and Rehabilitation of the Zone Affected by the Earthquake of May 31, 1970" (CRYAZA); as a separate entity within the government, gave its head Cabinet rank and complete power of decision and action within the ZAS.

These efforts made possible planning for a larger reconstruction program. The World Bank made a loan of \$30 million for roads, IDB provided a \$35 million loan, AID contributed \$3 million in the form of a Community Development Loan and \$28 million was provided under the AID Housing Investment Guarantee program.

Reconstruction of community facilities has been especially rapid. As part of the original immediate relief grant to the Government of Peru, the U.S. Government provided \$2,540,000 for educational facilities in the disaster area. To date, the secondary school in Huaraz has been repaired, the construction of education centers in Huaraz, Catac, and Ticapampa are nearing completion and construction of five basic education centers in Trujillo has begun. In addition, repair of eight rural schools with AID grant money has been approved. The British government has provided four large prefab schools for the disaster area and these have been set up and are in use. Several other countries and organizations have helped or are planning to assist the Peruvian government in the field of education.

Also great assistance has been given and much progress has been made in the area of health. Five health centers are being constructed or planned for construction in Anta, Pariacoto, Cajacay, Aija and Pira. These centers are to be financed with AID emergency grant funds. Several other governments and voluntary groups are building or have offered to build health centers through the area.

Through AID grant monies, totaling \$780,000, the expansion of farm credit was also possible. To date, 619 loans have been made to small farmers through a well organized agricultural lending bank. Projects to improve irrigation in the area are to begin soon. Land reform and agricultural studies are also in process.

Progress has been made in the installation and repair of power facilities. Ten diesel electric generators, purchased with AID grant monies are producing power for Yautan, Nepeña, Chiquian, Chavín, San Marcos, Casma, Huamey and Tumbes. The electric power line between the Cañon del Pato Plant at Huallanca and the city of Huaraz has been repaired with AID grant money. The United Nations repaired the hydroelectric plant in Huallanca at a cost of \$60,000. India has offered to electrify the Corongo-Cusca-Aco region. Projects for electrification utilizing the IDB loan money have begun. Within five years every town in the area and some of the rural areas are expected to have electricity.

Repair of the main transportation and communication lines in the area was rapid. Much still remains to be done to improve these areas, but much is planned for this sector. Water, sewage, urban development and housing have been planned in detail by CRYRZA and these programs are now ready to begin. Housing construction and urban development has already begun in Chimbote utilizing money from the IDB loan.

Even though the need, the demand and the interest for housing by the people of the region is intense, much progress still needs to be made in this sector.

The larger industries in the ZAS, the steel mill at Chimbote, sugar mills, and the fishmeal factories scattered along the Coast, were, because of their better construction, among the least affected by the earthquake and were able to resume normal activities within a few weeks.

Small businesses, both industrial and commercial, normally occupied buildings of the adobe construction typical in the area, and suffered the loss of buildings, stocks, machinery, and equipment, and furniture and fixtures. Further, many established businesses suffered the loss of markets for their products and services. In general, these smaller businesses have been unable to resume normal activity due to the lack of funds to replace and rebuild.

Adding to the effects of the initial disaster, in March of 1972, the rains in the Andes were the heaviest experienced in 50 years and the rivers in the Coast area flowed their banks, destroying communications, flooding towns, and ruining crops and irrigation systems.

Again, it was the small business man who suffered the greatest loss. Operating on the narrowest of margins, the loss of a few days sales, or a small percentage of his stock in trade can be sufficient to drive him out of business and back among the unemployed.

3. Framework for the A.I.D. Program in the ZAS

The GOP plan for the reconstruction of the disaster area is extensive. Concurrent with the reconstruction, the GOP wants to develop the disaster areas into an area of greater economic potential and to raise the standard of living for the people in the area. In order to meet this objective, the GOP has arranged for planned cities and communities, has planned projects in the areas of health, education, agriculture, community facilities, infrastructure, community organizations, industry, tourism, housing, mining, fishing, communication and transportation.

Planned Financial Assistance (GOP and other donors)

The following table illustrates the extent of the GOP's planned efforts in the disaster area and summarizes the reconstruction plan. The amount of financing required is an estimate. It is anticipated that 51% of the resources will come from international corporations and institutions. 30% from GOP revenues, 2% from GOP owned decentralized institutions, and 8% from private corporations and cooperatives.

REVISED: 4/5/72

SECTOR	FEDERAL PROMOTION OF PLANNED PROJECTS	FINANCIAL SOURCES	AMOUNT PROCURED
AGRICULTURE	1. Irrigation projects for Chirbote, Chao, Virú, Hucho, Supa, Chicana, Pativilca, etc.	GOP Public Treasury AID	\$/. 5,546,000,000
	2. Inorganization of production with assistance of farm cooperatives and credit unions	Other Foreign Financing	\$/. 92,200,000
	3. Intensification of Agrarian Reform		\$/. 20,500,000
	4. Studies		\$/. 60,000,000
	5. Agricultural and livestock promotion		\$/. 221,200,000
	6. Forestry and hunting		\$/. 64,300,000
	7. Marketing and Market Centers		\$/. 273,300,000
HEALTH	1. Construction or repair of hospitals in Caraz, Huari, Alja, Pira, Casma, Pariscoto, Cajacay, Chimbote, Huaraz, and Huarmey, plus other smaller sites (30 hospitals total)	GOP Public Treasury AID Cuban Assistance Other Foreign	Total planned for health facilities in the disaster region is more than \$/. 200,000,000
	2. Construction of 35,000 sanitary latrines		
	3. Sanitary fitting for the water systems of various cities		
	4. Other smaller health projects		
EDUCATION	1. To repair and reconstruct	Public Treasury	1) \$/. 5,922,000
	2. damaged educational facilities	AID	2) \$/. 331,945,000
	3. Construct and equip 82 schools	Voluntary Agencies	3) \$/. 900 per pupil per
	3. School lunch program to benefit 75% of the children in the Sierra and 43% of the children on the Coast	Other Foreign Assistance	
	4. 200 University scholarships for students from the disaster region		4) and 5) \$/. 100,000,000
5. 20 Scholarships for students to attend teacher training school			

SECTORS	GENERAL DESCRIPTION OF PLANNED PROJECTS	FINANCIAL SOURCES	AMOUNT PROGRAMMED
TOURISM	<ol style="list-style-type: none"> 1. Restore archeologic sites such as Sechin and Chavin 2. Construction of tourist hotels and hosteles 3. Promote tourism and provide information 4. Construction of Tourist Information Centers 	Public Treasury	More than S/.42,000,000
HOUSING AND URBAN DEVELOPMENT	(For details of this program see section 2.3)		
TRANSPORTATION AND COMMUNICATION	<ol style="list-style-type: none"> 1. Airports for Trujillo, Huaraz, and Chimbote 2. Improvement of Salaverry and Chimbote ports. Construction of a new port in Bahia de Salinas 3. Improvement and asphatting of major roads in the area 4. Improvement of telephone and telegraphic facilities 	Public Treasury IDB Loan Other Foreign Assistance	S/.4,850,000,000
POWER	<ol style="list-style-type: none"> 1. Power networks for Huaraz, Caraz, Carhuaz, and Ranrahirca 2. El Chorro Hydroelectric Power Plant in Santa River 3. Construction of thermal plant in Chimbote (60 kw) and two 150 kw groups in Chicama Valley 4. Transmission lines from Lima to Trujillo, and from Lima to Chimbote 	Public Treasury AID Foreign Assistance	About S/.4,000,000,000

SECTORS	GENERAL DESCRIPTION OF PLANNED PROJECTS	FINANCIAL SOURCES	AMOUNT PROGRAMMED
Continuation TOWER	<ol style="list-style-type: none"> 5. Feasibility studies for rural electricity 6. Rehabilitation of services in all cities of the disaster region 		
PROMOTION OF INDUSTRY	<ol style="list-style-type: none"> 1. Special Credit program through the Banco Industrial 2. Formation of an Industry Assistance Office 3. Infrastructure for small industries and crafts to be developed 4. Studies and feasibility plans 5. Promotion and improvement of larger industries 	Public Treasury Banco Industrial Private Sources	S/. 6,172,000,000
MINING	<ol style="list-style-type: none"> 1. Exploration and feasibility studies 2. Mining Projects 	Public Treasury Foreign Assistance (POLAND) Private Assistance	S/. 180,000,000 S/. 2,000,000,000
FISHING	<ol style="list-style-type: none"> 1. Scientific and Technical research 2. Fishing Production 3. Marketing 4. Training 5. Consumer Promotion 6. Complementary Construction and Equipment 	Public Treasurer Foreign Assistance	S/. 4,280,000,000

Economic Annex

Economic and Social Justification

a) General Conditions

Prior to the earthquake, the Disaster Area contained 13% of Peru's population and produced 14% of the country's GNP, including 21% of its agricultural production, 9.5% of its industrial production, 2.4% of its mining production and 48% of its production of fish products. A large proportion of this output was generated in a few, highly capital intensive, export oriented industries with absentee (Lima) owners and thus the economic benefits flowing from this production were not distributed largely or widely within the area. These relatively efficient industries, all located along the coast, included the SOGESA steel works, several plants producing fish products (primarily fishmeal), and several sugar plantations, and are estimated to have produced nearly 70% of the areas GNP and 22% of Peru's total exports. Due to the capital intensity of these firms, the limited and foreign markets for their output, and their absentee ownership, these firms did not provide employment in the area in proportion to their output, nor did they reinvest in the area any significant portion of their profit. Thus, over the years there has been a steady outflow of capital from the Disaster Area with resulting deleterious effects on the economy.

The real backbone of the economy of the Disaster Area in the sense of providing a livelihood for the vast majority of the populace consisted of the highly inefficient agriculture, the large number of medium and small size industrial and commercial firms located in the cities practically all of which were undercapitalized, and the innumerable small artisan shops employing one or two persons, usually on a part time basis. In addition, there existed the usual proliferation of services common to such an environment, but producing very little in the way of value added to the economy.

The extent of the economic problem of the area is evidenced by the fact that the per capita income in the area is estimated to be only \$224, with the average worker in the sierra earning only 25% of that earned by the average coastal worker. The per capita GNP of the country as a whole in 1971 was approximately \$410.

A close inter-relationship exists between the demographic characteristics of the Disaster Area and its economic performance.

The population of the affected area, estimated at approximately 1,850,000 persons in 1971, is young relative to most other areas of Peru and relative to developing countries in general. The

potentially economically active represent 27% of the population, as compared with 32% for the country as a whole. The unemployment rate varies seasonally, but recent estimates indicate an average rate for the area of over 30%. These two factors, the small percentage of the population economically active and the high unemployment rate, signify a high dependency ratio.

In addition, the productivity of labor in the Disaster Area is very low due primarily to the lack of capital, but partially to the existing migration patterns affecting the area. This latter is also a determinant of the age characteristics of the population of the area.

There are two significant migration runs in the area, one from the sierra to the coastal cities and the other from these coastal cities to Lima-Callao.

As a result of these (fertility and mortality rates do not differ significantly from other areas of Peru) the rate of growth of the population of Disaster Area is around 1.7%, compared with 3.1% to 3.5% for the country as a whole, and the population on the coast in the affected area is growing by 2.8% and that of the sierra by 0.7%, both significantly under the 5% growth of the Lima-Callao area.

The migration involves mostly males of economically active age and the physically and mentally most able of the population. As a consequence, there is a diminution in the support portion of the population in the Disaster Area and a general reduction in the productivity of the area's labor force; both critical losses for an area otherwise plagued with economic difficulties.

Another important demographic characteristic of the affected area is its rapid rate of urbanization, both within the sierra and along the coast. The rate of growth of the rural population on the coast is 1.4% while that of the sierra is 0.5%, compared with an urban growth rate of 4.8% and 1.2% respectively for the two areas. Currently, an estimated 40% of the area's population lives in cities, up from 33% in 1961, and again it is the more able who are leaving the rural environment. This drain of human capital from rural to urban and from sierra to coast to Lima-Callao in Peru has become a serious consideration for Peru's economic and social development policy.

The topographic and climatic conditions are also important determining factors in the economy of the Disaster Area. The rugged sierra makes transportation among the cities of the sierra and between these cities and the coast difficult and costly and for certain periods of the year impossible, with obvious effects upon the economy. In addition, only small valleys scattered among the mountains are level enough to be suitable for cultivation.

The complete absence of rainfall on the coast limits agricultural production to those areas which can be irrigated, and the heavy winter rains in the sierra leach and erode the soil, reducing agricultural productivity there.

b) Coastal Area

The coastal area within the Disaster Zone contains approximately 7.5% of Peru's population, and 57% of the population of the affected area. About 59% of the population of this coastal area is urban.

Historically all of the coastal cities have received a flow of migrants from the sierra, most of whom, with relatively short delay, have continued on to the Lima-Callao metropolitan area. In addition, these cities have traditionally lost a significant portion of their native populations to the same center. One of the most serious affects of the earthquake of May 1970 was to accelerate this migration, thus straining even more the already inadequate capacity of these coastal cities and Lima-Callao to supply the necessary job opportunities and social services.

The average unemployment rate in the coastal area is estimated at 35% of the labor force, with the rate in Chimbote reaching 50%, which, together with the high underemployment rate existing in the area, points up the severity of the economic and social problem facing Peruvian officials in their rehabilitation and reconstruction program. Also, of course, this lack of job opportunities is a major factor encouraging the flow of migrants to the Lima-Callao area.

Economic activity along the coast consists of relatively highly productive irrigated agriculture situated in long river valleys formed by the run off from the sierra, and a varied industrial structure composed of a few large scale enterprises and a large number of medium and small scale firms. In addition, there exists a large number of individual or family Artisan shops located primarily in the cities.

All agricultural production along the coast requires irrigation because of the complete absence of rainfall, and irrigation systems have been established bringing extensive areas under cultivation. These irrigation systems suffered extensive damage in the flood of March, 1972, and will require extensive investment for reconstruction. The principal crops produced are sugar, cotton, corn, rice, beans and potatoes. Productivity is high compared with agriculture in the sierra, but low with respect to international standards.

The current government's agrarian reform efforts have resulted in the expropriation of many of the large haciendas (including some sugar plantations) along the coast and in their redistribution to cooperatives and, in some cases, to individual campesinos. However, unless

additional acreage can be brought into production in the near future, which is highly unlikely given the cost and problems involved in tapping new water sources, coastal agriculture cannot be expected to have any immediate impact on the employment problem in the area.

The industrial structure of the coastal area was composed of a small number of relatively large scale firms situated in the coastal cities and producing primarily for export (including a sugar complex and several fishmeal plants) and a large number of medium and small size firms located primarily in the urban area. In addition, there were innumerable 1 or 2 worker artisan shops which in total were estimated to have employed on a part-time basis over 50,000 persons.

c) Mountain Area

The mountainous part of the Area contains approximately 800,000 inhabitants or about 43% of the population of the affected area. The population growth rate of this area is only 0.7% reflecting the heavy outmigration to the coast. The phenomenon of rapid urbanization is affecting this area as well. Since this migration consists of the younger more able members of the work force, there is a tremendous loss of manpower to the area resulting a high dependency ratio and low productivity.

The agriculture in the area is highly inefficient due to a combination of factors including the leaching and erosion of soils by heavy rains, lack of capital and technical knowhow, and bad management practices on the farms. Most of the farming is done in small valleys interspersed among the mountains with the farms situated around a small village which is the center of the economic and social activities in the area. There is very little unused land available in this area and the agrarian reform has yet to significantly affect the agrarian structure. The possibility of any short term expansion of employment and income on the basis of the agriculture in the mountainous area of the Disaster Area is negligible.

There exists very little that could be considered industry in the mountainous region of the affected area. The cities located in the area have the usual mechanic shops, small construction firms, etc., but there are few large or medium size firms producing for export even to neighboring villages.

This area does contain some natural resources which could eventually provide the basis for some large scale industry, however exploit-
int these resources commercially will be costly, especially with respect to providing the necessary infrastructure, eq., roads to transport the product to market. The Callejon de Huaylas, situated beneath the majestic ice peaks of the Cordillera Blanca, has significant undeveloped potential for tourism.

d) Reconstruction Plan for the Earthquake

In the early rehabilitation and reconstruction planning in the aftermath of the earthquake the GOP decided that it would not merely replace the poverty that existed in the area prior to the earthquake, but rather it would undertake an economic and social development program for the area which would lift it out of its previous stagnant economic and social situation. With this in mind, a new agency was established (Comisión de Reconstrucción y Rehabilitación de la Zona Afectada - CRYRZA) charged with the responsibility of planning and executing a program for the rehabilitation and reconstruction of the area. The specific objectives of the agency were:

- 1) The gradual and effective participation of the population in the basic decisions affecting them, especially with respect to the rehabilitation and reconstruction effort.
- 2) The acceleration of the process of structural reform in the areas of agriculture, mining, credit, industry, education, etc.
- 3) The extension of social services, especially to marginal groups.
- 4) The introduction of an economic policy which maximizes production and productivity with emphasis on reinvestment of resources generated in the area, plus state investment and incentives for private investment.
- 5) The reorientation of migration flows from the zones of high population density to areas constituting centers of demand for labor and economic frontier areas.

The Commission divided its work into three different stages. The first stage involved providing immediate emergency services to the area, including the evacuation of those hurt and/or orphaned by the disaster, the provision of emergency food items, the opening of roads, and the construction of provisional housing. The second stage involved those works necessary for the normalization of the activities paralyzed by the earthquake, such as repairing roads, reestablishing communication lines, removing rubble from city streets, etc. The third stage involved the planning and execution of a program to provide for the social and economic development of the area.

At the present time, the first two stages have been completed, and the Plan for the Rehabilitation and Reconstruction of the Affected Area has been designed and is in the process of being implemented.

The Plan is no less than a regional economic and social development plan for the northern region of Peru. It involves considerable State participation in the economy of the region, especially in the establishment of infrastructure. The major public works to be initiated within the next year as foreseen in the Plan include: the relocation to more secure areas of several cities, including Chimbote (the major coastal city with some 168,000 inhabitants); expansion of the road system to provide all weather transport to several cities heretofore isolated, plus the improvement of the Pan-American highway and several other roads, improvement and expansion of airport and terminal facilities in the area, extension of telecommunication and telephone systems to several additional urban centers; rehabilitation and improvement of the electrical system throughout the area; agricultural improvement projects involving cattle, seeds, etc., plus the provision of agricultural tools and equipment and credit, and the extension and improvement of irrigation systems; the construction of 44 basic school centers and 23 educational establishments in rural and urban areas, plus the repair and improvement of many others; the repair and re-equipping of 3 hospitals, 8 health centers, and 6 sanitary posts, plus the construction and equipping of 2 hospitals, 5 health centers and assistance to 6 rural hospitals, the extension of drinkable water to 40 localities, sewers for 8 small cities, and the construction of over 13,000 sanitary centers in the area; the construction of commercial centers and brickmaking plants in various localities, the repair of tourist hotels in two major cities in the area; and the construction of several thousand new housing units.

The entire reconstruction and rehabilitation (Development) program is expected to take ten years, and studies are currently underway to flesh out the program.

ESTIMATED POPULATION OF THE DISASTER AREA
As of May 31, 1970

	<u>Coastal Area</u>		<u>Mountain Area</u>		<u>TOTALS</u>	
URBAN	514.800	58.8%	163.800	25.1%	678.600	44%
RURAL	<u>361.400</u>	<u>41.2%</u>	<u>488.600</u>	<u>74.9%</u>	<u>850.000</u>	<u>56%</u>
TOTALS	<u>876.200</u>	<u>57.3%</u>	<u>652.400</u>	<u>42.7%</u>	<u>1,528.600</u>	<u>100%</u>

(Total Population of Peru: 13,171,800)

Active Manpower (15-64 years)	565.582	37%
Actually Employed (See Table 2)	<u>413.000</u>	<u>27%</u>
Difference	<u>152.582</u>	<u>10%</u>

Estimated persons per family	5.51
Growth Rate: Average	1.7%
Coast	2.8%
Sierra	.7%

Source of Tables: Plan for Rehabilitation and Development of the Zone Affected by the Earthquake; ORCEN, ILPES, CEPAL; Lima, March, 1971, 3 Vols.

ESTIMATED EMPLOYMENT IN THE DISASTER AREA

As of May 31, 1970

	<u>Total</u>	<u>%</u>
Agriculture	233.767	56.6
Fishing	14.945	3.6
Mining	3.687	.9
Power	1.600	.5
Industry (Registered - See Table 3)	15.235	3.7
Small Industry and Handicrafts (See Table 4)	52.500	12.7
Commerce	39.000	9.5
Transportation	8.700	2.2
Other services	5.900	1.4
Banks and Finance	.500	.2
Education	11.500	2.8
Health	2.400	.6
Government	<u>22.000</u>	<u>5.3</u>
TOTAL	<u>413.000</u>	<u>100.0</u>

"Small and Medium Business" employment includes:	<u>Employees</u>	<u>% of Above Total</u>
Medium and Small Industry (Registered)	1,200	.3
Small Industry and Handicrafts	52,500	12.7
Commerce	39,000	9.7
Transportation	8.700	2.1
Other Services	<u>5.900</u>	<u>1.4</u>
TOTAL	107.300	26.0

Note: Includes part-time employment

REGISTERED INDUSTRY IN THE DISASTER AREAMay 31, 1970

	<u>N° of Estab- lish ments</u>	<u>Gross value of Production Millions of Soles</u>	<u>Employees</u>
<u>LARGE INDUSTRY</u> ¹ (10 or more employees)	<u>158</u>	<u>8,364</u>	<u>14,036</u>
Fishmeal processing	67	4,672	5,535
Food processing (mainly sugar mills) ²	32	2,483	4,192
Transportation material	10	44	264
Printing	7	19	183
Furniture Factories	7	28	239
Chemicals	7	165	510
Beverages	6	192	386
Leather goods	4	12	79
Clay products	4	17	107
Clothing & shoes	3	4	48
Machinery	3	107	572
Textiles	2	11	105
Metal working	2	57	95
Steel mills	1	537	1,609
Rubber goods	1	1	10
Unclassified	2	15	102
<u>MEDIUM INDUSTRY</u> ¹ (5 to 10 employees)	128	} 936	896
<u>SMALL INDUSTRY</u> ¹ (under 5 employees)	101		303
TOTAL Registered Industry	<u>387</u>	<u>9,300</u>	<u>15,235</u>

Note 1 - Classifications used by Ministry of Industry and Commerce.

Note 2 - Only one of the above listed "large" enterprises is in the Sierra, a flour mill in Huaraz employing only 12 persons.

SMALL INDUSTRY AND HANDICRAFTMay 31, 1970

	<u>Establishments</u>	<u>Coast</u>	<u>Sierra</u>
Textiles, leather & wearing apparel including weavers, spinners, tailors, hat and shoemakers	16,000	9,300	6,700
Metalworking of all types including goldsmiths, pipefitters, watchmakers, tinsmiths, electricians	4,700	3,400	1,300
Woodworking, from carpenters to cabinet makers	3,900	2,300	1,600
Construction including masons, painters tileworkers, plumbers	6,000	4,800	1,200
Food industry including bakers, butchers, grocers, etc.	3,700	2,200	1,500
Personal services including barbers, laundries, photographers, printers	1,700	1,300	400
Sundry services	<u>1,500</u>	<u>700</u>	<u>800</u>
TOTAL	<u>37,500</u>	<u>24,000</u>	<u>13,500</u>

Each establishment has been assumed by CRYRZA to employ 1.5 persons. Each establishment has also been assumed to produce approximately S/.120,000 per annum, about \$2,800, which would yield per employee about \$1,860 per year.

In addition, it has been estimated that one out of every two agricultural laborers works three months of the year at some handicraft at home to piece out his income - an additional labor force of 233,767 persons working 1/4 time.

Banco de Crédito del Perú

This commercial bank is a privately owned corporation with 901.3 million soles (\$21 million) of paid-in capital. It is the largest commercial bank operating in Peru. Founded in 1888, it has 100 small branches (agencies) in Lima and Callao and branches in every principal city of Peru. It has correspondent Banks all over the world and direct representatives in the United States of America, Germany, Japan, Amsterdam, Spain, Mexico, etc.

Table I, shows the growth and composition of its financial position from 1967 to 1971.

TABLE I
Historical Financial Position of Banco de Credito
(1967 - 1971)

<u>ASSETS</u>	1967	1968	1969	1970	1971	
	(figures in billions of soles)*					
Current Assets	8.2	8.9	9.2	10.2	11.2	
Permanent Investments	6.5	6.7	6.6	9.0	7.6	
Fixed Assets	<u>0.1</u>	<u>0.3</u>	<u>0.4</u>	<u>0.5</u>	<u>0.8</u>	
Total Assets	<u>14.8</u>	<u>15.9</u>	<u>16.2</u>	<u>19.7</u>	<u>19.4</u>	(\$440 million)
<u>LIABILITIES</u>						
Current Liabilities	8.1	8.6	9.2	11.0	11.9	
Long-term Liabilities	6.3	6.8	6.4	8.1	6.3	
<u>Equity</u>						
Paid-in Capital, Reserves & Profits	<u>0.4</u>	<u>0.5</u>	<u>0.6</u>	<u>0.6</u>	<u>1.2</u>	
Total Liabilities	<u>14.8</u>	<u>15.9</u>	<u>16.2</u>	<u>19.7</u>	<u>19.4</u>	(\$440 million)

* Exchange rate \$1 = 43.38 soles

The Bank's profits for 1971 amounted to 65 million soles or \$1.5 million, more than triple the 1962 level of profits.

Table II shows the deposits received by the Bank since 1967.

TABLE II
Deposits Received by Banco de Credito
(1967 - 1971)

	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>
	(figures in billions of soles) ^a				
Time deposits	1.7	1.8	2.0	2.3	2.2
Sight deposits	4.0	4.2	4.5	6.0	6.7
Savings	<u>2.3</u>	<u>2.5</u>	<u>2.7</u>	<u>2.7</u>	<u>3.0</u>
	<u>8.0</u>	<u>8.5</u>	<u>9.2</u>	<u>11.0</u>	<u>11.9</u> (5270 million)

We can conclude from Table II that sight deposits, on the average, amounted to 50% of total deposits all along the time period. Total deposits in 1971 increased 48% over 1967

Table III shows the loan portfolio of the Bank broken-down by economic activity.

TABLE III
Loan Portfolio of Banco de Credito by Economic
Activity for 1967 - 1971

	<u>1967</u>	<u>1968</u>	<u>1969</u>	<u>1970</u>	<u>1971</u>
	(figures in billions of soles) ^a				
Productive Activities	2.6	3.0	3.5	3.3	3.9
Commerce	2.1	2.3	2.1	2.1	2.6
Others	<u>0.7</u>	<u>0.8</u>	<u>1.1</u>	<u>1.4</u>	<u>1.3</u>
	<u>5.4</u>	<u>6.1</u>	<u>6.7</u>	<u>6.8</u>	<u>7.8</u> (3177 ton)

^a Exchange rate \$1 = 43.38 soles

BANCO NOR-PÉRU

This regional Bank is a private corporation with 25 million soles* of paid-in capital, and was founded in 1961 to serve the North Region.

The principal office is located in Trujillo; and the branches are located in the following cities:

Chiclayo
Puerto Pimentel
Pacasmayo
San Pedro de Lloc
Cajamarca
Puerto Salaverry
Chimbote

The Banco Nor-Peru has been designated by Banco de la Nacion as its authorized agent to operate in the "divisas" market, thus the Banco Nor-Peru corresponds with several foreign Banks.

Table I, shows the composition of its financial position for the years 1969 and 1970, I have not been able to get the General Balance sheet for 1971 due to the distance.

TABLE I
YEARLY FINANCIAL POSITION OF BANCO NOR-PERU
(in million of soles)*

<u>ASSETS</u>	<u>1969</u>	<u>1970</u>
Current assets	317.4	413.0
Investments	132.6	96.9
Fixed assets	<u>13.8</u>	<u>16.2</u>
Total Assets	<u>463.8</u>	<u>526.1</u> (\$11.9 million)
<u>LIABILITIES</u>		
Current Liabilities	229.2	317.7
Long term Liabilities	200.4	173.0

* Exchange rate \$1 = 43.38 soles

<u>Equity</u>		
Paid-in Capital, Reserves & Profits	<u>34.2</u>	<u>35.4</u>
Total Liabilities & Net Worth	<u>463.8</u>	<u>526.1</u> (\$11.9 million)
Ratio of current assets to current Liabilities	1.38 times	1.30 times

The Banks' net profit for 1970 was 3.7 million soles compared with \$3.5 million for 1969.

TABLE II

DEPOSITS RECEIVED BY BANCO NOR-PERU
(in million of soles)*

	<u>1969</u>	<u>1970</u>	
Sight deposits	159	220	
Time deposits	194	280	
Saving	<u>268</u>	<u>376</u>	
Total Deposits	<u>621</u>	<u>876</u>	(\$19.9 million)

Saving deposits in 1970 increased 40.7% over the 1969 year.

Total deposits in 1970 increased 41% over the 1969 year.

TABLE III

LOAN PORTFOLIO OF BANCO NOR-PERU BY ECONOMIC ACTIVITIES
(in million of soles)*

	<u>1970</u>	
Productive Activities	153	45.94%
Commerce	91	27.31%
Construction	16	4.88%
Agriculture	16	4.84%
Others	<u>56</u>	<u>17.03%</u>
Total	<u>332</u>	<u>100.00%</u>

The loan portfolio of Banco Nor-Peru in 1969 was 251.8 million soles; this figure in comparison with 332 million for 1970 represents an increase of 31.9% in 1970.

* Exchange rate \$1 = 43.38 soles

THE CENTRAL RESERVE BANK OF PERU

Financial Analysis

The Central Reserve Bank of Peru is the central bank of issue of the GOP, maintaining its monetary reserves and accounts. It also performs the functions of Central Banks in other countries and those of the Federal Reserve Banking System in the U. S. A.

Its capital and reserves have shown an impressive 10 year growth from \$1,858,700 at December 31, 1961, to \$7,183,500 at October 31, 1971, the latest information available.

BALANCE SHEET

(In Millions of Soles) *

October 31, 1971

ASSETS

Cash and Cash Items	11,688
Foreign Currencies	188
Due from GOP, Banks and Bankers	15,640
Investments	2,477
Sundry assets	<u>2,967</u>
Total Assets	<u>32,960</u> (\$749 million)

LIABILITIES

Money in Circulation	19,960
Deposits at sight and other	4,213
Due to International Institutions	3,415
Deposits in Foreign Currency	188
Sundry Liabilities	4,872
Capital and Reserves	<u>312</u>
Total Liabilities	<u>32,960</u> (\$749 million)

* Exchange rate \$1 = 43.38 soles

APPLICABLE LAWS

A. Banking Laws

1. Restraints on Long Term Lending by Commercial Banks

Article 62 of Law 7159 prescribes that a Commercial Bank may make loans to be reimbursed in a period not exceeding one year. Law D/L 18957 of September 15, 1971 prescribes that Private Finance Companies may not lend for period of less than one year.

Law D/L 18967 of October, 1971 covers Regional Banks and, in general, repeats the requirements for the commercial banks.

2. Maximum Interest Rates

The maximum interest rates allowable in Peru are established by the Central Reserve Bank of Peru under the authority of Article 4 of Decree Law 18944 of August 31, 1971. These rates, as published in the official gazette "El Peruano" for September 6, 1971, are as follows:

- a) Maximum interest on any type of loan of money: 12% per An.
- b) Maximum charge for commissions, premiums, fees, and similar, in normal lending operations; and in credit obtained through the discount of commercial paper, or its renewal, an additional 1% per An.
- c) A charge, commensurate with the amount of the transaction, to cover "Postage", "cost of placing tax stamps", "transfer of funds", etc.
- d) Standby fee on unused line of credit:
1% per quarter. 4% per An.

B. Tax Laws

1. Stamp Taxes on Transactions

Notes and other obligations which are drawn and paid in the country pay stamp taxes as follows:

On the amount borrowed:

0.9% per quarter, maximum per annum 3.6%, plus
S/. 2.00 per document, and
S/.10.00 per document

On renewal of the same note an additional .45% of principal

Or upon issuance of a new note in substitution .675% of principal

2. Tax Holidays in Disaster Area

a) Decree Law N° 18308, and Supreme Decree 188-70-EF grant exemption from the stamp tax on all operations in effect on May 31, 1970, and subsequently entered into as follows:

- 1) Persons who suffered damage of less than 50% to their goods or incomes till Dec. 31, 1970
- 2) Persons who suffered damage of over 50% duly certified by CRYRZA till Dec. 31, 1972
- 3) New enterprises directly related to the reconstruction and rehabilitation effort and so certified by CRYRZA till June 30, 1976

b) New enterprises directly related to the reconstruction and rehabilitation effort, so certified by CRYRZA, are under Decree Law N° 18308 are granted exemption from duties, tariffs, consular fees, etc. on imports till June 30, 1976.

c) Enterprises engaged in the reconstruction and repair of roads into and within the Callejon de Huaylas financed by International organizations are exempt from all taxes, per Decree/Law N° 18799, until December 31, 1975.

d) Under the Industrial Law N° 18350, tariff incentives are given to industries outside of Lima, the tariff reduction dependent on the type of preferenced industry. This is in keeping with the present intention of the Andean Pact countries to work out special regulations on import duties for lesser developed zones. The Andean regulations will probably embrace not only disaster but economically depressed areas as well.

Businesses in the Area now qualify for some tariff exemptions and it is assumed that CRYRZA and the Local Bank would advise sub-borrowers of such opportunities.

C. Industrial Reform Law

One of the announced priorities of the Revolutionary Government of the Armed Forces of Peru was the "achievement of permanent self-supporting development of industrial activity destined to lead to economic independence." To that end, on July 27, 1970, The General Law of Industry, was issued.^{1/}

^{1/} Decree Law N° 18350, subsequently amplified and regulated by laws N° 18384, 18977 and 19262.

In brief, the major provisions of the laws are as follows:

- 1) The law divides all industry activity into classes according to a system of development priorities and provides incentives for the higher priorities in the form of reduced import duties and taxes. Industries of the first priority are reserved for the GOP but it may, at its discretion, allow private operation of a first priority industry under contract, or private participation in a mixed public/private enterprise.
- 2) The law also offers tax and tariff incentives for those enterprises established in geographic areas whose development is of priority interest. Some incentives are available to almost any industry established outside of the Lima-Callao area, with the highest incentives for those established in the jungle areas of the Amazon.
- 3) For the employees, the law provides that all companies with more than five employees or more than one million soles annual revenue (\$23,050) shall have a "Comunidad Industrial" to which all full time employees belong and which shares in the profits and management of the company, 25% of the net income before income taxes is allotted to the employees; 10% payable annually in cash in proportion to the employee's annual salary and 15% paid into the Comunidad Industrial to be used for the purchase of equity in the company. The Comunidad must purchase equities in the company until it has 50% ownership, thereafter the 15% of net income must be used for the purchase of other eligible equities.
- 4) Foreign capital is restricted to industries of low priority and to less than majority ownership of any industry.

Because of the Comunidad Industrial and the GOP reservation of priority industries for public ownership, there has been little domestic investment and virtually no foreign investment for the past two years. However, recent indications are that domestic investment is increasing and will further increase when the funds taken out of agriculture by the Agrarian Reform Act are applied to industrial investment.

The smaller entrepreneur has not been greatly affected by this law. In the first place, the bulk of the smaller industries are excluded as they have neither five employees nor annual income of S/.1,000,000 (\$23,050). In the second place, and most important, community and cooperative effort and ownership have been for generations the way of life of a majority of the Peruvian people.

The enactments of a Small Industries Law and of a Law of Commercial Establishments have been scheduled for this year and it is anticipated that these new laws will, in one way or another, carry similar provisions.

For the Peruvian entrepreneur, the Comunidad Industrial is now a fact of life on almost every level; there are no alternatives and the problem has now become that of efficient operation under the new rules.

In the size business to which this loan is addressed, there should be no deterrent effects either from the existing laws, or those now projected, as the community idea is generally accepted and will have little effect on existing management or ownership techniques.

Tentative Operating Procedures

A. Fiduciary Bank

1. Initial establishment and replenishment of the Fund

Upon the completion of the Conditions Precedent for the first disbursement under the loan, AID will deposit in the CRECE Fund in the selected fiduciary the soles equivalent of \$250,000.00 to cover the estimated requirements of the fund for 90 days. At the end of the first month, and each month thereafter, the Fiduciary will prepare a listing of disbursements from the Fund to the Local Banks detailing the sub-borrowers, and forward it to AID with a request for replenishment of the fund for the amounts disbursed during the month. AID will review the request and, after approval, deposit the sol amount into the CRECE Fund. This periodic replenishment will continue until the loan is fully disbursed.

2. Disbursement

In accordance with local banking practices used for the rediscounting of commercial paper, the Local Banks will forward to the Fiduciary Bank, attached to a debit note, the signed loan contract of the sub-borrower showing the amounts and due dates of the fund portion of the sub-loan authorizations approved by the CRYRZA representative, together with a copy of the CRYRZA approval letter.

The Fiduciary bank will verify that the documents and signatures are in order and will proceed to credit the accounts of the respective Local Banks for the Fund portion of the principal of the sub-loans.

3. Collection

a) Normal

The Fiduciary Bank, on maturity of any obligation, will charge the Local Bank with fund's portion of principal and the interest due. Collection would then be made by the Local Bank in due course.

b) Delinquent

the Local Bank has primary responsibility for collection and, since the account has been charged to it and represents an outlay

of its funds until settled, will press for early settlement.

Should this be unavailing, it will notify CRYRZA of the failure of the sub-borrower to meet his obligation and propose further action. At the same time, it will charge the Fund's portion of the delinquent account back to the Fiduciary Bank attaching a copy of its letter advice to CRYRZA as authority. The documents reflecting the obligation of the sub-borrower will be retained by the Local Bank pending agreement with CRYRZA as to procedure.

Upon receipt of the charge covering the Fund portion of a delinquent account and/or the charge for legal fees duly authorized by CRYRZA, the Fiduciary Bank will credit the account of the Local Bank and charge a special sub-account within the fund accounts. Subsequent recoveries of accounts previously written off to the special sub-account will be credited to that account.

The Fiduciary Bank will take no part in any collection effort or legal action. The interested parties being CRYRZA as the operator of the Fund for the GOP and the Local Bank as an agent for CRYRZA and/or in its own right.

B. Local Banks

1. Initial Review

A sub-borrower may initially contact CRYRZA or his Local Bank to request information regarding a loan. In either case the first stage in the preparation of the loan application will be done by the sub-borrower and the Local Bank. The Bank shall assist and advise his client in the development of his plan, and assure that all necessary information, such as a simple balance sheet and adequate consideration to working capital requirements have been provided. The Bank will naturally have made a review of the credit worthiness of the borrower, determined that he is eligible under the program, and that the proposal is of a nature appropriate for consideration under the CRECE Fund criteria. Having so analyzed the project the Local Bank then prepares a covering letter requesting CRYRZA to approve the proposed credit under the CRECE Fund.

2. Submission to CRYRZA

This covering letter together with the Loan application form is submitted to the regional CRYRZA representative charged with responsibilities under this program. CRYRZA is required to designate 4-5 officials who will be located in Chimbote, Huaraz, perhaps Trujillo and any other strategically located city in the area in which a significant volume of sub-lending business is anticipated. This official

shall function as the authorizing agent for sub-loans on behalf of CRYRZA, as well as the program monitor. Within the allocated amount set by CRYRZA for the sub-region, the official shall be able to approve loans in his area without reference to any other CRYRZA office for review.

To assist the CRYRZA area representative and provide adequate interest and input from the local community, CRYRZA will appoint a representative (s) of the private sector to serve as an advisor on sub-loan approvals. The chosen representative (s) shall meet on a regularly scheduled basis, preferably weekly, to review proposals submitted by the Local Banks. The CRYRZA representative will evaluate the project primarily from the standpoint of meeting development plan objectives, that is to say, whether the project fits in with the sub-regional plan generally, provides employment for local residents, and have satisfactory linkages with other commercial activities. He will naturally assure himself that the project is reasonably feasible from an economic and financial standpoint, but for this expertise he will predominantly rely on the judgement of the Local Bank. He may, however, request greater participation by the Local Bank if he considers the terms too favorable.

The local private sector representative(s) will furnish the background and assessment of both the project and the borrower from the local community's viewpoint, particularly on matters which would not appear on the face of the credit application.

3. CRYRZA Approval

After discussing the credit application at the regularly scheduled meeting with the local community representative, noting any comments, and reviewing the application relative CRYRZA criteria, the CRYRZA representative will approve or disapprove the application and will be required to notify the Local Bank of the action taken.

The notification shall consist of either a rejection of the application with a concise statement of the reason, a request for specific additional information or advice on what is under review and therefore delaying final action, or final approval.

Final approval notification will consist merely of the approval of the Local Bank's covering letter which will authorize the Local Bank to make the loan under specified terms and conditions, and to obtain from the Fiduciary reimbursement from the CRECE Fund for the appropriate share of the loan amount taken by the Fund.

This notification will have to be made before the next regularly scheduled meeting with the local community representative.

4. Borrower Notification and Execution

The Local Bank will then be required to advise his customer within one week after receipt of the action taken by the CRYRZA representative.

In the case of approval, the Local Bank will request the borrower to come to the bank to sign the notes and loan contract which have been prepared. The Local Bank will execute the notes both for itself and on behalf of the CRECE Fund, and will at that time disburse the necessary funds, setting up a separate account for the credit.

Disbursement of the sub-loan will normally be made by the Local Bank to the sub-borrower in a single payment of the total amount. However, when in the opinion of the Local Bank and/or CRYRZA a more careful supervision of sub-borrowers account is necessary, either of the following courses might be followed:

- a) When it is for recurring operating expenses, disbursements may be made monthly or in other periodic increments as needed, or
- b) When the loan is for the purchase of raw materials, machinery, or other goods, disbursement may be made against documentation from the supplier.

When the loan involves supplier discounting the supplier will be advised; and, before any discounting of the customer's note, evidence that the customer is in possession of the goods shall be required. This will include registration of the goods in the "Registro de Ventas", acknowledgement by the customer of receipt, or other such arrangements.

5. Local Bank Recovery from the Fund

The sub-borrower having completed the loan contract and the supporting notes, the Local Bank will prepare a debit note, attach a copy of the loan contract, and forward through banking channels to the nearest branch of the Fiduciary for credit to the Local Bank's account (normally, all banks in Peru maintain an account with the Central Reserve Bank). Credit will be given as outlined above in I A 2.

6. Local Banks Collection Responsibilities

On the due date of any obligation, the Local Bank will proceed to collect the account, crediting the Fiduciary with the Fund's portion. In the event of a delinquency it will proceed as described in I.A.3 to charge the Fiduciary for the Fund's portion of the delinquent account.

7. Normal Banking Practices

Some commercial banks in Lima do make loans to small businesses of the type considered for the CRECE Fund. Usually they are extended to past clients who have compensatory balances in either commercial or personal accounts with the bank, and furnish high quality security. With new accounts they require credit references, and perform credit checks which include evaluation of the borrower performance on previous credit. This information is obtained in coordination with other banks and the Local Chamber of Commerce. A simple balance sheet statement is required of all borrowers. Credit is customarily furnished in three ways:

- a) The "Pagare" (promissory note);
- b) Current Account Crediting (authorized overdrafts); and
- c) Supplier note discounting (Letras)

a. The use of a promissory note is probably the favored transaction, being simple a cash transfer in return for a promise to pay. Since the Central Reserve Bank will not discount notes of over 90 days and the 9 per mil stamp tax is payable quarterly, notes are usually prepared payable in 90 days and renewed at the end of that period, the new note reflecting the usual net charges on money lent in this fashion. The rate includes 12% interest, 1% per service charges, 1% for risk and about 1% per quarter for stamp taxes, depending on the size and length of time for repayment. (around 18%). The one year lending limit imposed in the banking law has not restricted the banks from serving the longer-term lending needs of preferred customers. Refinancing of notes, or "renovación" is the customary practice for extending credit for two or three years, and in this manner there can be provision for a grace period, rarely more than six months and never exceeding one year.

b. Current Account transactions (Cuenta Corriente) allow the Bank to authorize overdrafts on the Borrower's account. The banks charges on this type of lending are 12% interest and 1% risk charge on the money actually used, plus 1% per quarter for the total amount of the overdraft authorized, plus, of course, the stamp taxes. This method of lending is now disfavored by bankers because of the lack of a discrete document against which they may legally proceed if necessary.

c. Supplier note discounting involves a supplier discounting the note of his customer and serving as the guarantor of repayment to the bank. The supplier takes a lien on the goods sold to his customer as his assurance of repayment, and discounts the customers note with the bank with full recourse. The bank can then, at its option, proceed

for recovery against the supplier or the supplier's customer and is guaranteed by the pledged assets.

This mechanism is not a cash transaction to the borrower since he receives goods, and further requires registration of the sale of the goods in an official registry for the supplier to obtain his chattel mortgage. Therefore, it could provide a mechanism for assuring end-use of funds lent for capital financing.

d. Collection Procedures

The procedure for collection varies slightly from bank to bank but typically involves automatic transference to the collection department after passage of an 8 day grace period and the initial step in the legal process. Under Peruvian law, the creditor is entitled to publish a "Protesta" when a debt is due but unpaid. This amounts to notarial publication of the failure to pay in local journals, and costs about \$2.00. Despite this publication, the Bank can decide to refinance the note, but in any case the cost of the protest is debited to the borrower's account.

Failing some satisfactory resolution of the non-payment, the bank can take the protest to the judge and request an "Embargo" or execution of the lien on the goods. In certain cases, the judge may choose to include the seizure of other property to cover the non-payment. This action must be taken within 6 months of the issuance of the protest or the right to this summary action is lost.

The creditor does not lose, however, his right to the usual legal action. This is considerably more cumbersome and costly and may require years before execution of judgement. This right he retains for three years.

FUND OPERATIONS - EXAMPLE 1

<u>PRINCIPAL</u>	Year					<u>Total</u>
	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	
Fund Principal beginning of Year	\$ -	\$291	\$857	\$1,280	\$1,272	\$ -
Advanced by USAID	1,250	1,000	200	-	-	2,450
Collections of Principal	249	750	1,210	1,171	1,171	4,551
Interest (1)	41	65	67	70	72	315
Available for lending	1,540	2,106	2,334	2,521	2,515	7,316
Loans - fund portion (90%)	<u>1,249</u>	<u>1,249</u>	<u>1,054</u>	<u>1,249</u>	<u>1,249</u>	<u>6,050</u>
Fund Principal end of Year	<u>291</u>	<u>857</u>	<u>1,280</u>	<u>1,272</u>	<u>1,266</u>	<u>1,266</u>
Local Bank Lending (10%)	<u>139</u>	<u>139</u>	<u>117</u>	<u>139</u>	<u>139</u>	<u>673</u>
Total Loaned	<u>1,388</u>	<u>1,388</u>	<u>1,171</u>	<u>1,388</u>	<u>1,388</u>	<u>6,723</u>
Number of Loans	301	301	254	301	301	1,458
<u>INTEREST (1)</u>						
Interest charge 8%	105	169	173	180	186	813
Less: interest on Local Bank particip.-(13%)	<u>17</u>	<u>28</u>	<u>28</u>	<u>29</u>	<u>30</u>	<u>132</u>
Subtotal	88	141	145	151	156	681
Less: Service fee to Local Bank on fund participation (3%)	<u>35</u>	<u>57</u>	<u>59</u>	<u>61</u>	<u>63</u>	<u>275</u>
Subtotal	53	84	86	90	93	406
Less: Service charge to fiduciary on fund participation (1%)	<u>12</u>	<u>19</u>	<u>19</u>	<u>20</u>	<u>21</u>	<u>91</u>
Interest income to fund	<u>41</u>	<u>65</u>	<u>67</u>	<u>70</u>	<u>72</u>	<u>315</u>

Assumptions: - loans average 200,000 soles (\$4,610.43)

- Loans average three years with 6 month grace period, interest on first six months payable at end of sixth month, principal and interest payable monthly thereafter with equal principal payments and interest on declining balance.

- Maximum lending rate of fund - \$1,250,000 per year.

FUND OPERATIONS - EXAMPLE 2

<u>PRINCIPAL</u>	<u>Year</u>					<u>Total</u>
	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	
Fund Principal - beginning of year	\$ -	\$272	\$811	\$1,299	\$1,259	\$ -
Advanced by USAID	1,250	1,000	200	-	-	2,450
Collections - Principal	230	719	1,205	1,155	1,147	4,456
- Interest (1)	41	69	71	74	77	332
Available for Lending	1,521	2,060	2,287	2,508	2,483	7,238
Loans - fund portion (90%)	1,249	1,249	1,008	1,249	1,249	6,004
Fund Principal - end of year	272	811	1,279	1,259	1,234	1,234
Local Bank Lending (10%)	139	139	112	139	139	668
Total Loaned	1,388	1,388	1,120	1,388	1,388	6,672
Number of Loans	301	301	243	301	301	1,447
<u>INTEREST (1)</u>						
Interest charge 8%	207	178	183	190	198	856
Less: Interest on Local Bank partic. - (13%)	17	29	30	31	32	139
Subtotal	90	149	153	159	166	717
Less: Service Fee to Local Bank on fund participation - (3%)	36	60	62	64	67	289
Subtotal	54	89	91	95	99	428
Less: Service Fee to Fiduciary on fund participation - (1%)	13	20	20	21	22	86
Interest Income to Fund	41	69	71	74	77	332

Assumptions: Loans average \$/200,000 (\$4,610.43)

Loans average three years with six months grace period, interest on first six months payable
 5% and 1% thereafter and equal monthly payments of principal and interest thereafter.
 Annual lending rate of fund \$1,250,000 per year.

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FUND OPERATIONS - EXAMPLE 3

	<u>Year</u>					
	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>TOTAL</u>
<u>PRINCIPAL</u>						
Fund Principal - beginning of year	\$	\$150	\$367	\$682	\$822	\$ -
Advanced by USAID	1,250	1,000	200	-	-	2,450
Collections - Principal	94	377	608	748	915	2,742
- Interest (1)	<u>30</u>	<u>64</u>	<u>72</u>	<u>71</u>	<u>69</u>	<u>306</u>
Available for Lending	1,374	1,591	1,247	1,501	1,806	5,498
Loans - fund portion (90%)	<u>1,224</u>	<u>1,224</u>	<u>565</u>	<u>679</u>	<u>820</u>	<u>4,512</u>
Fund Principal - end of year	<u>150</u>	<u>367</u>	<u>682</u>	<u>822</u>	<u>986</u>	<u>986</u>
Local Bank Lending (10%)	<u>136</u>	<u>136</u>	<u>63</u>	<u>75</u>	<u>91</u>	<u>501</u>
Total Loaned	<u>1,360</u>	<u>1,360</u>	<u>628</u>	<u>754</u>	<u>911</u>	<u>5,013</u>
Number of Loans	236	236	109	131	158	870
<u>INTEREST (1)</u>						
Interest charge at 8%	107	194	198	198	197	894
Less: Interest on Local Bank particip.(13%)	<u>17</u>	<u>32</u>	<u>32</u>	<u>32</u>	<u>32</u>	<u>145</u>
Subtotal	90	162	166	166	165	749
Less: Service fee to Local Bank on funds participation (3%)	<u>47</u>	<u>76</u>	<u>72</u>	<u>73</u>	<u>74</u>	<u>342</u>
Subtotal	43	86	94	93	91	407
Less: Service charge to fiduciary on fund participation (1%)	<u>13</u>	<u>22</u>	<u>22</u>	<u>22</u>	<u>22</u>	<u>101</u>
Interest Income to Fund	<u>30</u>	<u>64</u>	<u>72</u>	<u>71</u>	<u>69</u>	<u>306</u>

Assumptions: Loans average 250,000 soles (\$5,763.02).

Loans average 5 years with 6 month grace period, interest on grace period payable at end of six months, principal and interest payable monthly thereafter in equal installments.

Maximum lending rate of fund \$1,225,000 per year.

LOAN AUTHORIZATION (Draft)

Provided from: Alliance for Progress Funds
PERU: Small Business Credit Loan

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 Government of Peru ("Borrower") of not to exceed two million five hundred thousand United States dollars (\$2,500,000) to assist in financing the United States dollar and local currency costs of a project to provide technical assistance and credit for the reconstruction and development of small businesses in the area affected by the earthquake of May 31, 1970 ("Project"). The Loan shall be subject to the following terms and conditions:

1. Interest and Terms of Repayment.

Borrower shall repay the Loan to A.I.D. in United States dollars within forty (40) years from the date of the first disbursement under the Loan, including a grace period 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 at the rate of two percent (2%) per annum during the grace period and three percent (3%) per annum thereafter.

2. Other Terms and Conditions.

(a) Goods, services (except for ocean shipping) and marine insurance financed under the Loan shall have their source and origin in Peru or in countries

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included in Code 941 of the A.I.D. Geographic Code Book. Marine insurance may be financed under the Loan only if it is obtained on a competitive basis and any claims thereunder are payable in freely convertible currencies. Ocean shipping financed under the Loan shall be procured in any countries included in A.I.D. Geographic Code 941.

- (b) United States dollars utilized under the Loan to finance local currency costs shall be made available pursuant to procedures satisfactory to A.I.D.
- (c) Prior to the first disbursement or the issuance of any commitment documents under the Loan, Borrower shall submit to A.I.D., in form and substance satisfactory to A.I.D., evidence that a special fund has been created in the Banco Central de la Reserva for administering the Small Business Credit program.
- (d) Prior to any disbursement of Loan funds for subloans, Borrower shall submit or cause to be submitted to A.I.D., in form and substance satisfactory to A.I.D., an implementation plan for the Project, which plan shall include, but not necessarily be limited to:
 - (i) detailed sublending policies, procedures and criteria;

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- (ii) a plan or system for providing technical assistance as needed to sub-borrowers.
- (e) The Loan shall be subject to such other terms and conditions as A.I.D. may deem advisable.

Deputy U. S. Coordinator

— Date
